SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 3

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U.S. BANK NATIONAL ASSOCIATION, solely in its capacity as Trustee of the HOME EQUITY ASSET TRUST 2007-1 (HEAT 2007-1),

Index No. 650369/2013

Plaintiff,

Motion Seq. 018 & 019

-against-

DLJ MORTGAGE CAPITAL, INC.,

Defendant.

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BRANSTEN, J.

In this action, U.S. Bank National Association ("Trustee") asserts claims for breach of contract against Defendant DLJ Mortgage Capital, Inc. ("DLJ") relating to DLJ's sale of residential mortgage-backed securities ("RMBS").

DLJ now moves for (1) partial summary judgment dismissing claims relating to loans as to which no breach of a contractual representation has been established, (2) summary judgment dismissing the claims for failure to prove that any breach had a material and adverse effect; (3) partial summary judgment as to claims relating to loans for which Plaintiff failed to provide timely notice of breaches; and (4) partial summary judgment regarding the contractual formula for calculating damages (Motion Sequence 018).

Plaintiff, in turn, moves for (1) partial summary judgment on the meaning of two representations and warranties made by DLJ concerning the quality and characteristics of the loans and (2) partial summary judgment dismissing the Fourth Affirmative Defense

relating to causation (Motion Sequence 019). Motion Sequence Numbers 018 and 019 are hereby consolidated for disposition. For the reasons set forth below, the motions are denied.

I. BACKGROUND

The allegations underlying this action were discussed to some extent in this court's October 8, 2015 decision on Defendant's motion to dismiss, *U.S. Bank National Association v. DLJ Mortgage Capital, Inc.*, 2015 WL 5915285 (Sup. Ct., N.Y. Cnty. 2015), familiarity with which is presumed. The facts set forth below are taken from the parties Rule 19-a statements of undisputed fact and the replies thereto,[1] the affidavits and documentary evidence submitted with the motions. Unless otherwise indicated, the facts are undisputed.

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[1] References will be made to (1) Defendant's Reply to Plaintiff's Responses to Defendant's Rule 19-A Statement of Undisputed Material Facts (DSOF ¶ ___) and Response to Plaintiff's Statement of Additional Material Facts in Opposition to Defendant's Motion for Summary Judgment (RPAF ¶ ___) (NYSCEF No. 736) and (2) Plaintiff's Reply in Further Support of its Statement of Undisputed Facts in Support of Plaintiff's Motion for Partial Summary Judgment (PSOF ¶ ___) and Responses to DLJ's Additional Statement of Undisputed Facts (RDAF ¶ ___) (NYSCEF No. 734) because each party has reproduced within them the complete text of the other parties' original Rule 19-a statements and responses. Reference to those statements also incorporates the information contained in exhibits cited in the 19-a Statements.

A. The Pooling and Servicing Agreement

The Home Equity Asset Trust 2007-1 (the "Trust") is a mortgage loan securitization trust created pursuant to a Pooling and Servicing Agreement ("PSA") between DLJ, as sponsor of the loans, and U.S. Bank, as Trustee of the Trust. (DSOF ¶¶ 1-2.) DLJ acquired the loans, performed due diligence on the loans, and conveyed the loans to Credit Suisse First Boston Mortgage Securities Corp. ("Credit Suisse") pursuant to an Assignment and Assumption Agreement, dated as of January 1, 2007. Credit Suisse conveyed the loans to the Trust pursuant to the PSA, dated January 1, 2007. (PSOF ¶ 2.) DLJ's transaction management group, together with its outside counsel and other parties, including the Trustee, prepared the PSA and other transaction documents. (*Id.* ¶ 4.)

Nearly half of the transaction loans had been underwritten with reduced documentation, meaning either income or assets or both were not verified at origination. Approximately 1,894 of the 5,149 loans in the Trust were described as reduced, stated income/stated assets or no income/no assets documentation loans. (*Id.* ¶ 7; RDAF ¶ 1.) Most of the loans had a combined loan-to-value ("CLTV") of 90% or greater, meaning the borrowers had little equity in their homes and were particularly vulnerable to declines in housing prices. (DSOF ¶ 8.)

1. *The PSA's Representations and Warranties*

The PSA contains certain representations and warranties ("R&Ws") about the underlying loans. Schedule III of the PSA sets forth the following R&W regarding the loans' compliance with underwriting guidelines (the "Underwriting Standards R&W") as follows: "(iv) The Mortgage Loan complies with all the terms, conditions and requirements of the originator's underwriting standards in effect at the time of origination of such Mortgage Loan." (*Id.* ¶ 12; PSOF ¶ 8.) Plaintiff's reunderwriting expert, Robert Hunter, testified that the Underwriting Standards R&W "is breached where a loan was not underwritten according to the guidelines." (DSOF ¶ 13.) US Bank's corporate representative, James Byrnes, testified that only the origination underwriting guidelines and the loan file are needed to determine if there was a breach of the Underwriting Standards. He also testified that the Underwriting Standards R&W does not contemplate the use of any other documents other than the origination underwriting guidelines and the loan file, including documents post-dating the closing of the loan, that the origination underwriter did not possess. (*Id.* ¶¶ 14-15; RDAF ¶ 3.)

Schedule III also contains an R&W regarding the criteria employed in assessing a borrower's ability to repay (the "Objective Criteria R&W"):

> (xx)(l) To the knowledge of the Seller . . . with respect to any Group 1 Mortgage Loan, the methodology used in underwriting the extension of credit for each such Mortgage Loan did not rely solely on the extent of the Borrower's equity in the collateral as the principal determining factor in approving such extension of credit but instead employed objective criteria such as the Borrower's income, assets and

> liabilities, to the proposed mortgage payment and, based on such methodology, the Mortgage Loan's Originator made a reasonable determination that at the time of origination the borrower had the ability to make timely payments on the Mortgage Loan.

(DSOF ¶ 16.) Hunter testified that the Certificates backed by Group 1 loans were owned by or being purchased by Freddie Mac, and this R&W warranted that the Group 1 loans were in compliance with Freddie Mac's predatory lending requirements. (*Id.* ¶ 17.)

