



Global Finance ADVISORY ■

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RMBS “Put-Back” Litigation: Is the *Assured Guaranty* Decision a Game-Changer?

The Takeaway

Based on a recent bellwether federal court decision, plaintiffs in mortgage loan put-back litigations may now have a roadmap to establish pool-wide representation and warranty breach claims in a streamlined manner through the use of statistical sampling. While the process will be lengthy and will involve a “war of the experts,” detailed loan reviews and a multiday trial, from the plaintiff’s perspective, the path to recovery is now clearer.

The Case in Brief

In *Assured Guaranty Municipal Corp. v. Flagstar Bank, FSB, et al.*,¹ the Southern District of New York held that Flagstar breached loan-level representations and warranties concerning residential mortgage loans and awarded bond insurer Assured \$90.1 million, plus attorneys’ fees. Assured had guaranteed the timely payment of principal and interest to the certificateholders of two Flagstar securitizations, which contained approximately 15,000 HELOCs with an original balance of \$900 million. In 2011, after paying more than \$90 million in claims, Assured sued Flagstar, alleging that the loans materially breached Flagstar’s contractual representation and warranties that (1) each loan was originated in accordance with Flagstar’s underwriting guidelines, and (2) there were no errors, omissions, misrepresentation, negligence or fraud with respect to the loans. Following a 12-day trial, which involved numerous expert and fact witnesses, the court held for Assured.

Key Rulings

The court interpreted several critical aspects of industry-standard mortgage loan repurchase provisions—the same language that appears in purchase and sale and insurance agreements involving trillions of dollars of loans. In a typical agreement, the seller “reps” to the characteristics of each loan. If a loan breaches a representation and warranty, and the breach causes a “material and adverse” effect on the loan’s value or

¹ 11 Civ. 2375 (S.D.N.Y.) See Opinion & Order, Feb. 6, 2013.

the certificateholder's interest in the loan, the seller, upon the receipt of prompt notice, is obligated to cure the defect or repurchase the loan within a set period. Where a party is seeking to establish breaches in a large loan pool, there is a practical proof issue: will a party have to identify and prove every breach, or can a party prove the existence of breaches throughout the loan pool using only a small loan sample?

In 2010, a New York court in *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*² ruled—apparently for the first time—that a plaintiff in a residential mortgage loan put-back case could use statistical sampling, without endorsing any particular methodology.

The *Assured Guaranty* decision takes a further step. The court accepted Assured's expert methodology at trial, which involved a review of a random sample of 800 (of 15,000) loans and statistical sampling, loan underwriting and damages experts. Assured's experts testified that in excess of 75 percent of the loans were materially defective. In deciding in Assured's favor, and largely accepting Assured's sampling methodology, the court held that the loans "pervasively breached" Flagstar's representation and warranties.

Conclusion

From a plaintiff's perspective, the *Assured Guaranty* decision provides a model for success at trial in large-scale mortgage loan put-back litigation. Alston & Bird will be monitoring the practical effects of this decision as it relates to loan origination and servicing and will send updates accordingly.

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² 30 Misc. 3d 1201(A), at*4 (N.Y. Sup. Ct. 2010).

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