APL-2019-00127
New York County Clerk's Index No. 652877/14

Court of Appeals
of the
State of New York

In Re: PART 60 PUT-BACK LITIGATION

DEUTSCHE BANK NATIONAL TRUST COMPANY, solely in its capacity as Trustee of the MORGAN STANLEY ABS CAPITAL I INC. TRUST 2007-NC4,

Plaintiff-Respondent,

– against –

MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC, as Successor-by-Merger to MORGAN STANLEY MORTGAGE CAPITAL INC., and MORGAN STANLEY ABS CAPITAL I INC.,

Defendants-Appellants.

MOTION FOR LEAVE TO FILE AN *AMICUS* BRIEF

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STATE OF NEW YORK
COURT OF APPEALS

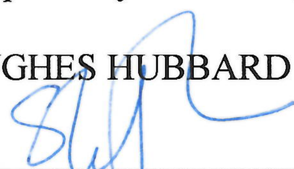
IN RE: PART 60 PUT-BACK LITIGATION DEUTSCHE BANK NATIONAL TRUST COMPANY, solely in its capacity as trustee of the MORGAN STANLEY ABS CAPITAL I INC. TRUST 2007-NC4, *Plaintiff-Respondent,* – against – MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC, as Successor-by-Merger to MORGAN STANLEY MORTGAGE CAPITAL INC., and MORGAN STANLEY ABS CAPITAL I INC., *Defendants- Appellants.*	APL-2019-00127 New York County Clerk's Index No. 652877/14 **NOTICE OF MOTION**

PLEASE TAKE NOTICE, that upon the annexed affirmation of Shahzeb Lari, dated October 31, 2019, and upon all proceedings heretofore had herein, the Securities Industry and Financial Markets Association ("SIFMA") will move this Court at 20 Eagle Street, Albany, New York, on November 12, 2019, at 9:30 a.m. or as soon thereafter as counsel may be heard, for an order granting SIFMA leave to file a brief as *amicus curiae* in the above-captioned case, and for such other and further relief as this Court deems just and proper. A copy of SIFMA's proposed brief accompanies this motion.

Dated: New York, New York
November 1, 2019

Respectfully submitted,

HUGHES HUBBARD & REED LLP



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COURT OF APPEALS OF THE STATE OF NEW YORK

DEUTSCHE BANK NATIONAL TRUST COMPANY, solely in its capacity as trustee of the MORGAN STANLEY ABS CAPITAL I INC. TRUST 2007-NC4, *Plaintiff-Respondent,* – against – MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC, as Successor-by-Merger to MORGAN STANLEY MORTGAGE CAPITAL INC., and MORGAN STANLEY ABS CAPITAL I INC., *Defendants-Appellants.*	New York Index No. 652877/14

AFFIRMATION OF SHAHZEB LARI, ESQ. IN SUPPORT OF MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF

Shahzeb Lari, Esq., an attorney admitted to practice in the State of New York, affirms under penalty of perjury the following statements to be true:

1. I am a member of Hughes, Hubbard & Reed LLP, attorneys for prospective *amicus*, the Securities Industry and Financial Markets Association ("SIFMA") in the above-captioned appeal. I submit this affirmation in support of SIFMA's Motion for Leave to File an *amicus curiae* brief in the above-captioned action.

2. SIFMA is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry while promoting investor knowledge, capital formation, job creation, economic growth, and trust and confidence in the financial markets. This case presents important issues regarding the application of "sole remedy" provisions that define the remedies for breaches of contractual representations and warranties in issuances of residential mortgage-backed securities ("RMBS"). This Court's resolution of this appeal, which will address whether standard contractual terms commonly contained in RMBS contracts between sophisticated parties will be enforced as written pursuant to longstanding New York law, will likely have financially significant implications for SIFMA's members.

3. SIFMA's *amicus* brief presents the position of SIFMA's members on the issues regarding the application of "sole remedy" provisions, provides the Court with relevant information about the RMBS marketplace, and discusses the practical consequences of affirming or reversing the Appellate Division's decision below. SIFMA's position is not provided by any of the parties to this appeal, and SIFMA believes that it would be of assistance to the Court.