Finally, Schedule III contains the following R&W concerning the information in the Mortgage Loan Schedule (the "MLS R&W"): "(v) The information set forth in the Mortgage Loan Schedule, attached to the Agreement as Schedule I, is complete, true and correct in all material respects as of the Cut-off Date." (*Id.* ¶¶ 18; PSOF ¶ 7.) The parties used the Mortgage Loan Schedule ("MLS") to identify the specific loans that were transferred by the depositor to the Trust. (DSOF ¶¶ 19.) The MLS sets forth information about each loan, listing 27 characteristics such as the type of property and its occupancy status, the interest rate and maturity date, the debt-to-income ratio and the borrower's credit score. (*Id.* ¶ 20; PSOF ¶ 6.)

Plaintiff contends that the MLS also served to provide information to potential investors and others, but admits that no copy of it was attached to the PSA and was merely referenced as available upon request. (DSOF ¶¶ 19, 21; RDAF ¶ 9.) Because the MLS was not attached to the PSA, the parties stipulated to using a loan tape produced by Plaintiff as the source for the MLS data for the parties to use in reunderwriting. Through counsel, DLJ also agreed that the loan tape could be used "as the final MLS for the deal."

(DSOF ¶ 22; PSOF ¶¶ 1, 6; RDAF ¶ 10.)

The PSA does not contain a common representation in the industry called a "No Fraud" R&W, which generally represented that no fraud, error, omission, misrepresentation, negligence or similar occurrence had taken place in connection with the origination of the mortgage loan. (DSOF ¶ 23.) Moreover, the PSA does not contain a "No Default" R&W, which generally warranted that no mortgage loan "default" exists. (*Id.* ¶ 24.)

2. *The Repurchase Protocol*

Section 2.03(d) of the PSA describes the process for remedying any R&W breach (the "Repurchase Protocol"). As relevant here, that section provides:

> [W]ithin 90 days of the earlier of its discovery or its receipt of written notice from any party of a breach of any representation or warranty made pursuant to Section 2.03(b) which materially and adversely affects the value of the related Mortgage Loan or the interests of the Certificateholders, it shall cure such breach in all material respects, and if such breach is not so cured, shall, (i) if such 90-day period expires prior to the second anniversary of the Closing Date, remove such Mortgage Loan (a "Deleted Mortgage Loan") from the Trust Fund and substitute in its place a Qualified Substitute Mortgage Loan, in the manner and subject to the conditions set forth in this Section; or (ii) repurchase the affected Mortgage Loan or Mortgage Loans from the Trustee at the Repurchase Price . . . .
>
> It is understood and agreed that the obligation under this Agreement of any Person to cure, repurchase or substitute any Mortgage Loan . . . shall constitute the sole remedy against such Persons respecting such breach available to Certificateholders, the Depositor or the Trustee on their behalf.

(DSOF ¶ 25; PSOF ¶ 10.)

In the event of repurchase, the PSA specifies a formula to determine the "Repurchase Price" that DLJ would pay for that specific breaching loan. (DSOF ¶ 26.) That term is defined as follows in Section 1.01:

> With respect to any Mortgage Loan required to be purchased by the seller pursuant to this Agreement or purchased by a Special Servicer pursuant to Section 3.25 of this Agreement, an amount equal to the sum of (i) 100% of the unpaid principal balance of the Mortgage Loan on the date of such purchase, (ii) accrued and unpaid interest thereon at the applicable Mortgage Rate (reduced by the Servicing Fee if the purchaser of the Mortgage Loan is also the Servicer thereof) from the date through which interest was last paid by the Mortgagor to the Due Date in the month in which the Repurchase Price is to be distributed to Certificateholders . . . .

(*Id.* ¶ 27; PSOF 11.)

On December 6, 2011 and March 30, 2012, Plaintiff sent letters to DLJ regarding purported breaches concerning a total of 1,204 Group 1 loans. The December 6, 2011 letter recited that the Federal Housing Finance Agency had requested that DLJ repurchase certain loans and "any others that did not comply with the representations and warranties." Plaintiff's March 30, 2012 letter did not include the "any others that did not comply with the [R&Ws]" language that was included in Plaintiff's December 6, 2011 letter. (DSOF ¶¶ 28-30; PSOF ¶¶ 12-13.) DLJ agreed to repurchase 40 loans identified in the two letters, but otherwise disputed Plaintiff's breach allegations. (DSOF ¶ 31; PSOF ¶ 14.)

B. The Instant Action

On February 1, 2013, Plaintiff filed a Summons and Complaint as Home Equity Asset Trust 2007-1 "acting by and through" U.S. Bank against DLJ for breach of contract. (DSOF ¶ 33.) DLJ moved to dismiss the complaint on May 15, 2013. An Amended Complaint was filed on June 28, 2013, revising the caption of the case to reflect that U.S. Bank was the Plaintiff, solely in its capacity as Trustee of the Trust. (DSOF ¶ 34.) A Second Amended Complaint (the "Complaint") was filed on August 7, 2014. (*Id.* ¶ 35.)

On August 18, 2014, DLJ again moved for dismissal. The court denied the motion by order dated October 8, 2015. In rejecting DLJ's argument that the complaint should be dismissed as to the loans not itemized in the Trustee's December 6, 2011 and March 30, 2012 breach letters the court held:

> The Trustee's December 6, 2011 breach letter clearly provided notice to DLJ of its obligation to repurchase "all loans that breached representations and warranties.["] The letter cited to two batches of 112 and 192 loans for which the Federal Housing Finance Authority sought repurchase but noted that DLJ's obligation under Section 2.03 of the PSA went beyond these loans to include "any others that did not comply with the representations and warranties" made by DLJ in the PSA. While DLJ now seeks to impose a more stringent notice requirement upon the Trustee, this is beyond what the PSA language requires.

U.S. Bank v. DLJ, 2015 WL 5915285, *2 (internal citations omitted).

