

Recent Developments in Repurchase Litigation

Contracts between lenders originating subprime mortgage loans and purchasers of those loans typically require the originating lender to buy back faulty loans in certain circumstances. For example, repurchase is often required if a borrower defaults on an early payment, or if loans violate representations and warranties because a borrower provided false information.¹ In addition, the originating lender may need to reimburse the purchaser when loans are prepaid in their entirety within a specified period. The total amount of loans subject to repurchase is unknown, but such agreements encompass billions of dollars in mortgages.²

As the subprime crisis has deepened, purchasers of loans have attempted to avoid their losses by bringing suit to enforce repurchase agreements. Their complaints typically include claims for breach of contract, specific performance, and breaches of representations and warranties, and may seek tens of millions of dollars in damages.

Defendants have sometimes challenged whether conditions precedent have been met for a repurchase obligation. However, loan originators were among the first casualties of the subprime crisis, and some litigation has been resolved with default judgments because lenders were too financially strapped to continue contesting allegations. New Century Financial Corp., which filed for bankruptcy in April 2007, estimated prior to filing that it might owe as much as \$8.4 billion in mortgage repurchases.³

Examples of recent Complaints alleging breaches of repurchase agreements are:

March 13, 2006:

EMC Mortgage Corp. v. MortgageIT, Inc., Docket No.: 3:06-cv-00440 (N.D. Tex.): EMC Mortgage has brought suit against MortgageIT on its own behalf and on behalf of asset backed securities trusts, alleging numerous breaches of the parties' Mortgage Loan Purchase and Interim Servicing Agreement (MLPA). In an amended complaint, EMC claims that MortgageIT failed to comply with its contractual obligations to repurchase tens of million of dollars in loans due to defaults on borrowers' first three scheduled monthly payments and breaches of the MLPA's representations and warranties.

In its Second Amended Answer, MortgageIT asserts counterclaims for breach of the implied covenant of good faith and fair dealing, and breach of contract due to EMC's alleged failure to give sufficient notice and an opportunity to cure in connection with loans subject to repurchase. MortgageIT also questions whether it could rely on EMC's records and repurchase claims in light of the company's own subprime-related troubles, which allegedly include investigations by state Attorneys General and the Federal Trade Commission, as well as class action lawsuits. In a Motion to Dismiss the Plaintiff's Fourth Amended Complaint filed the same day as its Second Amended Answer, MortgageIT challenges EMC's standing to sue, and argues that any breaches were immaterial.

¹ See, e.g., *EMC Mortgage Corp. v. MortgageIT, Inc.*, Docket No. 3:06-cv-0040 (N.D. Tex. Filed March 13, 2006).

² Carrick Mollenkamp, et al., *Banks Go on Subprime Offensive*, THE WALL STREET JOURNAL, March 13, 2007.

³ Final Report of Michael J. Missal, Bankruptcy Court Examiner, *In re New Century TRS Holdings, Inc.*, Docket No. 07-10416 (KJC) (Bankr. D. Del. Feb. 29, 2008) at 106.

February 27, 2007:

DLJ Mortgage Capital, Inc. v. Sunset Direct Lending, LLC et al, Docket No.: 1:07-cv-01418-HB-THK (S.D.N.Y.): DLJ Mortgage, a unit of Credit Suisse, claims that breaches of contract by Sunset Direct and Sunset Mortgage resulted in almost \$24 million in damage to DLJ. DLJ alleges that both Sunset companies, which originated and sold mortgages, failed to comply with contractual provisions that required the repurchase of certain defaulting loans and loans in breach of representations and warranties, as well as contractual obligations to reimburse DLJ when mortgage loans were prepaid in full within a year of closing. In addition, DLJ argues that it should be awarded its costs and fees under a contractual provision requiring the Sunset companies to indemnify it for expenses related to their failure to comply with the agreements.⁴

Sunset ultimately failed to contest the suit, and the court granted a default judgment for DLJ and referred the matter to the magistrate judge for a determination of damages. Sunset Direct Lending's website now includes a statement that: "Sunset Direct Lending is no longer accepting applications and has discontinued originating loans. We want to thank all of our business partners over the years."⁵

May 25, 2007:

DB Structured Products, Inc. Litigation, Docket Nos. 1:07-cv-04099-GBD, 04105-GBD, 04106-DLC, 04109-DLC, 04115-DLC to 04127-DLC (S.D.N.Y.): DB Structured Products, a subsidiary of Deutsche Bank, filed 17 breach of contract actions in New York against mortgage lenders on May 25, 2007. The complaints allege that the defendants, which sold mortgages to DB, failed to meet their contractual obligations to repurchase certain defaulting loans, causing damages of up to \$14.1 million. The complaints are similar and generally allege breach of contract, unjust enrichment, indemnification of legal fees and costs, and specific performance.

As of March 28, 2008, DB Structured Products had obtained default judgments against six defendants: Invest Corporation for \$5.8 million, Maribella Mortgage, LLC for \$13.1 million, Commonsense Mortgage, Inc. for \$1.9 million, Act Lending Corporation for \$3.7 million, Mortgage Corporation of America, Inc. for \$13.5 million, and Innovative Mortgage Capital, LLC for \$816,432. In a seventh case against Baltimore American Mortgage Corporation, Inc., a default judgment appeared imminent. Two cases have settled, one case has been dismissed, and seven other cases remain open.

⁴ The court in *EMC Mortgage Corp. v. MortgageIT, Inc.* granted MortgageIT's motion to dismiss a similar claim for indemnification or attorneys' fees on grounds that the contractual provision at issue did not clearly apply to claims between the parties, as required under controlling New York law. Order at 3-7, *EMC Mortgage Corp. v. MortgageIT*, No. 3:06-cv-00440 (N.D. Tex. Oct. 16, 2006).

⁵ <http://www.sunsetdirectlending.com/>.