4. No party's counsel contributed content to the brief; no party or party's counsel contributed money toward the preparation or submission of the brief; and no person or entity, other than SIFMA, contributed money toward the preparation or submission of the brief.

5. Attached hereto is the proposed *amicus*' brief.

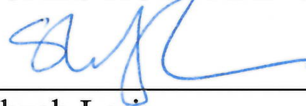
6. No previous application for the relief requested herein has been made.

WHEREFORE, SIFMA respectfully requests that this Court grant its Motion for Leave to File as *amicus curiae,* and grant such other and further relief as this Court deems just and proper.

Dated: New York, New York
November 1, 2019

Respectfully submitted,

HUGHES HUBBARD & REED LLP



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PROPOSED BRIEF

OF *AMICI CURIAE*

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Defendants-Appellants.

BRIEF FOR *AMICUS CURIAE* SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

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<u>RULE 500.1(f) CORPORATE DISCLOSURE STATEMENT</u>

Pursuant to Rule 500.1(f) of the Rules of Practice for this Court, the undersigned counsel for *amicus curiae* the Securities Industry and Financial Markets Association ("SIFMA") states that it has no parents, subsidiaries or affiliates.

TABLE OF CONTENTS

Page

STATEMENT OF INTEREST OF AMICUS CURIAE 1

PRELIMINARY STATEMENT 3

BACKGROUND 5

ARGUMENT 10

I. The Appellate Division's Application of the Gross Negligence Exception to the Sole Remedy Provision Was Erroneous. 10

II. Affirmance of the Appellate Division's Order Would Upset the Carefully Structured Allocation of Risk in RMBS Contracts. 15

CONCLUSION 19

TABLE OF AUTHORITIES

Page(s)

Cases

ACE Sec. Corp. Home Equity Loan Trust, Series 2007-HE3 v. DB Structured Prods., Inc., 5 F. Supp. 3d 543 (S.D.N.Y. 2014) 11, 13

Am. Tel. & Tel. Co. v. N.Y. City Human Res. Admin., 833 F. Supp. 962 (S.D.N.Y. 1993) 19

Ambac Assurance Corp. v. Countrywide Home Loans, Inc., 31 N.Y.3d 569 (2018) ....*passim*

Assured Guar. Corp. v. EMC Mortg., LLC, No. 650805/12, 2013 WL 1442177 (N.Y. Sup. Ct. April 4, 2013) 10, 11

Assured Guar. Mun. Corp. v. DB Structured Prods., Inc., 44 Misc. 3d 1206(A), 997 N.Y.S.2d 97 (N.Y. Sup. Ct. 2014) 11

AXA Mediterranean Holding, S.P. v. ING Ins. Int'l, B. V., 106 A.D.3d 457 (1st Dep't 2013) 14

Bd. of Educ. of Hudson City Sch. Dist. v. Sargent, Webster, Crenshaw & Folley, 71 N.Y.2d 21 (1987) 10

Bluebird Partners v. First Fid. Bank, N.A., 94 N.Y.2d 726 (2000) 19

Holy Props. Ltd., L.P. v. Kenneth Cole Prods., Inc., 87 N.Y.2d 130 (1995) 15

Home Equity Mortg. Tr. Series 2006-1 v. DLJ Mortg. Capital, Inc., Nos. 156016/2012, 653787/2012, 2019 NY Slip Op. 06576 (1st Dep't Sept. 17, 2019) 15

Laidlaw Transp., Inc. v. Helena Chem. Co., 255 A.D.2d 869 (4th Dep't 1998) 19

Metro. Life Ins. Co. v. Noble Lowndes Int'l, Inc., 84 N.Y.2d 430 (1994) 10, 13

Net2Globe Int'l, Inc. v. Time Warner Telecom of New York, 273 F. Supp. 2d 436 (S.D.N.Y. 2003) 13

Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc., 133 A.D.3d 96 (1st Dep't 2015) 14, 15

Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc., 30 N.Y.3d 572 (2017) .... *passim*