On November 4, 2015, DLJ filed its answer to the Complaint. The Fourth Affirmative Defense asserts that "If Plaintiff suffered cognizable damages (which DLJ

denies), those damages resulted from causes other than any alleged act or omission by DLJ, including but not limited to macroeconomic and mortgage industry events, such as the collapse of the U.S. housing market." (PSOF ¶ 22.)

On December 1, 2015, Plaintiff informed DLJ that it intended to reunderwrite 1,059 selected loans. (DSOF ¶ 36.) All but 11 in the sample were loans that had been in default. (*Id.* ¶ 37.) 622 of the loans were not identified in Plaintiff's 2011 and 2012 repurchase demand letters. (*Id.* ¶ 38.)

C. Expert Reports

1. *Robert Hunter*

Plaintiff retained Robert Hunter as an reunderwriting expert. Hunter reviewed the 1,059 loans and issued a report opining that 854 loans breached representations and warranties, with a total of 4,705 breaches. (*Id.* ¶ 39.) He also testified that loans issued with reduced documentation, CLTVs above 90%, and low credit scores have a risk of loss "exponential[ly]" greater than conventional loans. (*Id.* ¶ 10; RDAF ¶ 2.)

DLJ's reunderwriting expert, Peter Kempf, reviewed the 854 loans that Hunter opined were breaching. Kempf found pervasive flaws in Hunter's analysis, including that he failed to approximate the process that was actually required during origination, provided his reunderwriting team with direction targeted at identifying perceived material breaches prior to a review of the loans in question, and misapplied the underwriting guidelines applicable at origination. He concluded that Hunter's approach did not

approximate what was required at origination and that reunderwriting a loan potentially over a decade after it was originated is by its very nature a flawed practice because documentation that may have been available to the origination underwriter may no longer be available in the loan file as produced in litigation many years later. He also opined that Hunter inappropriately assumed that any documentation missing from the litigation loan file was missing at the time of origination, misapplied the underwriting guidelines or applied standards that were not required by the applicable guidelines, and ignored that lenders permitted compensating factors that permitted underwriters appropriately to consider the unique, positive attributes of each borrower and each loan application. (PSOF ¶ 28.)

In his rebuttal report, Hunter opined that 783 loans out of the 1,059 reviewed loans breached representations and warranties, with a total of 4,205 breaches. (DSOF ¶ 40; PSOF ¶ 35.). Of the 783 loans for which Hunter maintained a breach claim, 480 loans were not specifically identified in Plaintiff's 2011 and 2012 repurchase demand letters. (DSOF ¶ 41.)

Hunter's review included the collection of a range of information that post-dated the closing of the loan ("post-closing information") for each borrower, such as borrower bankruptcy petitions filed years after the loan closed. (*Id.* ¶ 42.) His process included the use of verification of employment and income forms ("VOEs"), which were created by Plaintiff's vendor requesting information about employees, and asking employers to provide employment and income information for their employees. (*Id.* ¶ 43.) Hunter

also used information from the Work Number ("Work Number reports"), a database with certain employment status, title, and salary information. (*Id.* ¶ 44.) Both sources reflect borrowers' partial Social Security Numbers, and the VOEs reflect the loan numbers associated with mortgage loans obtained by the borrowers. (*Id.* ¶ 45.)

Hunter's team did not notify borrowers that they were requesting verifications of employment. (*Id.* ¶ 46.) However, the loan file of virtually every borrower contained an executed Form 1003 which represented that "[e]ach of the undersigned hereby acknowledges that any owner of the Loan, its servicers, successors and assigns, may verify or reverify any information contained in this application . . . for any legitimate business purpose . . . ." (RPAF ¶ 1.)

Using the VOEs or Work Number reports, Hunter's team contacted current or former employers for "nearly all" borrowers of the 1,059 selected loans. (DSOF ¶ 47.) The team requested income information from employers even for borrowers who had stated income loans that provided the income information would not be verified. (*Id.* ¶ 48.) The VOEs and Work Number requests did not state that information was being sought for purposes of private civil litigation in which the employees were not parties. (*Id.* ¶ 49.) Instead, the VOEs and Work Number requests typically represented to borrowers' employers that the information was sought in connection with a "quality assurance" or "quality control" review. (*Id.* ¶ 50.) For most borrowers of the 1,059 selected loans, their connection to the Trust had ended because their loan had already been liquidated by the time Hunter's team first contacted them. (*Id.* ¶ 52.)

Working with a team of reunderwriters at Opus Capital Markets Consultants, LLC ("Opus"), Hunter's team evaluated each loan using a list of up to 150 potential breaches. (*Id.* ¶ 53.) Hunter and his "core staff" then provided added layers of review and "looked for additional breaches" that the front-line reviewers missed. (*Id.* ¶ 54.) Hunter concluded that Opus' findings were supported about 99% of the time, and in second and third levels of review his team would sometimes identify additional breaches, seek additional support for the ones flagged by Opus, or reject Opus' conclusions. (*Id.* ¶ 55.)

Hunter reported 482 breaches of the Underwriting Standards R&W and 31 breaches of the Objective Standards R&W relying information in the loan files as well as post-closing information. (*Id.* ¶¶ 56-57.) In some instances, he reported breaches despite the absence of red flags in the originator's file. (*Id.* ¶¶ 58, 60.) A number of Hunter's claims of misrepresentation were based on his view that "the delivery of any false, misleading or inaccurate statements to the Lender by the Borrower, or any agent thereof in connection with the approval of the Loan constitutes a default under the Mortgage." (*Id.* ¶ 59; Hunter Dep. at 331:4-332:4 [NYSCEF No. 625].)

Hunter reported 66 breaches that a borrower's stated income was unreasonable relying upon Bureau of Labor Statistics' ("BLS") Occupational Employment Statistics survey data. (DSOF ¶ 61.) BLS collects wage information via mail surveys for specified job categories in geographic locations for a given year and publishes them in the following year; e.g., data from surveys conducted in 2006 are not published until 2007. (*Id.* ¶ 62.)

