SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK – PART 60

PRESENT: Hon. Marcy Friedman, J.S.C.

FEDERAL HOUSING FINANCE AGENCY, AS CONSERVATOR FOR THE FEDERAL HOME LOAN MORTGAGE CORPORATION, on behalf of the Trustee of the NOVASTAR MORTGAGE FUNDING TRUST SERIES 2007-1 (NHEL 2007-1),

Plaintiff,

– against –

NOVATION COMPANIES, INC., f/k/a NOVASTAR FINANCIAL, INC., and NOVASTAR MORTGAGE, INC.,

Defendants.

Index No.: 650693/2013

DECISION/ORDER

This residential mortgage-backed securities (RMBS) breach of contract action, commonly known as a "put-back" action, alleges breaches of representations and warranties by defendant NovaStar Mortgage, Inc. (NMI), the Sponsor, regarding the quality and characteristics of the mortgage loans underlying the securitization. Defendant Novation Companies, Inc., f/k/a NovaStar Financial, Inc. (Novation), NMI's parent company, is allegedly "a co-obligor with respect to NMI's obligations for breaches of the R&Ws [representations and warranties]." (Am. Compl., ¶ 81.) Deutsche Bank National Trust Company is Trustee of NovaStar Mortgage Funding Trust Series 2007-1, the Trust to which the loans were conveyed. Federal Housing Finance Agency (FHFA), acting as conservator for The Federal Home Loan Mortgage Corporation (Freddie Mac), a certificateholder in the Trust, commenced this action by filing a summons with notice. The Trustee subsequently filed the complaint and amended complaint.

Defendants move to dismiss the amended complaint pursuant to CPLR 3211 (a) (1), (3), (5) and (7) on the ground, among others, that the claims are not timely.

Except as discussed below, this motion raises issues that do not differ in any material respect from those determined by this court and the Appellate Division in a number of recent decisions in put-back actions commenced by FHFA. (See Federal Hous. Fin. Agency v Morgan Stanley ABS Capital I Inc., 146 AD3d 566 [1st Dept 2017] [FHFA (Morgan Stanley)], affg Federal Hous. Fin. Agency v Morgan Stanley ABS Capital I Inc., 2016 WL 1587345 [Sup Ct, NY County, Apr. 12, 2016, No. 650291/2013] [FHFA (NC1)] and Federal Hous. Fin. Agency v Morgan Stanley Mtge. Capital Holdings LLC, 2016 WL 1587344 [Sup Ct, NY County, Apr. 12, 2016, No. 651959/2013] [FHFA (NC3)];[1] U.S. Bank N.A. v DLJ Mtge. Capital, Inc., 141 AD3d 431, 432-433 [1st Dept 2016], lv granted 29 NY3d 910 [2017]; Federal Hous. Fin. Agency v HSBC Fin. Corp., 2017 WL 1479480 [Sup Ct, NY County, Apr. 25, 2017, No. 651627/2013] [FHFA (HE2)]; Federal Hous. Fin. Agency v UBS Real Estate Secs., Inc., 2016 WL 4039321 [Sup Ct, NY County, July 27, 2016, No. 651282/2012] [FHFA (OA1)]; Federal Hous. Fin. Agency v EquiFirst Corp., 2016 WL 3906070 [Sup Ct, NY County, July 19, 2016, No. 650692/2013] [FHFA (BC2)] [collectively, the FHFA Opinions].) Familiarity with these decisions, the RMBS securitization process, and the landmark Court of Appeals and First Department decisions in ACE Securities Corp. v DB Structured Products, Inc. (25 NY3d 581 [2015], affg 112 AD3d 522 [1st Dept 2013] [collectively, ACE]), is presumed.[2]

[1] Where FHFA (NC1) and FHFA (NC3) are cited in this decision without reference to the FHFA (Morgan Stanley) affirmance, it should be understood that the Appellate Division affirmance was on other grounds.

[2] By Order of the Administrative Judge, dated May 23, 2013, this court was designated to hear "all actions hereafter brought in this [C]ourt alleging misrepresentation or other wrong in connection with or arising out of the creation or sale of residential mortgage-backed securities." This court has accordingly issued numerous decisions in the RMBS litigation. In determining issues on this motion that were previously decided on substantially similar pleadings and governing agreements, the court will generally rely on the prior decisions, without repeating their reasoning.