OFSI Fund II, LLC v. Canadian Imperial Bank of Commerce, 82 A.D.3d 537 (1st Dep't 2011) 14

In re Part 60 Put-Back Litig., 169 A.D.3d 217 (1st Dep't 2019) 8, 12, 15

Scott v. Palermo, 233 A.D.2d 869 (4th Dep't 1996) 19

Sommer v. Federal Signal Corp., 79 N.Y.2d 540 (1992) 12, 14

U.S. Bank Nat'l Ass'n v. DLJ Mortg. Capital, Inc., No. 650369/2013, 2013 WL 6997183 (N.Y. Sup. Ct. Jan. 15, 2014), *aff'd,* 121 A.D.3d 535 (1st Dep't 2014) 10

Statutes and Rules

26 U.S.C. § 860A 17

26 U.S.C. § 860D 18

26 U.S.C. § 860F 18

26 U.S.C. § 860G 18

Regulations

26 C.F.R. § 1.860G-2(f) 18

Secondary Sources

Final Report of the New York State Bar Association's Task Force on New York Law in International Matters 6 (June 25, 2011) 15

Jason H.P. Kravitt & Robert E. Gordon, *Securitization of Financial Assets*, § 16.01 (3d ed. 2014) 6, 17

Office of Fed. Hous. Enter. Oversight, *A Primer on the Secondary Mortgage Market*, Mortgage Market Note 08-3 (July 21, 2008) 7

Robert T. Miller, *The RMBS Put-Back Litigations and the Efficient Allocation of Endogenous Risk Over Time*, 34 REV. BANKING & FIN. L. 255 (2014) 18

Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1485 (2009) 15

Thomas P. Lemke et al., *Mortgage-Backed Securities* § 1.1 (2014) 6, 8

STATEMENT OF INTEREST OF AMICUS CURIAE

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry while promoting investor knowledge, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA has offices in New York and Washington, D.C., and is the United States' regional member of the Global Financial Markets Association. Although it is judicious in its case selection, SIFMA regularly files *amicus curiae* briefs in cases that raise matters of vital concern to participants in the securities industry—cases that raise important policy issues that impact the markets represented by SIFMA, or that otherwise concern common practices in the financial services industry.

This case presents important issues regarding the application of "sole remedy" provisions that define the remedies for breaches of contractual representations and warranties in issuances of residential mortgage-backed securities ("RMBS"). This Court's resolution of this appeal, which will address whether standard contractual terms commonly contained in RMBS contracts between sophisticated parties will be enforced as written pursuant to longstanding New York law, will likely have financially significant implications for SIFMA's

members. SIFMA therefore respectfully submits this brief as *amicus curiae* to present the position of SIFMA's members on this important issue, and to provide the Court with information about the RMBS marketplace, as well as the practical consequences of affirming or reversing the Appellate Division's decision below.

PRELIMINARY STATEMENT

This case is one of the many currently pending cases involving RMBS repurchase (or put-back) claims that have proliferated in the years following the 2008 financial crisis. Issuances of RMBS—which, in a nutshell, are securities that provide their holders with the right to cash flows from pools of mortgage loans—are predicated upon standardized contracts such as the contracts at issue here, which govern the mortgage pools underlying the securities.

These contracts (mortgage loan purchase agreements and pooling and servicing agreements) typically contain representations and warranties made by the sponsor of the RMBS transaction (here, Defendant-Appellant Morgan Stanley Mortgage Capital Holdings LLC, successor in interest to sponsor Morgan Stanley Mortgage Capital, Inc.) about the loan characteristics of the thousands of mortgage loans in each pool. The contracts also contain "sole remedy" provisions, which, in the event there is a breach of loan-related representations, provide that the only remedies available to the aggrieved party are to require the sponsor to cure, replace, or repurchase the offending loan.

Under longstanding precedent holding that contractual provisions negotiated between sophisticated parties must be enforced as written, these "sole remedy" provisions cannot be disregarded. This Court recently confirmed that principle in

Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc., 30 N.Y.3d 572 (2017) and *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, 31 N.Y.3d 569 (2018). Both those decisions held that sole remedy provisions in RMBS contracts provide the exclusive remedies available to address breaches of contractual representations and warranties regarding loans within a RMBS securitization.