For the vast majority of his claims based on BLS, Hunter relied on data for the same year that the loan closed, which would not have been published by BLS until many months after the loan was originated and thus not available to the origination underwriter at the time of origination. (*Id.* ¶ 63.) Hunter's allegations that relied on BLS compared the borrower's stated income to the 90th percentile for a given occupation in a given geographic region, except in a handful of instances when the 90th percentile was not reported by BLS, in which case he used the 75th percentile. (*Id.* ¶ 64.) None of the applicable guidelines required an underwriter to use BLS. (*Id.* ¶ 65.) Hunter was not aware of any originators who used BLS to assess the reasonableness of stated income in 2006, although he knew of some who required or recommended the use of third-party sources such as Salary.com. (*Id.* ¶ 66.) He attempted to use BLS as a proxy for those sources because they did not provide their historic information for the 2005-2007 period, and he could not determine whether those source's data from that time would have matched BLS's salary estimates. (*Id.* ¶¶ 67-68.)

Hunter reported 465 claims for failure to investigate. (*Id.* ¶ 69.) He concluded that a finding of failure to investigate excessive unrelated credit inquiries could increase the credit risk of a loan, but that that finding would not be material standing alone. (*Id.* ¶¶ 70-71.)

He further reported 179 "Documentation Type" claims, where he asserts that the MLS reflects an incorrect loan documentation type. (*Id.* ¶ 72.) A loan's "documentation type" refers to the type of mortgage or loan that the borrower obtained—for example, a

"stated income" loan documentation type refers to a loan where the borrower's income is stated on the application but not verified by the underwriter. (*Id.* ¶ 73.) Documentation type is not one of the 27 loan characteristics specifically defined as the "Mortgage Loan Schedule." (*Id.* ¶ 74.)

Hunter additionally reported 182 claims for which the Mortgage Loan Schedule reflects an incorrect debt-to-income ratio, based upon comparison of the borrower's stated income with conflicting post-origination data. (*Id.* ¶ 75.) Plaintiff contends that the debt-to-income ratio for a stated income loan should be calculated as the ratio of the borrower's debts to the borrower's actual income, whereas Defendant contends that the various originators' underwriting guidelines required that the stated income must be used. (*Id.* ¶¶ 76-79.) Hunter testified that for stated income loans, the origination underwriter is required to assess the reasonableness of the borrower's stated income, not whether the amount stated was accurate. (RDAF ¶ 4.)

Hunter opined that "breaches that significantly increase the risk of loss on a loan necessarily adversely affect the interests of the certificateholders in the loan" and that each of the loans he identified had "one or more" breaches that materially and adversely affected the value of the loan or the interests of the Certificateholder. (DSOF ¶ 80; RPAF ¶ 3.) However, he did not opine on whether specific individual breaches increased the risk of loss for the loan. (*Id.* ¶ 81.)

Plaintiff's expert Dr. Snow did not make any determinations about the "material and adverse" element on any individual loan or breach and did not attempt to quantify the increased risk of loss by any particular breach. (*Id.* ¶ 84.)

2. *William Trickey*

DLJ submitted an expert report by William Trickey on the custom and industry understanding of the MLS Warranty. He asserted that the industry "invariably understood" the MLS Warranty "not to affirm the underlying truthfulness of information provided by borrowers and other third parties in the origination process." (PSOF ¶ 30.) Trickey claimed that the MLS Warranty attests to data quality of the specific data points listed on the MLS as compared to DLJ's books and records, including, without limitation, the mortgage loan files. He opined that the MLS R&W "was not understood in the industry at the time to relate to fraud in the origination of the loans" and that industry participants understood that to obtain protection against borrower misrepresentation, they needed a "No Fraud" R&W. (*Id.* ¶ 31.)

According to Trickey, construing the MLS Warranty to cover anything other than accurate transcription would be tantamount to a so-called "No Fraud" warranty, which generally warrants against any fraud during the origination of the loans. His report states that "[a]t the time of the HEAT 2007-1 Securitization, the MLS [representation and warranty] was not understood to relate to anything beyond data consistency with books and records." In contrast, he asserted, the "No Fraud" representation "essentially

provid[es] a guarantee that there was no fraud in the origination of the loans, including as to parties outside of the issuer's control, such as the borrower." (*Id.* ¶ 32.)

3. *Dr. Karl Snow and Dr. Walter Torous*

Plaintiff retained Dr. Karl Snow as its damages expert. Snow authored an expert report, dated June 1, 2016, an amended reply expert report dated February 8, 2017, and an amended Expert Report dated September 30, 2016. (*Id.* ¶ 26.) Snow calculated the Repurchase Price for each of the 783 breach Loans, for an aggregate amount of $246,385,914.19 as of June 1, 2016. (*Id.* ¶ 27.) Under his calculation of damages, the loans accrued interest until the repurchase date, regardless of whether those loans were liquidated. (DSOF ¶ 85.) He used a repurchase date of March 5, 2012 for each allegedly breaching loan to calculate damages. (*Id.* ¶ 86.)

DLJ also retained Dr. Walter Torous to opine on, among other things, "the implications of changes in home prices and other macroeconomic factors on default rates and loss severity. (PSOF ¶ 33.)

II. DISCUSSION

It is well-established that summary judgment is a drastic remedy and should only be granted if the moving party has sufficiently established the absence of any material issues of fact, requiring judgment as a matter of law. *Vega v. Restani Constr. Corp.*, 18 N.Y.3d 499, 503 (2012) (citing *Alvarez v. Prospect Hosp.*, 68 N.Y.2d 320, 324 (1986)).

The burden then shifts to the party opposing the motion to produce evidentiary proof, in admissible form, sufficient to establish the existence of material issues of fact which require a trial of the action. *Zuckerman v. City of N.Y.*, 49 N.Y.2d 557, 562 (1980). When deciding a motion for summary judgment, the Court must view the evidence in the light most favorable to the non-movant. *Branham v. Loews Orpheum Cinemas, Inc*i, 8 N.Y.3d 931, 932 (2007).

However, mere conclusions, unsubstantiated allegations or expressions of hope are insufficient to defeat a summary judgment motion. *See Zuckerman*, 49 N.Y.2d at 562; *Ellen v. Lauer*, 210 A.D.2d 87, 90 (1st Dep't 1994) ("[it] is not enough that the party opposing summary judgment insinuate that there might be some question with respect to a material fact in the case. Rather, it is imperative that the party demonstrate, by evidence in admissible form that an issue of fact exists . . . .") (citations omitted).

