

New CREFC Mediation Proposal: A Response to SEC'S Proposed Breach Enforcement Regulation

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In response to the growing proliferation of CMBS mortgage loan put-back litigation for loan seller breaches of representations and warranties and the SEC's new focus on issuer/seller disregard (as well as some purchaser litigation abuse) of requests for repurchase, the Commercial Real Estate Finance Council has proposed a Model Dispute Resolution and Remedies Provision ("Model Provision") to be incorporated into Mortgage Loan Purchase Agreements (MLPAs) and Pooling and Servicing Agreements (PSAs) industry-wide to provide consistency and transparency to a process that many CMBS investors have lost confidence in as a protection against poor originator loan underwriting. CREFC has submitted the Model Provision to the SEC as a proposed template for an enforceable breach repurchase protocol under the SEC's proposed risk retention regulation.

In General

The proposed Model Provision is an alternative dispute resolution and remedies section for inclusion in future PSAs and MLPAs, and is designed to expedite the resolution of any representation and warranty dispute in a timely and reliable manner without resort to litigation, at least in the first instance. Under the provision, parties are required to mediate (not arbitrate) any breach claims before commencing any legal action, such as litigation, administrative proceedings or arbitration, and it covers any dispute arising out of, or relating to, a request for cure, substitution or repurchase under a PSA or MLPA that contains the provision. The mediation is to be conducted in accordance with official CMBS Mediation Guidelines to be developed and published from time to time by the Commercial Real Estate Finance Council (CREFC).

The Process

Either the party requesting—or the party rejecting the request for—a cure, substitution or repurchase may commence a mediation process by filing a written request for mediation with the designated mediation agency and notifying the opposing party of such request in writing. The request should provide sufficient detail about

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the subject matter of the dispute, as well as the specific relief being requested.

Although the mediation is mandatory, it is non-binding, but the parties must make a good faith effort to resolve the dispute through the process. All parties are directed to cooperate with one another by scheduling proceedings for mutually acceptable times and locations and providing all documents and information requested by the mediator. Each party should attend the mediation session and make available a person with full settlement authority. Any party may seek equitable relief prior to or during the mediation if it is necessary in order to preserve the status quo or for other emergency relief pending the completion of the mediation.

The Mediator

The party commencing the process can choose a recognized dispute mediation organization from among those organizations that have been certified by the CREFC or any other recognized mediation agency that has been mutually agreed to by the parties (the "Mediation Agency"). The disputing parties will then select an individual neutral mediator from the Mediation Agency's panel of qualified mediators. All parties must work with the mediator and comply with the Mediation Agency's published rules of procedure. To assist the mediator in understanding CMBS documents, structures and the market, the mediator may consult in writing with neutral members of a CMBS Mediation Advisory Board comprised of experts (appointed by CREFC) to obtain business and legal expert advice in the real estate finance and structured finance industries and markets.

Costs

Each party will be responsible for paying their own fees and expenses. The parties will share equally any costs arising from the mediation and the Mediation Agency. However, if a mortgage loan seller is required to repurchase the mortgage loan or resulting REO property, it will reimburse the special servicer for the loan or REO property and for all costs and expenses incurred in connection with the mediation. In the event that a mediation party does not comply with the provisions of this section, the party successfully seeking enforcement shall be entitled to an award of all the costs and fees resulting from the other party's failure to participate in the mediation process.

Tolling

Once the dispute is submitted to mediation, any statute of limitations, statute of repose or doctrine of laches will be tolled as of the date the written request is delivered to the Mediation Agency and the opposing party. The parties waive any right to assert in any litigation, administrative proceeding or arbitration that the time proscribed has run or expired during the tolling period. Upon proper termination of the mediation, the tolling period will end three days after the date that the termination notice is sent.

Resolution by Special Servicer

The commencement of a mediation proceeding should not prevent a special servicer from taking any action that is in the best interest of the certificate holders. At any time before or after the request is submitted, the special servicer may commence or continue a liquidation, workout or other resolution of a mortgage loan or REO property, so long as the action is consistent with the applicable contractual servicing standard. In the

event of a successful completion of a liquidation, workout or other resolution, the mortgage loan seller will be liable for the difference between the aggregate of all resolution proceeds, insurance and condemnation proceeds, net REO revenues and all other amounts previously received from the resolution in respect of such mortgage loan and the purchase price to the extent the repurchase claim is successful.