Nomura and *Ambac* implicitly recognize that it is in the joint interest of the parties to a RMBS transaction to contract for a predictable and cost-efficient remedy that provides assurances to the purchaser regarding the underlying loans and expressly limits the sponsor's liability to cure or repurchase any offending loan(s). The sole remedy provision achieves that goal: it excludes undefined liability for investors' damages or losses; limits the sponsor's liability while providing a fair remedy for injured purchasers; provides certainty regarding both the substance and mechanics of that remedy; and does so without disturbing the rest of the loans in the pool or jeopardizing the RMBS issuance as a whole.

Nonetheless, the Appellate Division here ruled that such sole remedy provisions may *not* apply to claims for breaches of loan-related representations and warranties. The Appellate Division incorrectly allowed plaintiffs to plead around the applicable sole remedy provision through the expedient of alleging "pervasive"

loan-related breaches—despite the fact that both *Nomura* and *Ambac* emphasized that plaintiffs cannot avoid sole remedy provisions in this manner (*i.e.*, by alleging systematic or pervasive breaches). *See Nomura*, 30 N.Y.3d at 582-584; *Ambac*, 31 N.Y.3d at 582. In doing so, it effectively reconfigured the allocation of risk that the parties relied upon in entering into the underlying contracts.

As discussed below, the Appellate Division's refusal to enforce the sole remedy provision is not only contrary to New York law, but also runs the very real risk of disrupting the carefully considered and negotiated structure of RMBS transactions and the benefits they provide to homeowners, as well as casting substantial uncertainty over the ongoing efficacy of remedy provisions across the spectrum of commercial transactions. Therefore, this Court should reverse the Appellate Division's decision and reconfirm that this standard "sole remedy" provision will be respected by New York courts.

BACKGROUND

Residential mortgage loan securitization revolutionized housing finance when it was introduced in the 1970s. Prior to the creation of the RMBS structure (now ubiquitous across the industry), a bank making a mortgage loan to a family for the purchase of a residential property had to consider the investment benefits and risks of keeping that single loan on the bank's balance sheet for the term of the

mortgage (often as long as 30 years). Under this system, any bank or financial institution would require a substantial return on its investment in order to compensate it for committing its capital in this way for an extended period of time, imposing significant transaction costs on homeowners seeking housing finance.

RMBS lowered these transaction costs associated with individual loans, providing individuals and families seeking financing with greater flexibility and lower costs.[1] Under the RMBS structure, a financial institution, usually called the "sponsor" or "seller," purchases, aggregates, and then sells thousands of residential mortgage loans to a depositor, which then conveys the mortgage loans to a trust. The trust then issues securities—or "certificates" —that entitle the purchaser of each certificate to cash flows generated by the loans in the trust.[2] The purchasers of the certificates are typically sophisticated parties, including "banks, insurance

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1. *See* Jason H.P. Kravitt & Robert E. Gordon, *Securitization of Financial Assets*, § 16.01 (3d ed. 2014) (explaining that the high transaction costs and associated risks with loan originators maintaining individual loans on the bank's balance sheets is reduced by securitizing pools of mortgage loans and selling them in the secondary market).

2. *See* Thomas P. Lemke et al., *Mortgage-Backed Securities* § 1.1 (2014).

companies, hedge funds, mutual funds, foreign central banks, and sovereign wealth funds, as well as Fannie Mae and Freddie Mac."[3]

The certificates are freely bought and sold because the terms of the contracts negotiated among the sponsor and trust, defining the rights of the certificates and their purchasers, are fully disclosed and standardized across the industry. The contracts typically include mortgage loan purchase agreements ("MLPAs") and pooling and servicing agreements ("PSAs"). The MLPAs and PSAs typically contain numerous representations and warranties regarding the mortgage loans securitizing the certificates, but also contain a corresponding provision that establishes an exclusive remedy for a breach of representations or warranties regarding the loans.