A. Defendants' Motion for Summary Judgment

In moving for summary judgment, Defendant contends that (1) Plaintiff cannot pursue those claims that do not establish a breach of any of the relevant R&Ws, (2) Plaintiff has failed to establish that any of the alleged breaches of the R&Ws materially and adversely affected the value of any loan; (3) Plaintiff has failed to give the timely notice of breaches for 480 of the loans and (4) Plaintiff has improperly calculated the Repurchase Price of the loans. These are arguments are not persuasive.

1. *Breach of the Representations and Warranties*

Defendant argues that many of Plaintiff's breach claims fail because (1) Plaintiff improperly used post-origination information, (2) Plaintiff misconstrued the MLS R&W, and (3) Plaintiff's expert conceded that certain breaches relating to excessive credit inquiries were immaterial.

a. *Post-Origination Information*

In objecting to Plaintiff's use of post-origination information, Defendant makes three contentions. First, Defendant asserts that the plain language of the Underwriting Standards and the Objective Criteria R&Ws forbid consideration of information that was not available at the time the loan was made. Thus, under the Underwriting Standards R&W, the only inquiry was whether the loan complied with the existing guidelines based on the information in the original loan files. The underwriter was constrained to consider only whether the borrower's stated income was reasonable, not whether it was truthfully represented, and was under no obligated to verify stated income loans. With respect to the Objective Criteria R&W (applicable to Group 1 loans only), Defendant similarly urges that the borrower's ability to make timely mortgage payments can only be gauged by reference to reasonable inferences drawn from loan file data, not later discoveries of borrower misrepresentation or fraud. Defendant asserts that Plaintiff has impermissibly imported into the PSA "No Fraud" and "No Default" R&Ws that were not bargained for, and thereby skewed metrics such as the debt-to-income ratio by employing debt and

income figures that were not available at the time of origination.

Plaintiff counters that the Underwriting Standards R&W is an absolute guarantee of loan quality that represents that each loan objectively complies with the standards. Once that is established, Plaintiff contends, the reason for non-compliance is irrelevant. Plaintiff argues that the underwriter's failure or inability to discover negative information about the borrower, whether through negligence or not, does not affect the existence of a breach. Plaintiff also argues that even if the focus of the R&W is merely upon procedural compliance with the R&W, there is a question of fact as to whether the originators properly assessed the reasonableness of the borrower's representations in light of all of information contained in the loan files, and whether they failed to investigate when such information put them on notice of potential fraud. Plaintiff also contends that the absence of the kind of "No Fraud" R&W that may be utilized in other transactions has no bearing on Defendant's affirmative obligations under the R&Ws at issue here.

i. *Plain Language of the Underwriting Standards and the Objective Criteria R&Ws*

The court finds that summary judgment on the meaning of the R&Ws would be premature at this juncture. In the context of resolving related issues involving the "No Monetary Default" representation and the MLS R&Ws, the First Department recently held that the interpretation of such clauses was best determined at trial, where the facts could be developed "to clarify the relevant legal principles and their application" to the

R&Ws. *MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC*, 165 A.D.3d 108, 115 (1st Dep't 2018) (quoting *Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 151 A.D. 3d 83, 89 (1st Dep't 2017), *aff'd* 31 N.Y.3d 569 (2018)). As is relevant here, the court found that a trial was necessary to resolve whether the R&Ws could be interpreted so broadly as to protect against borrower misrepresentation and guarantee underlying truthfulness.

As in *MBIA*, this court concludes Defendant's experts did not completely rebut the conclusions expressed by Hunter's reports and testimony or otherwise resolve all questions of fact. The conflicting conclusions of the parties' expert witnesses merely raise issues of fact and credibility that cannot be resolved on a motion for summary judgment. *See Scholastic Inc. v. Pace Plumbing Corp.*, 129 A.D.3d 75, 87 (1st Dep't 2015); *Bradley v. Soundview Healthcenter*, 4 A.D.3d 194, 194 (1st Dep't 2004); *see also Manswell v. Montefiore Med. Ctr.*, 144 A.D. 3d 564, 565 (1st Dep't 2016).

Additionally, granting summary judgment would not be particularly productive insofar as Defendant does not dispute that the R&Ws may be violated where the underwriter failed to make a reasonable assessment of the borrower's income or ability to repay, or where Hunter's assessment of a breach was based only in part on post-origination information. Even if the court could resolve the meaning of the R&Ws at this stage, a trial would still be necessary to sort out which loans were covered by the R&Ws and which were analyzed solely with the use of post-origination data.

ii. *Suppression of Information Pursuant to CPLR 3013*

In its second objection to Plaintiff's use of post-origination data, Defendant argues that the information should be excluded under CPLR 3103 because it was unlawfully obtained. Defendant contends that Hunter violated the Gramm-Leach-Bliley Act and the Fair Credit Reporting Act by collecting confidential borrower information without the borrowers' consent. The court concurs with Plaintiff that the weight of authority allows the methods Plaintiff's experts utilized in obtaining the information relating to the securitization by virtue of the borrowers' consent to verify or reverify information contained in the Form 1003s. *See Old Republic Ins. Co. v. Countrywide Bank, FSB*, 2010 WL 9599070, at *4 (Ill. Cir. Ct. May 27, 2010); *see also In re RFC & RESCAP Liquidating Trust Actions*, 2015 WL 3408120, at *4 (D. Minn. May 27, 2015) (by executing a Form 1003, borrowers "authorized any owner of the loan to verify or re-verify any information contained in the application or to obtain any information or data relating to the loan through any source").

