



Finance ADVISORY ■

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New York Court of Appeals Concludes Breach of Representation and Warranty Claims Accrue from Date Contracts Are Executed

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On June 11, 2015, the New York Court of Appeals unanimously held that New York's six-year breach-of-contract statute of limitations had expired before certain residential mortgage-backed securities (RMBS) certificateholders commenced suit alleging breach of representations and warranties. In its opinion, *ACE Securities Corp., Home Equity Loan Trust, Series 2006-SL2 v. DB Structured Products, Inc.*, (Index No. 650980/12), New York's highest court affirmed the dismissal of a mortgage loan repurchase action against the transaction's sponsor on the grounds that the cause of action for breach of representations and warranties accrued on the date the transaction closed, not the date the sponsor refused to cure or repurchase allegedly defective loans. Because the litigation was not properly initiated within six years of the transaction closing, New York's statute of limitations barred the suit.

The suit was filed by two certificateholders in the ACE Securities Corp., Home Equity Loan Trust, Series 2006-SL2 (the "Trust") who contended that DB Structured Products, Inc. (DBSP), the sponsor, failed to repurchase loans that allegedly failed to conform to DBSP's representations and warranties regarding the loans' credit quality and characteristics as of the March 2006 closing date. Under the Trust's Pooling and Servicing Agreement (PSA), the Trust's sole remedy for breach of representations and warranties was for DBSP to cure or repurchase a nonconforming loan. The PSA required the trustee to promptly notify DBSP of an alleged breach and request that DBSP cure the breach. Upon failure to cure after 60 days' notice of breach, the trustee was authorized to enforce DBSP's obligation to repurchase the mortgage loan within 90 days.

Several years after the transaction closed and after the Trust suffered \$330 million in losses caused by defaults and delinquencies, the plaintiff certificateholders conducted a review of loans in the Trust. The review allegedly revealed that 99 percent of the loans failed to comply with at least one of DBSP's representations and warranties. Citing the high breach rate, two certificateholders sent a letter to the trustee on January 12, 2012, demanding that the Trust's mortgage loans be returned to DBSP for repurchase. The certificateholders also asked that the trustee request a tolling agreement in light of the potential expiration of the statute of limitations. The certificateholders ultimately sued DBSP for breach of contract exactly six years after the transaction's closing date.

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The trustee sought to substitute for the certificateholders on September 13, 2012. In its complaint on the Trust's behalf, the trustee asserted that the Trust had notified DBSP of the breaches as early as February 8, 2012, and that DBSP refused to repurchase. DBSP moved to dismiss the complaint, arguing it was filed more than six years after the trustee's claim accrued on March 28, 2006. The New York Court of Appeals agreed with DBSP, holding that the statute of limitations for breach of representations and warranties claims begins to run when the contract is signed rather than when the sponsor failed to heed its repurchase obligations.

In rejecting the trustee's argument that the cause of action did not accrue until DBSP refused to cure or repurchase, the court found it logical that DBSP's guarantees of loan quality would not extend over the life of the transaction because the loans could default years after origination for reasons unrelated to a sponsor's representations and warranties. The court held that when representations and warranties are made as of a certain date, they are breached, if at all, as of that date. The statute of limitations in breach of contract cases begins to run from the time liability for wrong arises, even if the injured party is ignorant of the existence of such wrong.

The court also rejected the trustee's argument that the 90-day notice period tolled the statute of limitations, concluding that DBSP's failure to cure was not a substantive condition precedent that delayed accrual of the Trust's claim, but rather a procedural prerequisite to bringing suit. The certificateholders failed to satisfy that condition precedent when they filed suit in March 2012, as they did not allow for the required 90-day repurchase period.

Under this ruling, trustees and investors not only must file suit within six years of the breach of representations and warranties, they must also satisfy conditions precedent (such as notice requirements) within that six-year period. This decision effectively forecloses new repurchase claims against mortgage loan originators and RMBS sellers/depositors for pre-2009 RMBS transactions, except for those for which tolling agreements are already in place.

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