Specifically, the PSAs (including the one at issue here) provide that the sole remedy available in respect of a material breach of a loan-related representation or warranty is the cure of the breach or repurchase of the particular loan that is the

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3. Office of Fed. Hous. Enter. Oversight, *A Primer on the Secondary Mortgage Market*, Mortgage Market Note 08-3 at 8 (July 21, 2008), *available at* http://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/20080721_MMNote_08-3_N508.pdf.

subject of the representation or warranty.[4] If a breach cannot be cured, the trustee, acting on behalf of the certificate-holders, can require the sponsor to buy back a particular offending loan at a "purchase price" that is defined to include the unpaid principal balance plus applicable interest, and therefore makes the trust whole with respect to any breaching loan.

This structure provides a complete remedy for any proven breach. If a loan breaches the representations and warranties made in the PSA or MLPA and cannot be cured, that loan is repurchased or replaced and thereby removed from the mortgage pool, without disturbing the rest of the portfolio or the RMBS issuance as a whole. This is consistent with the fundamental structure of "[t]he mortgage securitization process," which is "designed to distribute risk" and provide liquidity to loan sellers for the benefit of borrowers.[5]

The enforceability of the sole remedy provision has become increasingly important since the financial crisis of 2008, which saw a rise in mortgage delinquencies and the collapse of the RMBS market. Unsurprisingly, this led to a

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4. The sole remedy provision in the PSA at issue here states that "cure, repurchase or substitut[ion of] any Mortgage Loan as to which a breach of a representation and warranty has occurred and is continuing, shall constitute the sole remedies." *In re Part 60 Put-Back Litig.*, 169 A.D.3d 217, 224 n.1 (1st Dep't 2019).

5. *See, e.g.*, *Mortgage-Backed Securities* §1.

wave of RMBS litigation, including actions brought by hedge funds specializing in distressed debt opportunities (so-called "vulture funds"), which—after purchasing RMBS at steeply discounted prices—have encouraged RMBS trustees to assert buy-back claims. Certain trustees—including the Respondent in this action—have sought to avail themselves of remedies outside of the loan-by-loan cure/repurchase protocol expressly set forth in the governing contracts. New York courts, including this Court in its recent decisions in *Nomura* and *Ambac*, have repeatedly rejected such efforts because they are contrary to New York law and the very structure of the RMBS securitization contracts.

ARGUMENT

I. The Appellate Division's Application of the Gross Negligence Exception to the Sole Remedy Provision Was Erroneous.

It is black-letter law that contractual provisions restricting available remedies are binding and enforceable; contracting parties are free to delineate remedies in the event of a breach, and courts must enforce such provisions. *See Metro. Life Ins. Co. v. Noble Lowndes Int'l, Inc.*, 84 N.Y.2d 430, 436 (1994) ("the courts should honor" such provisions). "Parties to a contract have the power to specifically delineate the scope of their liability at the time the contract is formed. Thus, there is nothing unfair in defining a contracting party's liability by the scope of its promise as reflected by the agreement of the parties. Indeed, this is required by the very nature of contract law, where potential liability is determined in advance by the parties." *Bd. of Educ. of Hudson City Sch. Dist. v. Sargent, Webster, Crenshaw & Folley*, 71 N.Y.2d 21, 29 (1987).

This principle, of course, is equally applicable to sole remedy provisions in the RMBS context, as this Court made clear in *Ambac* and *Nomura*. *See, e.g., Ambac*, 31 N.Y.3d at 581-82; *Nomura*, 30 N.Y.3d at 581; *U.S. Bank Nat'l Ass'n v. DLJ Mortg. Capital, Inc.*, No. 650369/2013, 2013 WL 6997183, at *3 (N.Y. Sup. Ct. Jan. 15, 2014) (sole remedy provision precludes relief not specified in the provision), *aff'd*, 121 A.D.3d 535 (1st Dep't 2014); *Assured Guar. Corp. v. EMC

Mortg., *LLC*, No. 650805/12, 2013 WL 1442177, at *5 (N.Y. Sup. Ct. April 4, 2013) ("[plaintiff] is limited to the remedy of compelling [defendant] to repurchase defective loans"); *ACE Sec. Corp. Home Equity Loan Trust, Series 2007-HE3 v. DB Structured Prods., Inc.*, 5 F. Supp. 3d 543, 553 (S.D.N.Y. 2014) (under New York law, parties in RMBS contract may expressly select the remedies available as a result of breach).

