SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: MARCY S. FRIEDMAN *Justice* **PART** 60

Federal Housing Finance Agency, as Conservator for the Federal Home Loan Mortgage Corporation, on behalf of the Trustee of the Morgan Stanley ABS Capital I Inc. Trust, Series 2007-NC3 (MSAC 2007-NC3)

-against-

Morgan Stanley Mortgage Capital Holdings LLC, as Successor-by-Merger to Morgan Stanley Mortgage Capital Inc.

INDEX NO. 651959/2013

MOTION DATE _____

MOTION SEQ. NO. 002

The following papers, numbered 1 to _____ were read on this motion to/for Dismiss

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ... No (s). _____

Answering Affidavits — Exhibits _____ No (s). _____

Replying Affidavits _____ No (s). _____

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

Upon the foregoing papers, it is ORDERED that the motion to dismiss of defendant Morgan Morgan Stanley Mortgage Capital Holdings LLC, as Successor-by-Merger to Morgan Stanley Mortgage Capital Inc., is decided in accordance with this court's decision/order dated April 12, 2016.

Dated: 4-12-16

Marcy Friedman, J.S.C.

MARCY S. FRIEDMAN, J.S.C.

1. Check one: ..... ☐ CASE DISPOSED ☒ NON-FINAL DISPOSITION

2. Check as appropriate:.....Motion is: ☐ GRANTED ☐ DENIED ☐ GRANTED IN PART ☐ OTHER

3. Check if appropriate:..... ☐ SETTLE ORDER ☐ SUBMIT ORDER

☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

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 MORGAN STANLEY ABS CAPITAL I INC. TRUST, SERIES 2007-NC3 (MSAC 2007-NC3),

Plaintiff,

– against –

MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC, as Successor-by-Merger to MORGAN STANLEY MORTGAGE CAPITAL INC.,

Defendant.

Index No.: 651959/2013

DECISION/ORDER

This residential mortgage backed securities (RMBS) breach of contract action is based on breaches of representations and warranties regarding the quality and characteristics of the underlying loans by Sponsor Morgan Stanley Mortgage Capital Inc., the predecessor of defendant Morgan Stanley Mortgage Capital Holdings LLC (collectively Morgan Stanley). Deutsche Bank National Trust Company is Trustee of MSAC 2007-NC3, the Trust at issue. 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. Defendant Morgan Stanley moves to dismiss the complaint pursuant to CPLR 3211 (a) (1), (3), (5), and (7) on the grounds, among others, that the action was not timely commenced, and that the complaint is defectively pleaded.

The complaint pleads two causes of action. The first (Breach of Contract), alleges that Morgan Stanley breached the governing agreements in two respects: by conveying loans to the Trust whose value was materially and adversely affected by breaches of representations and warranties; and by failing to cure or repurchase such loans upon discovery or notice of the breaches. (Compl. ¶¶ 60, 64.) The second cause of action (Breach of the Implied Covenant of Good Faith and Fair Dealing) pleads that Morgan Stanley breached the covenant by "keeping silent" about defects in the loans "in a manner that has had the effect of destroying or injuring the Trustee's right to receive the benefit of its bargain." (Id. ¶ 73.)

Except as discussed below, this motion raises issues that do not differ in any material respect from those determined by this court in a decision also issued on this date in Federal Hous. Fin. Agency v Morgan Stanley ABS Capital I Inc. (Index No. 650291/13, Apr. 11, 2016 [FHFA (NC1)]). That decision, which was based on substantially similar pleadings and governing agreements, should be read together with this opinion.