This court has also expressly recognized an RMBS plaintiff's contractual right to verify borrowers' income and employment information by contacting employers and accountants. *See Ambac Assurance Corp. v. Countrywide Home Loans*, 2014 WL 2861560, at *1-3 (Sup. Ct., N.Y. Cnty. June 23, 2014). Likewise, the Special Master in *In Re: Part 60 RMBS Put-Back Litigation* found that the protections contained in the protective orders, such as the one in this case, "are sufficient to accord with any arguably-applicable provisions of the federal Gramm-Leach-Bliley Act." (Abrams Affirm. Ex. 6 at

4 [NYSCEF No. 711].) Furthermore, a protective order has also been found to satisfy the "permissible purpose" requirement of the Fair Credit Reporting Act concerning borrowers' verifications. *See Nat'l Credit Union Admin. Bd. v. RBS Sec. Inc.*, 2016 WL 1448480, at *3 (D. Kan. Apr. 13, 2016).

In any event, Defendant has not established that Plaintiff's inquiries were intrusive, unduly burdensome or actually harmful to any consumer, and that being the case, it would be a "draconian" sanction to prohibit Plaintiff from using the evidence to establish DLJ's improper underwriting practices and breaches of the R&Ws. *See Ambac*, 2014 WL 2861560, at *5 (denying preclusion of evidence absent "extreme circumstances").

iii. *BLS Statistics*

Defendant's third objection to the use of post-origination information concerns Plaintiff's use of BLS statistics to determine that the borrowers' stated income was unreasonable. Defendant argues that the wage information data upon which Hunter relied was not available until a year after the loans closed and was thus not available to the originators. Defendant also objects to the use of the BLS data as a proxy for salary information sources such as Salary.com that were available to the originators, because those alternate websites do not have historical archives from which it can be determined that their data matched other salary sources available at that time.

This objection, at best, addresses the weight and credibility to be accorded Hunter's resort to BLS statistics. Whether that data sufficiently approximates the actual, but unavailable data used by the originators to adjudge the reasonableness of the applicants' stated income is a question for the trier of fact. Furthermore, Hunter did not exclusively rely upon BLS data in making his determinations, but considered other factors in deciding whether the income was realistic in light of the borrower's job title and geographic location. This was an acceptable approach. *See FHFA v. Nomura Holdings Am., Inc.*, 104 F. Supp. 3d 441, 527-28 (S.D.N.Y. 2015) ("To assess the reasonableness of borrowers' income, Hunter examined all of the information in the loan file about a borrower's education, employment, and duration of employment, and reviewed the borrower's assets, liabilities, and disposable income. He also looked for any information in the loan file reflecting that the originator had verified the employment or income. Thus, Hunter's consultation of historical BLS data was only one step among many . . . Hunter's reliance on BLS data was entirely reasonable in the circumstances"), *aff'd*, 873 F.3d 85 (2d Cir. 2017).

Other courts have similarly approved of the use of BLS data. *See U.S. Bank, Nat'l Ass'n v. UBS Real Estate Sec. Inc.*, 205 F. Supp. 3d 386, 444 (S.D.N.Y. 2016) ("BLS data was properly considered by [the expert] Holt in forming his opinions as to whether debt-to-income ratio was misstated . . . because it was the type of material that an expert in underwriting relies upon in the ordinary course of his work as an underwriter"); *Assured Guar. Mun. Corp. v. Flagstar Bank, FSB*, 920 F. Supp. 2d 475, 505-06

(S.D.N.Y. 2013) (expert's use of BLS "data to determine whether a borrower's stated income was reasonable . . . was an adequate methodology to allow [the expert] to obtain the evidence of breach necessary to make a determination ... as to whether those breaches increased the risk to [plaintiff] on a given loan"). Defendant's reliance on cases involving the resort to third-party sources is misplaced insofar as they involved situations where the actual contemporaneous information was available, *see Celebrity Cruises Inc. v. Essef Corp.*, 434 F. Supp. 2d 169, 182 (S.D.N.Y. 2006), or the source had no meaningful correlation to the relevant issue. *See In re Exec. Telecard, Ltd. Sec. Litig.*, 979 F. Supp. 1021, 1027 (S.D.N.Y. 1997).

b. *Mortgage Loan Schedule R&W*

Defendant contends that Plaintiff cannot establish a breach of the MLS R&W for two reasons. Defendant argues that because stated income loans did not require verification, the originators acted within guidelines when they used the borrower's income to calculate the debt-to-income ratio. Defendant further argues that because the PSA definition of the Mortgage Loan Schedule did not list "documentation types" as one of the 27 covered characteristics, Plaintiff cannot pursue breaches based on the misclassification of documentation even if that category appears in the loan tapes.

As discussed above in connection with the Underwriting Standards and Objective Criteria R&Ws, the interpretation of the MLS R&W must await trial. Notably, it was the same MLS warranty that was at issue in the First Department's ruling in *MBIA Ins. Corp.*

v. Credit Suisse, supra. That inquiry will include whether the list of characteristics set forth in the PSA was intended to be exhaustive. Clarification will also be needed as to the meaning of the parties' email agreement that the loan tape could be used as "the final MLS for the deal", i.e. whether the agreement was intended as a substitute for the missing schedule or merely as an agreed source for certain data.

c. *Materiality of Credit Inquiry Breaches*

Defendant asserts that Hunter conceded that ten percent of the alleged breach claims, involving the underwriter's failure to investigate borrower credit inquiries, were immaterial. This claim does not accurately characterize Hunter's testimony or the conclusions of his reports. Hunter merely stated that a credit inquiry breach might be immaterial if considered in isolation, but that such inquiries were evaluated together with other information relevant to the ability to repay. Also, as discussed below, the meaning and presence of a material breach generally implicates a question of fact.

2. *Materiality of Breaches Generally*

Defendant argues that Plaintiff has failed to make a prima facie case that any breach had a material and adverse effect on the value of any loan or interest of the Certificateholders within the meaning of section 2.03 of PSA. Defendant contends that Hunter's reports and testimony at best supply evidence of potential breaches of the R&Ws, without sufficient, nonconclusory analysis to show whether and why any breach

fulfilled the materiality requirement. Defendant points to Hunter's testimony that he did not designate or name "a materiality per breach", but rather made a materiality designation for each loan as whole. These arguments are unpersuasive.