As this Court also clarified in *Ambac* and *Nomura*, the enforceability of a sole remedy provision cannot "be avoided by alleging 'broader' or numerous violations of representations and warranties contained in the governing contract." *Ambac*, 31 N.Y.3d at 581-83. There is no "carve-out from the Sole Remedy Provision where a certain threshold number of loan breaches are alleged. … [The trustee] is expressly limited to the … Sole Remedy Provision negotiated by the parties, *however many defective loans there may be*." *Nomura*, 30 N.Y.3d at 582-84 (emphasis added).[6] That is, the sole remedy provision does not become

6. *See also Assured Guar. Mun. Corp. v. DB Structured Prods., Inc.*, 44 Misc. 3d 1206(A), 997 N.Y.S.2d 97 (Table) (N.Y. Sup. Ct. 2014) (allegations of "pervasive breach" "cannot substitute for the contract remedy contemplated by the sophisticated parties who negotiated the Repurchase Protocol"); *Assured Guar. Corp.*, 2013 WL 1442177, at *4-5 (same).

inoperative simply because a plaintiff alleges that a large or "pervasive" number of loans did not comply with the PSA's representations and warranties.

Although the Appellate Division noted this Court's guidance on this issue, acknowledging that "a sole remedy provision cannot be 'nullif[ied by allegations of] multiple, systemic breaches" (*In re Part 60 Put-Back Litig.*, 169 A.D.3d at 224), it ultimately reached the opposite conclusion—that "the complaint's allegations of pervasive, knowing breaches" were sufficient to invalidate the sole remedy clause. *Id.* at 225. The Appellate Division's holding was based on the rationale that Plaintiffs' allegations of "pervasive" breaches fit within New York's "gross negligence" exception to the enforceability of limitation of remedy provisions. *See id.* at 225; *see also, e.g.*, *Sommer v. Federal Signal Corp.*, 79 N.Y.2d 540, 554 (1992) ("It is the public policy of this State, however, that a party may not insulate itself from damages caused by grossly negligent conduct.").

As detailed in Appellant's opening brief, this was error for three primary reasons.

First, as noted above, the Appellate Division's holding is directly contrary to this Court's decisions in *Nomura* and *Ambac*. *See supra* at 9-10. It impermissibly allows a plaintiff to "subvert an exclusive remedies provision by simply re-

characterizing its claims" from breach of contract to "gross negligence"—the precise danger warned against in *Ambac*. *See Ambac*, 31 N.Y.3d at 582.

Second, "[t]he conduct necessary to pierce an agreed-upon limitation of liability in a commercial contract, must smack of intentional wrongdoing." *Metro. Life*, 84 N.Y.2d at 438-39. That is, the offending conduct must be independently tortious. Simply alleging that there were so many contractual breaches that those breaches must have been reckless or intentional is not sufficient to invoke the gross negligence exception. *See id.*; *Net2Globe Int'l, Inc. v. Time Warner Telecom of New York*, 273 F. Supp. 2d 436, 454 (S.D.N.Y. 2003) (application of the exception requires "nothing short of [] a compelling demonstration of egregious intentional misbehavior evincing extreme culpability").

In effect, the Appellate Division's decision permitted Plaintiff to adorn what is ultimately a straightforward contractual claim—that Appellant did not comply with its contractual representations and obligations—with tort terminology, thereby allowing Plaintiff to avoid the specific remedy negotiated between the parties. Such a result is contrary to New York law. "Repeated incantations of the word 'willful' do not magically transform an economically motivated breach into the egregious conduct required to negate an unambiguous contract term negotiated by sophisticated parties." *ACE Sec. Corp. Home Equity Loan Trust, Series 2007-*

HE3, 5 F. Supp. 3d at 556; *see also, e.g., AXA Mediterranean Holding, S.P. v. ING Ins. Int'l, B. V.*, 106 A.D.3d 457, 458 (1st Dep't 2013) ("The mere allegation that the alleged breach of contract was maliciously intended or constituted willful misconduct does not render the breach of contract claim a separate and independent tort claim"); *OFSI Fund II, LLC v. Canadian Imperial Bank of Commerce*, 82 A.D.3d 537, 539 (1st Dep't 2011) (same). To hold otherwise would be to allow a plaintiff to evade contractual provisions governing its remedies through artful pleading.

