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Litigators of the Week: Orrick Scores a Market-Moving Reversal at New York's High Court

By Ross Todd
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There's no need to apologize if you've flushed your brain of all things related to residential mortgage-backed securities, or RMBS. The large pots of securitized home loans were among the alphabet soup of financial instruments many of us got up to speed on during the Great Recession.

But our Litigators of the Week, **Rich Jacobsen**, **Paul Rugani** and **Danny Rubens** of **Orrick Herrington & Sutcliffe** are very much still engrossed in the world of RMBS. This past week they won a key reversal from the New York Court of Appeals, the state's highest court, that will shape how disputes over billions of dollars of pending RMBS claims play out. The court found that the trustee of an RMBS suing an affiliate of their client Credit Suisse was required by contract to give "loan-specific pre-suit notice" prior to filing suit seeking to invoke repurchase obligations for individual loans.

How big a deal is that?

Here's one way to look at it: Ambac Financial Group, which is pursuing its own cases RMBS-related, saw its stock value dip 24% this week after the company reported how the decision could affect its own recoveries.

Litigation Daily: Who is your client and what is at stake?

Rich Jacobsen: Our client, DLJ Mortgage Capital, Inc., is an affiliate of Credit Suisse. Orrick serves as lead counsel for Credit Suisse's entire residential mortgage-backed securities litigation docket. Although this particular litigation concerned a single RMBS trust (referred to as "HEAT 2007-1"), our case put before New York's highest court issues that have broad implications for RMBS repurchase litigation generally.

RMBS are securities backed by thousands of individual mortgage loans. The contracts between RMBS sellers (like DLJ) and the trustees who act on behalf of investors (like U.S. Bank) contain what's known as the "sole remedy provision," which specifies that any claim that a loan breached a representation or warranty must comply with a contractual dispute resolution process, which includes requirements for pre-suit notice and an opportunity to cure the breach. If the trustee can prove a breach claim for a given loan, the seller is then required to repurchase that loan at a specified price. After the 2008 financial crisis, there was a wave of litigation against RMBS sellers, claiming that the underlying loans breached various representations and warranties and demanding repurchase. This lawsuit, filed by U.S. Bank in 2013, follows that pattern.

Courtesy photos

(L-R) Rich Jacobsen, Paul Rugani and Danny Rubens of Orrick.

This appeal presented a critical question about the meaning of the sole remedy provision and its notice requirement: whether the trustee, U.S. Bank, could sue DLJ over hundreds of purportedly defective loans that it never told DLJ were in breach before suing, despite agreeing to a contractual sole remedy provision with a pre-suit notice requirement. Also at stake was whether the trustee could recover as damages interest payments on the underlying mortgage loans that the borrower never actually owed, despite contractual language specifying that only interest that "accrued" on a loan was recoverable.

All of the lower court precedent was against RMBS defendants on each of these issues, but we were confident that our view would prevail before the Court of Appeals. Our victory last week means that the number of loans at issue in Credit Suisse's pending RMBS-repurchase suits could drop by more than half, significantly reducing Credit Suisse's exposure.

Who all is on your team and how did you divide the work?

Jacobsen: I'm privileged to lead a core team that has been defending Credit Suisse and other banks in RMBS cases for more than a decade. This case shows the value of having diverse, interdisciplinary teams on big cases. **Paul Rugani** brought securities expertise to bear to develop the approach we took on damages. **Danny Rubens** framed our strategy for persuading the Appellate Division to certify this case to the Court of Appeals for review—something it does in only a handful of civil cases each year. At the Court of Appeals level, senior associate **Jennifer Keighley** played an integral role in our briefing effort, focusing on first principles of the notice required under the plain language of the contract and relation-back, with careful attention to what the Court of Appeals had been saying in other cases involving the

RMBS sole remedy provision. Senior associates **Nick Poli** and **Camille Rosca** also played important roles. And I had a full team behind me in helping me prepare for the argument and think through every possible line of attack. In particular, **Barry Levin**, **John Ansbro** and **Dan Dunne** provided extremely valuable strategic guidance, and **Jennifer Lee**, **Greg Beaman** and **David Litterine-Kaufman** have been taking key leadership roles over expert strategy and discovery.