As a general matter, the materiality of the breach of a contractual warranty creates a question for the trier of fact. *See Anjay Corp. v. Those Certain Underwriters at Lloyd's of London subscribing to Certificate No. HN01AAF4393*, 33 A.D.3d 323, 324 (1st Dep't 2006) (reversing grant of summary judgment in defendant's favor where there was a question of materiality of a breach of warranty). It is only where materiality is "clear and substantially uncontradicted" that the issue may be resolved as a matter of law by the court. *Id.* (quoting *Continental Ins. Co. v. RLI Ins. Co.*, 161 A.D.2d 385, 387 (1st Dep't 1990)).

Moreover, the First Department has not yet ruled on the meaning of "material and adverse" in the RMBS context, and some courts, including this one, have indicated that it is a question best resolved at trial rather than on summary judgment. *See MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC*, 55 Misc.3d 1204(A), at *5 (Sup. Ct. N.Y. Cnty., Mar. 31, 2017) (holding that absence of definition of "material and adverse" precluded summary judgment even where Defendant allegedly conceded materiality of certain breaches), *aff'd* 165 A.D.3d 108 (1st Dep't 2018); *Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 2015 WL 6471943, at *11 (Sup. Ct., N.Y. Cnty. Oct. 22, 2015), *modified on other grounds*, 151 A.D. 3d 83 (1st Dep't 2017), *aff'd* 31 N.Y.3d 569 (2018).

Defendant errs in its contention that the Hunter reports fail to adequately address the question of materiality. His conclusion regarding whether the breaches materially and adversely affected the value of the loans was supported by extensive analysis of selected loans, in which he provided specific details of the defects or combination of defects.

Defendant's argument that the PSA requires every breach of a single, identified R&W to be adversely material in and of itself is erroneous. Section 2.03(d) refers to "a breach of a representations or warranty", and reasonably construed, a "breach" could refer to a combination of breached R&Ws which substantially increase the risk of a loan only when considered together. For example, a slightly overstated income which breached an R&W might not be material, standing alone, but the value of the loan might be significantly impaired if a series of similar (but again not individually material) misrepresentations regarding the borrower's credit score and the property's appraisal were also present.

"The materiality of an R&W breach is . . . loan-specific", *BlackRock Allocation Target Shares v. Wells Fargo Bank, Nat'l Ass'n*, 2017 WL 953550, at *5 (S.D.N.Y. Mar. 10, 2017), so whether that happens to be the case with respect to a particular loan is something that must be explored through cross examination of the experts at trial. *See U.S. Bank, Nat'l Ass'n v. UBS Real Estate Secs. Inc.*, 205 F. Supp. 3d 386, 477 (S.D.N.Y. 2016) (post-trial decision noting that "[t]he Court has considered the totality of the evidence relating to a loan in making findings on any specific issue relating to that loan. . . . The evidence most directly applicable to the claimed breach has not been considered in

isolation but in conjunction with the totality of the evidence concerning the loan."); *see also FHFA v. Nomura Holdings Am., Inc.*, 104 F. Supp. 3d 441, 531 (S.D.N.Y. 2015) (approving of Hunter's careful loan by loan analysis). Some loans may remain defective after some of their breaches are disproven and some may not. But Plaintiff is not required, at the summary judgment stage, to assess the status of a loan under every possible hypothetical scenario.

3. *Timely Notice of Breach*

Defendant contends that it is entitled to summary judgment as to 480 loans for which Plaintiff did not notify Defendant of any breaches prior to serving Hunter's report in 2016. Defendant argues that Plaintiff's recovery is limited to loans for which timely notice was given prior to November 1, 2012, and that Plaintiff's repurchase demands in December 2011 and March 2012 did not apprise Defendant of the allegedly breaching loans in dispute. Furthermore, Defendant asserts that the claims relating to those loans do not relate back to the filing of this action for statute of limitations purposes.

The court rejects these arguments for substantially the same reasons articulated in the October 2015 decision denying the motion to dismiss. There, the court held that the December 2011 notice "clearly provided notice to DLJ of its obligation to repurchase all loans that breach representations and warranties." *U.S. Bank*, 2015 WL 5915285 at *2. In doing so, the court specifically rejected DLJ's attempt to "impose a more stringent notice requirement upon the Trustee . . . beyond what the PSA language requires." *Id.*

Other courts considering the question since that ruling have also sanctioned this approach. *See Nomura Asset Acceptance Corp. Alt. Loan Trust v. Nomura Credit & Capital, Inc.*, 2014 WL 2890341, at *16 (Sup. Ct., N.Y. Cnty. June 26, 2014) ("In interpreting similar repurchase protocols, the Courts have generally held that the contractual notice requirement that triggers the seller's repurchase obligation is satisfied by a Plaintiff's breach notice that refers to specific allegedly defective loans identified by a statistical sampling of the loan pool, or other loan-level investigation, at least where the notice also demands repurchase of all other defective loans"), *modified on other grounds*, 2018 WL 6357913 (1st Dep't 2018); *Deutsche Bank Nat'l Tr. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 289 F. Supp. 3d 484, 505-06 (S.D.N.Y. 2018) ("The only language in the MLPA regarding adequacy of notice states that it must relate to a breach of any representation or warranty . . . which materially and adversely affects the value of the interests of the Purchaser . . . . Notably absent is any requirement that the notifying party provide 'actual' or 'loan-by-loan' notice of breach in particular loans. Notice of a pervasive breach within a representative sample of loans undoubtedly provides some notice, and the MLPA is completely silent as to whether such notice is effective only as to the identified loans, or whether it triggers a broader obligation.").