Third, the sole remedy provision neither "exonerates" Appellant from liability nor limits Plaintiff's damages to a "nominal sum"—the only circumstance in which the gross negligence exception applies. *See Sommer,* 79 N.Y.2d at 554 ("a party may not insulate itself from damages caused by grossly negligent conduct. This applies equally to contract clauses purporting to exonerate a party from liability and clauses limiting damages to a nominal sum.") (citation omitted). Rather, it fully compensates the trust for any injury caused by the offending loan by requiring either a cure or repurchase of the underlying loan.[7]

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7. In the event that a breaching loan had been liquidated—thereby making cure or repurchase impossible—Appellant would be required to pay the repurchase price (even if there was no existing loan to be repurchased). *See Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc.*, 133 A.D.3d 96, 106 (1st Dep't 2015). The Appellate Division appeared to rely on

II. Affirmance of the Appellate Division's Order Would Upset the Carefully Structured Allocation of Risk in RMBS Contracts.

New York precedent is rooted in a recognition of the importance of maintaining predictability in contractual relations and allowing sophisticated commercial actors to efficiently allocate risk when negotiating the terms of their business transactions.[8] In the RMBS context, the sole remedy provision is of

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this possibility to support the notion that allowing Appellee's allegations of gross negligence to proceed was appropriate because "at this [pleading] stage of the case, the actual effect of the sole remedy clause in making the investors whole cannot be ascertained." *In re Part 60 Put-Back Litig.*, 169 A.D.3d at 225. This was incorrect. Moreover, the sole remedy provision is required to be enforced as a matter of law; the uncertainty engendered by the Appellate Division's decision is precisely what the sole remedy provision is designed to eliminate. That uncertainty will apply to all of the many other RMBS litigations that are pending because all such contracts contain these same provisions.

8. *See, e.g.*, *Final Report of the New York State Bar Association's Task Force on New York Law in International Matters* 6 (June 25, 2011), *available at* https://www.nysba.org/WorkArea/DownloadAsset.aspx?id=49552 ("The New York Legislature and its courts have developed New York law with the policy in mind of ensuring predictability in commercial transactions"); *Holy Props. Ltd., L.P. v. Kenneth Cole Prods., Inc.*, 87 N.Y.2d 130, 134 (1995) ("Parties who engage in transactions based on prevailing [New York] law must be able to rely on the stability of such precedents."); *see also* Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1485 (2009) ("Unpredictable courts would undermine New York's campaign to attract contracts.").

critical importance to the entire—and carefully considered—structure of RMBS transactions.

The sponsor acquires individual mortgage loans to be aggregated into the mortgage pools that are sold to the depositor and eventually conveyed to the trust. The sponsor then makes its own representations and warranties about the loans, including specific representations about each loan's loan-to-value ratio and the creditworthiness of the borrowers. While this makes sense given the sponsor's role and its closer proximity to the loan originator, the sponsor opens itself to liability for breach of contract if the loans do not, in fact, have the characteristics provided for in the representations and warranties. Of course, given its role as intermediary between loan originators and investors, no sponsor would be willing to make such representations about each individual loan among thousands of loans if it could be subject to pool-wide damages claims.

The sole remedy provision provides each party with a predictable outcome in the event of breach. The sponsor, the trustee and the certificate-holders know exactly what is required in the event of a breach of the representations and warranties that materially and adversely affects the interests of the certificate-holders—cure or repurchase of the offending loan or loans. That certainty allows the parties to control the costs of securitization. Permitting pool-wide damages

claims against sponsors based on alleged "pervasive breaches" and extrapolated "breach rates" would drive up the costs of securitization and have the concomitant impact of increasing the costs of borrowing for consumers.