The first and second causes of actions are untimely to the extent that they plead breaches of contract against defendants for breaches of NMI's representations and warranties. The breach of representation and warranty claims accrued on February 28, 2007, the closing date of the securitization, when the representations and warranties were made.[3] (Mortgage Loan Purchase Agreement [MLPA], §§ 3.01 [b], 1.01; Pooling and Servicing Agreement [PSA], Appx. A [definition of "Closing Date"]; ACE, 25 NY3d at 589.) Although FHFA filed a timely summons with notice on February 28, 2013, the six-year anniversary of the closing date, that filing was defective because FHFA lacked standing to commence the action. The Trustee's initial complaint, filed more than six years after the securitization closing date, was untimely and does not relate back to FHFA's defective summons with notice. (See FHFA [Morgan Stanley], 146 AD3d at 567; U.S. Bank N.A. v DLJ Mtge. Capital, Inc., 141 AD3d 431, 432-433 [1st Dept 2016], lv granted 29 NY3d 910 [2017]; Nomura Asset Acceptance Corp. Alternative Loan Trust v Nomura Credit & Capital, Inc., 139 AD3d 519, 520 [1st Dept 2016]; ACE, 112 AD3d at 523, affd on other grounds, 25 NY3d 581, supra.)

The Courts' holdings in the above cases that FHFA and other certificateholders lacked standing to commence RMBS actions for breaches of representations and warranties were based on the terms of "no-action clauses" in the governing PSAs. The court rejects the Trustee's argument, made for the first time at oral argument, that this action is distinguishable from those cases because the no-action clause in the governing PSA here is limited to lawsuits brought by certificateholders "upon or under or with respect to this Agreement [i.e., the PSA]" (PSA, § 12.03), and thus does not apply to suits, like this one, for breaches of representations and

[3] In so holding, the court rejects defendants' contention that the breach of representation and warranties claims accrued on the "as of" date of the MLPA. (See FHFA [NC1], 2016 WL 1587345, at * 3 [rejecting a similar argument].)

warranties set forth in the MLPA. This court rejected a similar argument in FHFA (HE2) (2017 WL 1479480, at * 4-5), to which the parties are referred. Here, the PSA was entered into contemporaneously with or in close proximity to the MLPA, as part of the securitization of the loans.[4] The PSA was the means by which the Trustee was assigned rights, title and interest in the mortgage loans. (See PSA, § 2.01.) The PSA also set forth the certificateholders' rights as beneficiaries of the Trust, including their rights, upon compliance with the no-action clause, to sue on behalf of the Trust. (Id., § 12.03; see also id., § 8.02.) Although no-action clauses are to be "strictly construed" (Quadrant Structured Prods. Co., Ltd. v Vertin, 23 NY3d 549, 560 [2014]), to hold that FHFA's suit was not a suit "upon or under or with respect to" the PSA would be to ignore the structure of this transaction. (See FHFA [HE2], 2017 WL 1479480, at * 4-5.)

The court further rejects the Trustee's contention that the MLPA confers standing upon certificateholders independent of the PSA, and thus permits them to bring breach of representation and warranty claims against defendants without complying with the requirements of the PSA no-action clause. In support of this contention, the Trustee relies on section 3.01 (b) of the MLPA, which provides that "[i]t is understood and agreed that the obligation of the Sponsor [NMI] to cure any breach with respect to or to repurchase or substitute for, any Mortgage Loan as to which such a breach has occurred and is continuing shall, [subject to the indemnification provision, section 6.01] . . . constitute the sole remedy respecting such breach

[4] The MLPA is dated as of February 1, 2007, and was entered into between and among NMI, as Sponsor; NovaStar Mortgage Funding Corporation, as Depositor; U.S. Bank National Association, as Custodian; and Deutsche Bank National Trust Company, as Trustee. The PSA in this case is also dated as of February 1, 2007, and was entered into between and among NMI, as Servicer and as Sponsor; U.S. Bank National Association, as Custodian; and Deutsche Bank National Trust Company, as Trustee.

available to the Depositor, the Trustee, the Certificateholders or the Custodian against the Sponsor."

This section does not establish an independent right of certificateholders to institute an action under the MLPA for breaches of representations and warranties. As defendants correctly argue, the sole remedy clause does not create a right of action but, rather, limits the remedies otherwise available to the parties listed in that clause for breaches of representations and warranties. (See Defs.' Sur-Reply Memo., at 5.) Put another way, section 3.01 (b) merely limits certificateholders' remedies for breaches of representations and warranties to those specified in the sole remedy provision of the MLPA—whether the Trustee acts on their behalf in litigating the action, or the certificateholders themselves institute the action, when authorized to do so under the PSA no-action clause. Here, the Trustee fails to allege that the certificateholders were in compliance with the provisions of the no-action clause when they purported to commence this action.