Like the defendant in FHFA (NC1), Morgan Stanley argues that this action was not timely commenced. Morgan Stanley argues, among other things, that even if FHFA commenced the action within the statute of limitations, it lacked standing to sue, and that the Trustee's complaint, filed after the statute of limitations expired, did not relate back to the summons with notice.[1]

For the reasons stated and on the authorities cited in FHFA (NC1), as well as this court's decision in ACE Secs. Corp. v DB Structured Prods., Inc. (2016 WL 1222166 [Sup Ct, NY County, Mar. 29, 2016, No. 651854/14]), the court holds that this action was not rendered

[1] FHFA commenced this action by filing a summons with notice on May 31, 2013, the six-year anniversary of the securitization Closing Date of May 31, 2007. The Trustee, purporting to substitute itself as plaintiff, filed the complaint on November 6, 2013, more than five months after FHFA filed the summons with notice.

untimely by plaintiff's failure to satisfy a repurchase demand condition precedent prior to the commencement of the action by the filing of the summons with notice or prior to the expiration of the limitations period. (FHFA [NC1], at 5.) The court also rejects Morgan Stanley's contention that the Trustee's claims accrued on the "as of" date of the Pooling and Servicing Agreement (PSA) (Rouhandeh Aff., Exh. 4), rather than on the securitization Closing Date.[2] (See id. at 6.) The court holds, however, that FHFA lacked standing to commence this action, and that the Trustee's first cause of action, to the extent based on breaches of representations and warranties, is untimely because it did not relate back to FHFA's summons with notice. (Id. at 6-7.)

The arguments made by the Trustee in opposition to Morgan Stanley's timeliness challenge largely duplicate those it made in FHFA (NC1), and are rejected for the same reasons. The first cause of action is not rendered timely by the accrual clause set forth in Section 4 (a) of the RWA. (FHFA [NC1], at 8-9.) Nor is it timely under the federal Housing and Economic Recovery Act of 2008 (HERA). (Id. at 9.) FHFA's purported commencement of the action "on behalf of the Trustee" was ineffective. (Id. at 7.)

The court rejects the argument, not made in FHFA (NC1) but asserted by the Trustee here, that "Morgan Stanley lacks standing to challenge any noncompliance with the no-action clause in the [PSA] . . . because it is not a party to that contract." (Tee.'s Memo. in Opp. at 1, 5.) In the Appellate Division decision in ACE Secs. Corp. v DB Structured Prods., Inc. (112 AD3d 522 [1st Dept 2013], affd on other grounds 25 NY3d 581 [2015]), the Court held that

[2] The representations and warranties on which this cause of action is based were made by Morgan Stanley to the securitization Depositor in a Representations and Warranties Agreement (RWA) dated "as of May 31, 2007." They were made "as of the [securitization] Closing Date," a term defined in the introduction to the agreement as May 31, 2007. (RWA § 2 & Exh. I. [Rouhandeh Aff., Exh. 3].) The Depositor then assigned its rights under the RWA to the Trustee in the PSA. The PSA is dated "as of" May 1, 2007 and provides for a Closing Date of May 31, 2007. (PSA § 2.01 [a]; Def.'s Memo. in Supp. at 4.)

certificateholders lacked standing to bring a claim for breach of representations and warranties based on provisions of the governing PSA, which included a no-action clause. (See id. at 523.) As described by the Appellate Division, the no-action clause authorized certificateholders to commence an action only upon a "written notice of default" to the Trustee and "the continuance thereof." The PSA, however, defined Events of Default only as defaults of the servicers, and not as breaches by the sponsor of representations and warranties. (Id.) The Appellate Division accordingly concluded that the PSA did not authorize certificateholders "to provide notices of 'default' [and therefore to commence suit] in connection with the sponsor's breaches of the representations." (Id.) The PSA in this case includes a substantially similar no-action clause (PSA § 12.08) and Events of Default provision (id. § 7.01).

Courts in other jurisdictions, applying New York law to no-action clauses, have expressly rejected the argument that a non-party to the contract lacks standing to challenge a plaintiff's non-compliance with such a clause. (See e.g. Akanthos Capital Mgt., LLC v CompuCredit Holdings Corp., 677 F3d 1286, 1292 [11th Cir. 2012] [holding that officer and director defendants could assert the applicability of the no-action clause against plaintiff noteholders, although such defendants were not parties to the trust indenture containing the clause, and collecting authorities]; Peak Partners, LP v Republic Bank, 191 Fed Appx 118, 126-127 [3d Cir 2006] [rejecting RMBS noteholder's argument that no-action clause was inapplicable because defendant servicer was not a party to the indenture agreement containing the clause]; see also Feldbaum v McCrory Corp., 1992 WL 119095, *7 [Del Ch, June 2, 1992, Civ. A. Nos. 11866, 11920, 12006] [explaining that "[t]he policy favoring the channeling of bondholder suits through trustees mandates the dismissal of individual-bondholder actions no matter whom the bondholders sue," and that no-action clauses generally "make their scope depend on the nature of

the claims brought, not on the identity of the defendant"].)[3] Consistent with this authority, the court holds that Morgan Stanley has standing to raise the issue of FHFA's non-compliance with the clause.