It would also potentially jeopardize the RMBS trust's status as a tax-exempt Real Estate Mortgage Investment Conduit or "REMIC." REMICs are special purpose entities, which are designed specifically to "pass through" all income derived from the mortgages in a RMBS pool directly to certificate-holders as investment income, exempting the REMIC from federal income taxes. *See* 26 U.S.C. § 860A. The RMBS trust's REMIC status is essential to the success of the RMBS structure:

> In order to minimize cost, the issuer of pass-through mortgage-backed securities is structured to avoid a double layer of federal taxation. That is, an issuer of pass-through mortgage-backed securities will find it difficult to sell its securities if interest and other income payments received on the underlying mortgage loans are first subjected to tax when realized by the issuer (an entity level tax) and then again when such payments are passed through and received by the investors.

See Kravitt, *Securitization of Financial Assets*, at § 16.02; *see also id.* at § 10.02 ("choosing an entity that incurs little or no tax liability is a primary consideration in selecting the entity to serve as the [trust] in a securitization transaction").

REMIC status strictly limits the income that a REMIC can receive. It can only

derive income from qualified mortgage loans. *See* 26 U.S.C. §§ 860D, 860F, 860G. Any other contributions or income are subject to a 100 percent tax and may result in revocation of REMIC status. *See id.* §§ 860F(a), 860D(a)(4), (b)(2). In keeping with these requirements, REMIC regulations prohibit a RMBS trust from seeking any recovery for a breaching loan, other than cure, substitution or repurchase—*i.e.*, the remedies allowed by the sole remedy provision. *See* 26 C.F.R. § 1.860G-2(f); 26 U.S.C. § 860F. Permitting additional damages would undermine the REMIC status that makes RMBS issuances possible.

Failure to reverse the Appellate Division's Order would jeopardize this carefully constructed structure, not solely in the RMBS issuances in question in this case but across the RMBS market and in the numerous RMBS actions currently pending in New York courts, where the enforceability and impact of sole remedy provisions are being litigated.[9]

The ramifications of the Appellate Division's Order go well beyond RMBS litigation. The Order would "engender uncertainties [for] untold numbers of sophisticated business transactions—a not insignificant potentiality in the State that

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9. *See, e.g.,* Robert T. Miller, *The RMBS Put-Back Litigations and the Efficient Allocation of Endogenous Risk Over Time,* 34 REV. BANKING & FIN. L. 255, 276 (2014) (noting the general language of sole remedy provisions throughout the RMBS market).

harbors the financial capital of the world." *Bluebird Partners v. First Fid. Bank, N.A.*, 94 N.Y.2d 726, 739 (2000). Sole remedy provisions and limitations of liability provisions can routinely be found in complex business contracts negotiated in New York.[10] The purpose of those provisions is to promote efficiency and forestall litigation. If such provisions could be rendered superfluous through the careful crafting of breach of contract claims, the doors to liability in this state would be thrown open.

CONCLUSION

For the foregoing reasons, SIFMA respectfully submits that this Court should reverse the holdings in the Appellate Division's January 17, 2019 Decision and Order.

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10. *See, e.g.*, *Scott v. Palermo*, 233 A.D.2d 869 (4th Dep't 1996) (enforcing contractual provision limiting damages in a contract for the purchase and sale of perishable goods); *Am. Tel. & Tel. Co. v. N.Y. City Human Res. Admin.*, 833 F. Supp. 962, 986 (S.D.N.Y. 1993) (contract for the sale of goods may contain express warranties limiting remedies to the repair or replacement of the equipment sold); *Laidlaw Transp., Inc. v. Helena Chem. Co.*, 255 A.D.2d 869, 870 (4th Dep't 1998) (contract for lawn services limited recovery to the purchase price and the court precluded recovery for consequential and incidental damages because "[i]n cases involving transactions of a commercial nature, it is generally not unconscionable to allocate the risk to the buyer[.]")

Dated: November 1, 2019

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify pursuant to 22 NYCR § 500.13(c) that the foregoing brief was prepared on a computer.

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