Confidentiality

All communications, oral or written, made in the course or in connection with the mediation are confidential, privileged, inadmissible and non-discoverable for any purpose, including impeachment, in any action involving the mediation parties. This includes all offers, promises, conduct and statements made by the parties, their agents, employees, experts and attorneys, as well as the mediator and any of the Mediation Agency's employees. However, any documents that would otherwise be admissible will remain discoverable and admissible, notwithstanding the mediation.

Legal Proceedings

Mediation does not intend to completely preclude legal actions, but only conditions their commencement on an initial attempt at mediation. A legal action may not be commenced with respect to an unresolved matter that was submitted to mediation until the mediation is terminated in accordance with the termination provision below. In the event that a legal action is properly commenced after termination, the parties may agree to simultaneously continue the mediation process.

Termination

Either party may terminate the mediation process after the earlier of either (a) the initial mediation session, plus a 10-day "cooling off" period following such mediation meeting and (b) 90 days after the opposing party's receipt of the initial written request for mediation. The party wishing to terminate the mediation must do so by sending written notice to the opposing party.

Implementation

Before the process of convincing the CMBS industry to incorporate its Dispute Resolution and Remedy provisions into new MLPAs and PSAs can commence, CREFC must accomplish the following to assure that the mediation process is fully operational: (a) chose and designate an official Mediation Agency; (b) develop and publish official mediation guidelines; (c) establish the advisory expert panel and appoint its members; (d) establish a procedure for questions to be submitted in writing as hypotheticals certified to the Expert Panel for a written response without identifying the parties, the property, the loan or the CMBS trust; (e) develop a standard CREFC Mediation Agreement for use with other Mediation Agencies chosen by mediation parties; (f) establish more objective standards than the PSA/MLPA servicing standards, which may be problematic for special servicers; and (f) impose a strict confidentiality standard (with the usual legal compulsion exceptions) on the entire mediation process and the certification of questions to the expert panel.

Ultimately, bridging the current gap between CMBS originators/issuers and investors will best be accomplished by requiring, among other things, an enforceable breach repurchase protocol that will provide investors with

the degree of predictability and stability that they seek, where they can once more rely with some degree of confidence on truly enforceable representations and warranties. What is not yet fully appreciated or understood by market participants are the potential enforcement consequences for originators and issuers of the proposed SEC regulation's mandated disclosure in individual originator/issuer quarterly reports (going back three years) of loan put-back requests (including details of whether the request has been resolved, and if not, why), which the credit rating agencies are required to consider in their ratings, but which investors may use in their loan breach put-back litigation and the SEC may use for its own yet unknown purposes.

This article was written by Joseph Forte, a partner in the New York office and a member of its Global Finance & Debt Products Group.

ALSTON + BIRD_{LLP}

www.alstonfinance.com

Atlanta: One Atlantic Center • 1201 West Peachtree Street • Atlanta, Georgia, USA, 30309-3424 • 404.881.7000 • Fax: 404.881.7777

Brussels: Level 20 Bastion Tower • Place du Champ de Mars • B-1050 Brussels, BE • +32 2 550 3700 • Fax: +32 2 550 3719

Charlotte: Bank of America Plaza • 101 South Tryon Street, Suite 4000 • Charlotte, North Carolina, USA, 28280-4000 • 704.444.1000 • Fax: 704.444.1111

Dallas: 2200 Ross Avenue • Chase Tower • Suite 3601 • Dallas, Texas, USA, 75201 • 214.922.3400 • Fax: 214.922.3899

Los Angeles: 333 South Hope Street • 16th Floor • Los Angeles, California, USA 90071-3004 • 213.576.1000 • Fax: 213-576-1100

New York: 90 Park Avenue • New York, New York, USA, 10016-1387 • 212.210.9400 • Fax: 212.210.9444

Research Triangle: 4721 Emperor Blvd., Suite 400 • Durham, North Carolina, USA, 27703-85802 • 919.862.2200 • Fax: 919.862.2260

Silicon Valley: 275 Middlefield Road • Suite 150 • Menlo Park, California, USA, 94025-4004 • 650-838-2000 • Fax: 650.838.2001

Washington, DC: The Atlantic Building • 950 F Street, NW • Washington, DC, USA, 20004-1404 • 202.756.3300 • Fax: 202.756.3333

Ventura County: Suite 215 • 2801 Townsgate Road • Westlake Village, California, USA 91361 • 805.497.9474 • Fax: 805.497.8804