Finally, as in FHFA (NC1), the Trustee relies on two tolling agreements to support the timeliness of its breach of contract claim. The Trustee contends that it is a third-party beneficiary of each of these tolling agreements. (Tee.'s Suppl. Memo. at 6; AIG Tolling Agreement [Suppl. Rouhandeh Aff., Exh. 6]; NCUA Tolling Agreement [Suppl. Rouhandeh Aff., Exh. 7].) The first, entered into between Morgan Stanley and American International Group (AIG), a certificateholder in the Trust, and these parties' "subsidiaries and affiliated entities," was considered by the court in FHFA (NC1). As the agreement fails to specify a definite termination date, it is unenforceable under General Obligations Law § 17-103 (1), and cannot render the action timely. (FHFA [NC1], at 10-13.)

The second tolling agreement on which the Trustee relies was not considered in FHFA (NC1), but is equally ineffective. This agreement was entered into on September 23, 2011 between Morgan Stanley, specifically named entities related to Morgan Stanley, and the National Credit Union Administration, a certificateholder in the Trust. (NCUA Tolling Agreement, at 1.) Section 1 of the agreement provides that "[t]his Tolling Agreement relates to any and all causes of action and claims that the NCUA may have against Morgan Stanley arising out of or relating in any way to the Potential Claims," which are defined as "claims in connection with the purchase of the securities listed on Exhibit A hereto [including the Trust] . . . for, among other things . . . breach of contract . . . ." (Id. at 1.) Section 1 further provides that "[f]or the

[3] In ACE, the Appellate Division did not expressly consider the standing of the defendant sponsor to assert the no-action clause as a bar to the certificateholders' standing to commence the action. It is noted, however, that the defendant sponsor, like Morgan Stanley here, was not a party to the PSA containing the no-action clause. (See PSA, Exh. A to the Complaint, ACE [Sup Ct, NY County, Sept. 13, 2012, No. 650980/2012] [NYSCEF No. 8].)

avoidance of doubt, the Potential Claims do not include causes of action and claims by any person or entity that is not a party to this tolling agreement . . . ." The agreement is to be construed and enforced in accordance with the laws of the District of Columbia. (Id. § 10.)

Insofar as is pertinent to this motion, District of Columbia law on the subject of third-party beneficiaries is consistent with New York law, which is discussed extensively in FHFA (NC1). Under District of Columbia law, "'[t]hird-party beneficiary status requires that the contracting parties had an express or implied intention to benefit directly' the party urged to be a third-party beneficiary." (Oehme, van Sweden & Assocs., Inc. v Maypaul Trading & Servs. Ltd., 902 F Supp 2d 87, 100 [D DC 2012], appeal dismissed 2013 WL 1187417 [DC Cir, Mar. 14, 2013], quoting Fort Lincoln Civic Assn., Inc. v Fort Lincoln New Town Corp., 944 A2d 1055, 1064 [DC 2008].) The parties must "directly and unequivocally intend to benefit a third-party in order for that third-party to be considered an intended beneficiary," as "evidenced by the intent or words of the contract." (Bowhead Info. Tech. Servs., LLC v Catapult Tech., Ltd., 377 F Supp 2d 166, 171 [D DC 2005] [internal quotations marks, ellipses, and citations omitted].) Although "[a] plaintiff need not be named in a contract to be a third-party beneficiary" (id.), the fact that an agreement describes those who are intended to benefit from the contract, but does not include the plaintiff, suggests that the plaintiff is not an intended third-party beneficiary. (See Oehme, 902 F Supp 2d at 100 [provision that agreement "shall be binding upon and inure to the benefit of the parties and their respective successors, permitted assigns, legal or personal representative [sic], or partners" suggested that "the parties did not 'directly and unequivocally' intend the Agreement to benefit [the respondent], since it expressly lists the Agreement's beneficiaries and does not include [the respondent] among them"].)