Moreover, because the repurchase letters identified some timely claims, the later-identified claims relate back to the original filing. *See Nomura Home Equity Loan, Inc. v. Nomura Credit & Capital, Inc.*, 133 A.D.3d 96, 108 (1st Dep't 2015) ("the court correctly refused to dismiss claims relating to loans that Plaintiffs failed to mention in

their breach notices . . . . Plaintiffs' presuit letters put defendant on notice that the certificateholders whom Plaintiffs (as trustees) represented were investigating the mortgage loans and might uncover additional defective loans for which claims would be made"), *modified on other grounds*, 30 N.Y.3d 572 (2017).[2]

Finally, Defendant's reliance on this court's decision in *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, 2015 WL 6471943 (Sup. Ct., N.Y. Cnty. 2015) is misplaced. In *Ambac* the plaintiff "admit[ted] that it never made a pre-suit demand for the repurchase of all breaching loans." *Ambac*, 2015 WL 6471943 at *5. This court distinguished the case from those in which, as here, Plaintiff has "demanded that, in addition to the loans specifically cited, all other breaching loans be repurchased." *Id.*

4. *Calculation of Repurchase Price*

Defendant seeks summary judgment on two issues relating to the calculation of the Repurchase Price. Defendant contends that Plaintiff is not entitled to interest past the date that any loan was liquidated, and that the date of repurchase must be set at 90 days after Defendant received notice of a specific breach.

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[2] Plaintiff also suggests that because the Court of Appeals has deemed a loan repurchase demand to be a "procedural" rather than "substantive" condition precedent to suit, the written notices are mere technical requirements which need not be "alleged and proven." *See ACE Secs. Corp. v. DB Structured Prods., Inc.*, 25 N.Y.3d 581, 597-98 (2015). In fact, ACE did not dispense with or minimize the contractual notice requirement at issue here, or address the level of specificity required in the notice. Rather, the court merely held that a demand was not a substantive element of the cause of action for for statute of limitations purposes.

With regard to the interest, Defendant argues that interest cannot "accrue" on a liquidated loan because once the loan leaves the trust, it is charged off and ceases to exist. Defendant's argument has some logic to it, but by the same reasoning, neither could a liquidated loan be "repurchased." Yet, the parties do not dispute that such loans can be repurchased.

Moreover, several courts have held that the loans must be allowed to be repurchased in order to effectuate the parties' intent, despite the existence of an express provision governing the treatment of liquidated loans in the repurchase protocol. Courts have rejected the argument that repurchase is impossible because the loans are no longer assets of the trust, or that their defined purchase prize is zero, because the seller "would be perversely incentivized to fill the Trust with junk mortgages that would expeditiously default so that they could be released, charged off, or liquidated before a repurchase claim is made." *ACE Secs. Corp., Series 2006-SL2 v. DB Structured Prods., Inc.*, 40 Misc. 3d 562, 567, 569 (Sup. Ct., N.Y. Cnty. 2013), *rev'd on other grounds*, 112 A.D. 3d 522 (1st Dep't 2013), *aff'd* 25 N.Y.3D 581 (2015); *see Nomura Asset Acceptance Corp. Alternative Loan Trust v. Nomura Credit & Capital, Inc.*, 2014 WL 2890341, at *10 (Sup. Ct., N.Y. Cnty. June 26, 2014) (noting whole point of how the agreements were structured was to shift risk of noncomplying loans to seller), *modified on other grounds*, 2018 WL 6357913 (1st Dep't 2018); *Deutsche Alt-A Secs. Mtge. Loan Trust, Series 2006-OA1*, 958 F. Supp. 2d 488, 504 (S.D.N.Y. 2014) (approvingly quoting ACE trial court's reasoning).

Accordingly, interest should continue to accrue on the loans despite their liquidation. As Plaintiff notes, the PSA provides that the accrual continues until the "the month in which the Repurchase Price is to be distributed to Certificateholders." The court also agrees with Plaintiff that the date can reasonably be set as March 5, 2012, 90 days from the date of Plaintiff's demand for the repurchase of the loans. Therefore, this branch of the motion is also denied. This ruling, of course, is without prejudice to Defendant's right to contest any breach or its obligation to repurchase any loan.

B. Plaintiff's Motion for Partial Summary Judgment

The first part of Plaintiff's motion for partial summary judgment seeks a ruling that the MLS R&W and the Underwriting Standards R&W are unambiguous. The court has held otherwise in connection with Defendant's motion for summary judgment with respect to those two R&Ws, so no further discussion is necessary on this issue.

The second part of Plaintiff's motion seeks dismissal of Defendant's Fourth Affirmative Defense, which asserts that Plaintiff's damages were caused by intervening economic events rather than breaches of the PSA. Relying upon *MBIA Insurance Corp. v. Countrywide Home Loans, Inc.*, 105 A.D. 3d 412 (1st Dep't 2013), Plaintiff argues it is not obligated to prove loss causation, but merely the existence of a material breach. As relevant here, the First Department in *MBIA* held:

> [P]laintiff is entitled to a finding that the loan need not be in default to trigger defendants' obligation to repurchase it. There is simply nothing in the contractual language which limits

> defendants' repurchase obligations in such a manner. The clause requires only that "the inaccuracy [underlying the repurchase request] materially and adversely affect [ ] the interest of" plaintiff. Thus, to the extent plaintiff can prove that a loan which continues to perform "materially and adversely affect[ed]" its interest, it is entitled to have defendants repurchase that loan. Whether or not such proof is actually possible is irrelevant to plaintiff's summary judgment motion.

MBIA, 105 A.D. 3d at 413 (internal citations omitted).

Although MBIA dispensed with the requirement that a Plaintiff demonstrate the default or other non-performance of a loan to trigger its right to repurchase, its holding did not expressly eliminate the need for a showing of causation. Rather, the requirement that a breach adversely "affect" a loan at least arguably implies that the breach is the "cause" of the diminution in value, as opposed to some other cause. Defendant seeks to present proof that there was no meaningful difference in performance between breaching and non-breaching loans, and thus that the performance of the loans was not affected by the breaches by rather by outside factors. This, coupled with the necessity that Plaintiff established the very meaning of "material and adverse" at trial, makes any ruling on the affirmative defense premature.

III. **CONCLUSION**

Accordingly, it is hereby

ORDERED, that Defendant's motion for summary judgment is denied, and it is further

ORDERED, that Plaintiff's motion for partial summary judgment is denied, and it is further

ORDERED, that the parties are directed to appear in Room 442, 60 Centre Street, for a pretrial conference on 2/26/19 at 11:30 A.M.

Dated: New York, New York

December 26 2018

ENTER:

HON. EILEEN BRANSTEN
J.S.C.