We worked incredibly closely at every stage with the exemplary legal team at Credit Suisse. We simply could not have achieved this result without their strategic vision, steadfast support, and confidence in the strength of our positions.

So this case centers on Home Equity Asset Trust 2007-1, a residential mortgage-backed securities trust that dates back to before the Great Recession. What's the best explanation for why New York's courts are still grappling with disputes over contracts concerning the underlying home loans in 2022?

Paul Rugani: Like what happened in this case, most trustee plaintiffs waited until 6 years after the securities were issued before filing suit. The cases involve complex financial instruments with complicated fact and expert discovery issues, which take extra time to prepare. And getting any issue before the Court of Appeals is a lengthy process—we filed our first summary judgment motion on these issues more than five years ago and had to doggedly pursue every appellate avenue to bring about the right result.

This case was argued twice at the New York high court. How did those arguments differ? And did anything about the arguments cue you in on how the court might rule?

Jacobsen: The arguments were very different, in part because the Court of Appeals' composition changed so significantly between the two arguments. The second time around, we had three newly appointed Court of Appeals judges and a fourth vouched in from the Appellate Division. And we also had a chance to submit another brief, in response to an amicus filing, shortly before argument that let us address in writing some of the practical questions the court had asked during our first argument. I came out of the second argument cautiously optimistic. The judges' questions suggested that they appreciated that the key contractual language required the plaintiff to give loan-specific notice.

The court in its decision writes "As with much of our RMBS precedent, this controversy presents a question of contract interpretation fitting within 'a consistent theme: does the contract mean what it says?'" What's the plain language version of what the contract said here?

Danny Rubens: The plain language version is that the contract requires the trustee to identify each particular loan that it thinks breaches representations and warranties before it files suit. This is not the first time the Court of Appeals has made that point, and we emphasized in our briefing that this "consistent theme" compelled a decision in our favor.

What are your key takeaways from the majority's holding?

Rugani: The New York courts are going to enforce the terms of contracts as written. These are highly negotiated contracts among sophisticated commercial parties, leading to securities bought mainly by institutional investors and hedge funds. The court's decision provides great certainty to contracting parties that the words of their agreements matter and will be enforced, not subject to revision when one of the parties no longer finds it convenient to comply with them. And in the RMBS context, the court has again made clear that a plaintiff cannot try to avoid the consequences of the sole remedy provision and pursue claims without complying with the contract's notice requirements.

The stock for Ambac Financial Group, which has its own batch of breach-of-contract cases related to its insured residential mortgage-backed securities transactions, took a 24% drop this week after the company reported that this decision could affect its recoveries in its own cases. How else would you say this decision has impacted the market?

Rubens: Because the sole remedy provision in our case is common across RMBS securitizations, the decision is likely to have a monumental impact on the scope of many of the repurchase suits still pending in New York courts by reducing the number of loans at issue. It will also have an impact on other arguments at issue in these cases—the Court of Appeals' reasoning makes clear that, for instance, plaintiffs who try to proceed on loans under a theory that the defendant independently discovered the breaches should also need to prove that fact with reference to specific breaches and loans at issue, rather than pointing to generalized evidence.

What will you remember most about this matter?

Jacobsen: How ecstatic our client was when we told them about this win. It's hard to describe what a big victory this is, especially given the series of trial court and intermediate appellate decisions resolving these issues against RMBS defendants. Yet, our client believed in this case, and they were right. To finally come out victorious in the Court of Appeals is very gratifying. And after two years of virtual hearings, it was great fun to stand at a lectern for both arguments, in open court.

I'll also remember how important it is to stick to your pre-argument rituals and superstitions. The first argument went pretty well, so the second time around, I recreated the routine: we ate at the same restaurant for lunch, and I even made sure to get another parking ticket. That parking ticket was the best $30 I've ever spent.