Here, the contracting parties not only expressly set forth the intended beneficiaries of the NCUA Tolling Agreement – that is, the entities listed as parties – they provided that "[f]or the avoidance of doubt, the Potential Claims do not include causes of action and claims by any person or entity that is not a party to this tolling agreement . . . ." (NCUA Tolling Agreement § 1.) The Trustee argues that it must be considered a third-party beneficiary because the "agreement expressly covers claims for 'breach of contract,' which generally can only be brought by the Trustee." (Tee.'s Suppl. Memo. at 10.) As this court noted in FHFA (NC1) (at 18-19), however, this question of a certificateholder's standing to bring repurchase claims was unsettled in 2011, when the NCUA Tolling Agreement was made. Although the law now sharply limits the circumstances in which certificateholders may bring repurchase claims, the present state of the law cannot be relied upon to show that the parties intended, earlier, to make the Trustee a third-party beneficiary. Nor do the terms of their agreement clearly evidence that intent.[4] (See Oehme, 902 F Supp 2d at 100 [holding that "third-party beneficiary theory looks to the parties' intentions at the time the contract was executed" (internal quotation marks and citation omitted)].)

For all of the above reasons, neither tolling agreement saves the Trustee's first cause of action for breach of contract. This cause of action will therefore be dismissed.

To the extent that the Trustee argues that the first cause of action includes a timely claim based on Morgan Stanley's failure to repurchase defective loans, that contention is barred by the Court of Appeals decision in ACE. (25 NY3d at 599; FHFA [NC1], at 19.) The second cause of

[4] To the contrary, the phrasing of the first Whereas Clause evinces the parties' understanding that NCUA itself would bring subsequent repurchase litigation. This clause states that the agency "may file a complaint against Morgan Stanley . . . asserting claims in connection with the purchase of the securities listed on Exhibit A hereto (the 'Potential Claims') . . . ."

action for breach of the implied covenant of good faith and fair dealing will be dismissed in accordance with extensive authority dismissing implied covenant claims based on substantially similar allegations. (See FHFA [NC1], at 20-21 [collecting authorities].)

As the complaint will be dismissed in its entirety, the court need not and does not reach the additional grounds advanced by defendant Morgan Stanley for dismissal. The Trustee's request for leave to replead the first and second causes of action will be denied for the reasons stated in FHFA (NC1) (at 21-22).

It is noted that by joint letter, dated December 22, 2015, and in accordance with a protocol developed by the parties in the coordinated put-back actions, the Trustee informed the court that "the Trustee intends to amend its pleadings in [this] action to include a failure-to-notify claim." (Letter [NYSCEF No. 113]; Case Management Order No. 2, ¶ V [Index No. 777000/15, NYSCEF No. 96].) The court has requested coordinated briefing on the scope and viability of failure to notify claims in light of the Appellate Division decision in Nomura Home Equity Loan, Inc. v Nomura Credit & Capital, Inc. (133 AD3d 96 [1st Dept 2015], appeal docketed [APL-2016-00024]). The dismissal of this action will be without prejudice to a motion for leave to replead brought in connection with such briefing.

Accordingly, it is hereby ORDERED that the motion to dismiss of defendant Morgan Stanley Mortgage Capital Holdings LLC, as successor-by-merger to Morgan Stanley Mortgage Capital Inc., is granted to the extent of dismissing the complaint in its entirety.

Provided that: Deutsche Bank National Trust Company (DBNTC) may seek leave to replead a claim with respect to the failure to notify, in conformity with procedures to be established in the coordinated put-back actions in Part 60. 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], appeal docketed [APL-2016-00024]) with respect to such claims; and it is further

ORDERED that the request of DBNTC to replead the first cause of action (for Breach of Contract) and the second cause of action (for Breach of the Implied Covenant of Good Faith and Fair Dealing) is denied.

This constitutes the decision and order of the court.

Dated: New York, New York
April 12, 2016

MARCY FRIEDMAN, J.S.C.