Contrary to the Trustee's contention, FHFA also lacked standing to commence this action under common law principles. Those principles permit the beneficiary of a trust to commence a derivative action on behalf of the trust, provided that a demand upon the trustee to bring suit was rejected or would be futile. "In an action brought by a beneficiary on behalf of the trust, the beneficiary must show why he has the right to exercise the power, which the law and the trust agreement in the first instance confide in the trustees, to bring a suit on behalf of the trust. This will normally require either a showing of a demand on the trustees to bring the suit, and of a refusal so unjustifiable as to constitute an abuse of the trustee's discretion, or a showing that suit should be brought and that because of the trustees' conflict of interest, or some other reason, it is futile to make such a demand." (Velez v Feinstein, 87 AD2d 309, 315 [1st Dept 1982], lv

dismissed in part, denied in part 57 NY2d 737; see also Walnut Place LLC v Countrywide Home Loans, Inc., 2012 WL 1138863, * 3, 5-6 [Sup Ct, NY County, Mar. 28, 2012, No. 650497/2011, Kapnick, J.], affd on other grounds 96 AD3d 684 [1st Dept 2012].)

This line of authority was relied upon by the First Department in its recent affirmance of this court's decisions in FHFA (NC1) and FHFA (NC3). The Court held that FHFA did not, in those cases, validly commence derivative actions on behalf of the trustee or demonstrate that FHFA was excused from the requirements of the no-action clause, where "FHFA did not allege that the plaintiff (the trustee) had acted in bad faith or declined to act" and "failed to 'set forth with particularity [its] efforts . . . to secure the initiation of action by the trustee[], or the reasons for not making such effort.'" (FHFA [Morgan Stanley], 146 AD3d at 567-568 [parentheses, brackets, and ellipses in original], quoting Velez, 87 AD2d at 316.) Here, similarly, FHFA's failure to allege a demand or futility bars the breach of representation and warranty claims.

The Trustee's remaining arguments in support of the timeliness of its claims for breaches of representations and warranties have been repeatedly rejected by this court in the FHFA Opinions. The defect in FHFA's standing was not cured by the Trustee's belated attempt to substitute itself as plaintiff in this action. (FHFA [HE2], 2017 WL 1479480, at * 4-5; FHFA [OA1], 2016 WL 4039321, at * 2-3.) For the reasons stated and on the authorities cited in FHFA (NC1), the claims are not timely under the federal Housing and Economic Recovery Act of 2008. (2016 WL 1587345, at * 5, citing Deutsche Bank Natl. Trust Co. v Quicken Loans Inc., 810 F3d 861, 868 [2d Cir 2015].) The court also rejects the Trustee's argument that defendants are equitably estopped from invoking the statute of limitations based on their failure to notify the Trustee of breaches of representations and warranties. (FHFA [HE2], 2017 WL 1479480, at * 3.)

For the above reasons, the court will dismiss the first and second causes of action to the extent that they are based on alleged breaches of representations and warranties. In view of this holding, the court need not and does not reach defendants' additional contentions that the amended complaint fails to state a cause of action for breaches of representations and warranties as to any loan not specifically identified in the complaint, and that any claim for monetary damages should be dismissed in light of the sole remedy provision of the PSA.[5]

The court will also dismiss the first and second causes of action to the extent that they are based on purported breaches of defendants' repurchase obligations. Under the Court of Appeals decision in ACE, there is no independent cause of action for a sponsor's failure to repurchase loans that breach representations and warranties. (FHFA [NC1], 2016 WL 1587345, at * 10.)

The second cause of action is also based on allegations that defendants breached their contractual obligation to notify the Trustee of their discovery of breaches of representations and warranties. (Am. Compl., ¶¶ 94, 98.) The branch of defendants' motion to dismiss this "failure to notify" claim will be denied without prejudice. Defendants may seek dismissal of the claim in connection with the coordinated briefing requested by this court following the Appellate Division's decisions in Nomura Home Equity Loan, Inc. v Nomura Credit & Capital, Inc. (133 AD3d 96 [1st Dept 2015], rearg ordered 29 NY3d 992 [2017]) and Morgan Stanley Mortgage Loan Trust ARX v Morgan Stanley Mortgage Capital Holdings LLC (143 AD3d 1, 3-4 [1st Dept 2016]). The parties to this action have consented to this procedure. (Transcript of Oral Arg., at 2-3, 17.) It is noted that bellwether briefing on failure to notify issues has been submitted in FHFA (NC1) and FHFA (NC3).

