

NEW YORK COURT OF APPEALS ROUNDUP

LATEST DECISION REAFFIRMS RMBS STATUTE OF LIMITATIONS PRINCIPLE

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The Court of Appeals recently issued the latest in a series of decisions construing the application of New York's statute of limitations to residential mortgage backed securities (RMBS) claims. In *Deutsche Bank National Trust Company v. Flagstar Capital Markets Corporation*, the court addressed the interplay between competing public policies of the freedom to contract and the prohibition on pre-accrual agreements to extend statutes of limitation. In doing so, the Court of Appeals reaffirmed the principle it established in *Ace Securities Corp. Home Equity Loan Trust, Series 2006-SL2 v. DB Structured Prods.*, 25 N.Y.3d 581 (2015) (*Ace*), that an RMBS breach of contract claim accrues at the time that the allegedly breached representations and warranties were made.

Defendant Quicken Loans was the originator of certain mortgage loans that it sold pursuant to a June 2006 Mortgage Loan Purchase and Warranties Agreement (MLPWA). The mortgage loans were eventually sold into a trust for the purpose of issuing RMBS backed by the loans. Plaintiff Deutsche Bank National Trust Company serves as trustee of the trust and is entitled to enforce the rights of the mortgage loan purchaser under the MLPWA. In the MLPWA, Defendant made a number of representations and warranties concerning the characteristics and quality of the mortgage loans "as of the related Closing Date for such Mortgage Loan." The latest closing date for any of the loans was May 31, 2007. Plaintiff commenced this action by filing a summons with notice on Aug. 30, 2013 and filed its complaint on Feb. 3, 2014. The complaint alleged that defendant breached the MLPWA by selling mortgage loans that did not comply with the representations and warranties.

Defendant moved to dismiss on the grounds that the action was time-barred by New York's six-year statute of limitations for contract actions since it was commenced more than six years after the closing date of the last mortgage loan sale. Plaintiff attempted to distinguish this case from the Court of Appeals' holding in *Ace* that RMBS breach of representations and warranties claims accrue at the closing date of the mortgage loan sale by pointing to an "accrual clause" in the MLPWA (not contained in the contract at issue in *Ace*) providing that "[a]ny cause of action against the Seller relating to or arising out of the breach of any representations and warranties ... shall accrue as to any Mortgage Loan upon (i) discovery of such breach by the Purchases or notice thereof by the Seller to the Purchaser, (ii) failure by the Seller to cure such breach, substitute a Qualified Substitute Mortgage Loan or repurchase such Mortgage Loan ... and (iii) demand upon the Seller by the Purchaser for compliance with this Agreement." Plaintiff argued that this provision extended the accrual date for its claims. The Supreme Court, New York County rejected this argument and dismissed the case as

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time-barred under the holding in *Ace*. The Appellate Division, First Department affirmed in a unanimous decision and granted plaintiff leave to appeal.

The Court of Appeals affirmed the First Department in a decision by Judge Eugene M. Fahey, who was joined by Chief Judge Janet DiFiore and Judges Leslie Stein and Paul Feinman. The court began by noting the general rule that contract actions accrue when the contract is breached and that, given the importance of certainty in determining when an action accrues, the court has repeatedly adopted this bright line approach and rejected efforts to apply a discovery rule that would otherwise extend the accrual date. The majority further noted that in *Ace*, the court rejected the argument that a breach of representations and warranties claim did not accrue until the defendant failed to cure or repurchase a defective mortgage loan. The court found in *Ace* that the defendant's obligation to cure or repurchase simply represented the trustee's remedy for a breach and was not a separately actionable "promise of future performance."

Plaintiff here argued that the language in the accrual clause that a claim "shall accrue" upon the occurrence of three events demonstrates the parties' intent to define a breach of the MLPWA as not just the falsity of the representations and warranties made as of the closing date but as defendant's subsequent failure to cure or repurchase the defective loans after notice and demand by plaintiff. The majority rejected this argument and found that, despite the language in the accrual clause, the obligation to cure or repurchase constitutes plaintiff's remedy for a breach and was not a condition precedent to defendant's obligations under the MLPWA. Accordingly, as in *Ace*, the actual breach was the alleged failure of the mortgage loans to comply with the representations and warranties made as of the closing date.

The court next addressed the possibility that, despite the fact that any representation and warranty breach would have occurred at closing, the accrual clause could evidence the parties' intent to nevertheless delay commencement of the statute of limitations period. While plaintiff urged this interpretation, defendant argued that the parties only intended to create a procedural requirement before bringing suit and did not intend to delay accrual of a breach of representations and warranties claim. The majority found that it did not need to resolve this dispute because, even if plaintiff's interpretation of the accrual clause were correct, enforcing that clause would violate public policy.

The court explained that contracting parties may agree to a shorter limitations period, but that (1) public policy renders unenforceable an agreement to extend the statutory limitations period before a claim has accrued, and (2) an agreement to extend the statutory limitations period entered into after a claim has accrued must comply with General Obligations Law §17-103, which only permits an extension for a time period no longer than the original statute of limitations period. Accordingly, the accrual clause here is unenforceable because it was entered into before the breach of representations and warranties claim accrued and also because it extends the limitations period to an indefinite future date that may not be shorter than the original, six-year limitations period. While the majority recognized that the freedom to contract is an important public policy, when that policy conflicts with the public policy prohibiting pre-accrual extensions of the statute of limitations, the latter policy will take precedence. Accordingly, the majority affirmed the First Department's order.

Judge Jenny Rivera dissented in an opinion in which Judge Rowan Wilson concurred in a separate dissenting opinion. (Judge Michael Garcia took no part in the decisions.) Judge Rivera did not take issue with the court's holding in *Ace*, but rather found that the holding is inapplicable because the parties here expressly bargained for an accrual date different from the "default rule" set forth in *Ace*. Judge Rivera stressed the importance of the freedom to contract, particularly given New York's "unique status as a global center of finance and

commercial transactions,” and noted that the potential harms to be avoided by enforcing statutes of limitation—such as the litigation of stale claims or the deterioration of evidence—present minimal risk here.

Judge Wilson, on the other hand, took direct issue with the court’s holding in *Ace* as “bad law” and asserted that it represented a fundamental misunderstanding of the structure of RMBS agreements. In an apt cultural reference (given the upcoming holiday season), Judge Wilson explained the changed nature of the mortgage lending business using the example of the building and loan association in the film *It’s a Wonderful Life*. Because mortgage loans are now securitized into RMBS, Judge Wilson argued that the requirement that defendant cure or repurchase any defective mortgage loan should be viewed essentially as a warranty for the life of each underlying mortgage loan that represents a separately bargained-for, and actionable, obligation. Accordingly, Judge Wilson found that plaintiff’s claim did not accrue until defendant failed to cure or repurchase.

Nevertheless, *Ace* remains binding precedent and the majority has made clear that, in the context of RMBS litigation, the considerations of certainty and finality supporting the public policy prohibiting pre-accrual agreements to extend statutes of limitation trump the considerations behind the public policy of freedom to contract.

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