[5] This court has addressed similar arguments in prior decisions. (See e.g. ACE Secs. Corp. v DB Structured Products, Inc., 2014 WL 4785503, * 2-6 [Sup Ct, NY County, Aug. 28, 2014, No. 651936/2013] [identification of loans]; U.S. Bank Natl. Assn. v DLJ Mtge. Capital, Inc., 2016 WL 1365966, * [Sup Ct, NY County, Apr. 5, 2016, No. 653140/2015], affd on other grounds 146 AD3d 603 [1st Dept 2017] [damages].)

The Trustee's third and fifth causes of action will be dismissed for the reasons stated, and on the authorities cited, in this court's prior decisions addressing RMBS trustees' claims for anticipatory breach of contract and breach of the implied covenant of good faith and fair dealing, respectively. (FHFA [NC1], 2016 WL 1587345, at * 10-11 [implied covenant, citing additional authorities]; Law Debenture Trust Co. of N.Y. v DLJ Mtge. Capital, Inc., 2015 WL 1573381 [Sup Ct, NY County, Apr. 8, 2015, No. 651958/2013] [anticipatory breach and implied covenant]; Deutsche Bank Natl. Trust Co. v Barclays Bank PLC, 2015 WL 7625829, * 3 [Sup Ct, NY County, Nov. 25, 2015, Nos. 651338/2013, 652001/2013] [anticipatory breach].)

The fourth cause of action seeks a declaratory judgment that "NMI is required to reimburse the Trustee for all losses resulting from R&W [representation and warranty] breaches, as well as the expenses in enforcing its remedies . . . ." (Am. Compl., ¶ 127.) The branch of defendants' motion to dismiss this cause of action will be denied without prejudice. The motion was briefed before the First Department's decision in U.S. Bank N.A. v DLJ Mortgage Capital, Inc. (140 AD3d 518, 519 [1st Dept 2016]) and its more recent decisions in Wilmington Trust Co. v Morgan Stanley Mortgage Capital Holdings LLC (152 AD3d 421, 422 [1st Dept 2017]) and Deutsche Bank Natl. Trust Co. v EquiFirst Corp. (154 AD3d 605 [1st Dept 2017]). The applicability of those decisions should not be decided on this record, without affording the parties the opportunity to address the issue in connection with the coordinated briefing on the viability of indemnification claims following the First Department decisions. (See FHFA [HE2], 2017 WL 1479480, at * 6.)

It is accordingly hereby ORDERED that the motion of defendants Novation Companies, Inc., f/k/a NovaStar Financial, Inc., and NovaStar Mortgage, Inc. to dismiss the amended complaint is granted to the following extent:

It is ORDERED that the first cause of action (Breach of Contract: Specific Performance), the third cause of action (Anticipatory Breach of Contract), and the fifth cause of action (Breach of the Implied Covenant of Good Faith and Fair Dealing), are dismissed in their entirety; and it is further

ORDERED that the second cause of action (Breach of Contract: Equitable and Legal Remedies) is dismissed solely to the extent that it is based on breaches of representations and warranties or breaches of defendants' alleged duties to repurchase defective loans; and it is further

ORDERED that the branch of the motion to dismiss the second cause of action to the extent that this cause of action is based on defendants' alleged failures to notify the Trustee of defective loans is denied without prejudice to a new motion brought in conformity with procedures to be established in the coordinated put-back actions in Part 60 regarding additional motions with respect to failure to notify claims. Nothing herein shall be construed as determining the scope or import of the Appellate Division decision in Nomura Home Equity Loan, Inc. v Nomura Credit & Capital, Inc. (133 AD3d 96 [1st Dept 2015], rearg ordered 29 NY3d 992 [2017]) or Morgan Stanley Mtge. Loan Trust ARX v Morgan Stanley Mtge. Capital Holdings LLC (143 AD3d 1, 3-4 [1st Dept 2016]) with respect to such claims; and it is further

ORDERED that the branch of the motion to dismiss the fourth cause of action (Declaratory Judgment: Indemnification) is denied without prejudice to coordinated briefing on the viability of such claims following the Appellate Division's decisions in U.S. Bank Natl. Assn. v DLJ Mtge. Capital, Inc. (141 AD3d 431, 432-433 [1st Dept 2016]), Wilmington Trust Co. v Morgan Stanley Mortgage Capital Holdings LLC (152 AD3d 421, 422 [1st Dept 2017]),

and Deutsche Bank Natl. Trust Co. v EquiFirst Corp. (154 AD3d 605 [1st Dept 2017]).

This constitutes the decision and order of the court.

Dated: New York, New York
November 30, 2017

MARCY FRIEDMAN, J.S.C.