CRISIS CONSTRUCTION IN CONTRACT BOILERPLATE

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I

INTRODUCTION

Why might judges interpret a boilerplate contractual clause to reach a result clearly at odds with its plain language? Though courts don't acknowledge it, one reason might be the economy. Boilerplate provisions are pervasive and enforcing some common clauses as written might cause additional upheaval during an economic crisis. Under such circumstances, particularly where other government interventions to shore up the market are exhausted, courts may step in to help restore investor confidence.

In the past, a number of scholars have argued that this is an important function of lawmakers generally. Under this theory, because the economy operates differently in times of crisis, specifically when interest rates near zero, the law should function differently as well.[1] In normal economic times, policymakers can decrease interest rates to stimulate demand and spur a stagnating economy by incentivizing people to spend rather than save. However, when interest rates near zero, as they did during the Great Depression and the Great Recession, this tool is unavailable. Under these circumstances, the theory goes, the law should be adjusted to produce decisions that restore confidence and activity in the market.

In this Article, I argue that courts have in fact done this. In the aftermath of the financial crisis, residential mortgage backed securities (RMBS) trusts, which held pools of loans and issued securities to investors, sued securities sponsors en masse on contracts warranting the quality of the mortgages sold to the trusts. These contracts almost universally contained provisions requiring sponsors to repurchase individual noncompliant loans. Significantly, this was the "sole

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1. *See* Yair Listokin, *Law and Macroeconomics: The Law and Economics of Recessions*, 34 YALE J. ON REG. 791, 838 (2017) ("If law should be efficient and what is efficient changes with the business cycle . . . law should be different at the zero lower bound than at times in which the interest rate exceeds zero.") (emphasis omitted).

remedy" for bad loans available to the trusts under the contractual language.[2] Due to the sheer volume of bad loans in these pools following the mortgage crisis, however, it was prohibitively expensive and cumbersome for trustees to enforce repurchase of these loans on an individual basis. The clause therefore benefited sponsors, who argued that it must be enforced as written. Recent scholarship has explained how enforcing these provisions would effectively leave trustees without a meaningful remedy for the vast pools of fraudulent or otherwise noncompliant loans that they had bought.[3]

Despite the unambiguous language of the sole remedy provision, in the aftermath of the crisis court after court held that trustees and other parties to these contracts could claim damages by sampling the loan pools and calculating breach and damages based on the sample, rather than forcing repurchase loan-by-loan.[4] Although this approach was facially inconsistent with the plain text of the sole remedy provision, these decisions gave trustees, and through them investors, the leverage to salvage millions—even billions—of dollars in settlements from the sponsors and originators who had made the shoddy loans. These decisions are generally not paragons of clarity. They did not rely on classic contract doctrines; initially, they relied on dubiously applied precedent, or on no reasoning at all. However, as these cases permitting sampling accumulated, later opinions came to rely on each other, creating a judicial echo chamber; for a time, judges cited the general consensus permitting sampling, even though it was contrary to the contractual language.

I argue that these decisions were an exercise in "crisis construction." This term refers to the act of interpreting a contract in light of the general economic turmoil existing at the time. Although the decisions permitting sampling generally do not include transparent reasoning, it appears that bolstering investor confidence—and thus stabilizing demand for mortgage-backed securities (MBSs), which was virtually paralyzed at the time—was a key consideration in disregarding the loan-by-loan repurchase requirement. The timing of these decisions suggests that a broader assessment of economic conditions motivated the decisions relaxing the requirement of loan-by-loan proof in the years immediately following the crisis. But as the years went by and the economy began to recover, judges gradually retrenched. Decisions appearing after 2015 generally adhered to the plain language of the contracts, and held that parties must prove

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2. *See, e.g.*, Defendants' Memorandum of Law in Opposition to Plaintiff's Motion In Limine Regarding Sampling at 14–15, MBIA Ins. Corp. v. Countrywide Home Loans, 2010 WL 5186702 (N.Y. Sup. Ct. Dec. 22, 2010) (No. 602825/2008) ("In this case, the Transaction Documents negotiated by the parties, which form the basis of Plaintiff's breach of contract claim, provide that Plaintiff's sole remedy for any alleged breach is loan-by-loan repurchase or substitution.").

3. *See* Tracy Lewis & Alan Schwartz, *Unenforceable Portfolio Contracts*, 37 YALE J. ON REG. (forthcoming 2019) (manuscript at t24), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3361222 [https://perma.cc/ZHP5-4N7] ("[Trustees] had no effective legal rights: their cost of enforcing the contracts as written–i.e., loan-by-loan, were prohibitive.") (emphasis omitted).

4. Largely in New York, although these decisions occasionally pop up in other jurisdictions. *See, e.g.*, Deutsche Bank Nat'l Tr. Co. v. WMC Mortg., LLC, Nos. 3:12-cv-933 (CSH), 3:12-cv-969 (CSH), 3:12-cv-1699 (CSH), 3:13-cv-1347 (CSH), 2014 WL 3824333, at *9 (D. Conn. Aug. 4, 2014).

liability and damages loan-by-loan. While this reversal may seem arbitrary, I argue that it may have been a response to improving economic circumstances. While greater transparency in this line of crisis construction could provide greater certainty to courts and market participants, it is possible that the opacity of the current approach may enable more efficient outcomes by allowing courts to quietly bolster investor confidence in times of crisis.

Notwithstanding the difficulties of enforcement, the loan-by-loan repurchase remedy still regularly appears in MBS contracts. Existing scholarly theories of sticky boilerplate provisions may contribute to explaining this endurance.[5] I argue that in addition, specific events following the financial crisis decreased the perceived cost of retaining these provisions. First, it appears that some provisions of Dodd-Frank[6] have decreased the likelihood of some of the most pervasive breaches of MBS contracts, thus reducing the likelihood that plaintiffs would have to prove those breaches loan-by-loan on a mass scale. Second, the existence of the crisis construction decisions permitting sampling despite the loan-by-loan repurchase requirement may have signaled to investors that, even in absence of revision and the costs it would entail, courts probably would not leave them without redress in another economic panic. Accordingly, parties may have retained this provision in MBS contracts because the benefits of revision simply did not outweigh the perceived costs.

This paper proceeds as follows. Part II gives background on the mortgage market, the financial crisis, and the creation of MBSs, including the relevant contracts. Part III describes first the rise of sampling in defiance of the repurchase requirement in the aftermath of the crisis, and the decisions representing more recent judicial retrenchment, which hold the plain language of these contracts to require loan-by-loan proof. Part IV introduces the idea that contracts might be interpreted differently in times of crisis, assesses whether this is an appropriate role for courts, and examines legal bases for crisis construction. Specifically, it addresses how the courts permitting sampling did so based on unsound application of precedent, or with no reasoning at all, and why more conventional mechanisms, such as classic contract doctrine, were not used. Part V evaluates reasons for the persistence of these provisions. Part VI concludes.

II

BACKGROUND

A. The Mortgage Market and the Crisis

The MBS has been around for decades and is appealing to banks for a number of reasons. Banks making mortgages dispense a large lump sum in return for a stream of small payments. Simultaneously, they hold deposits which may be

5. *See infra* Part V.

6. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 113, 124 Stat. 1376, 1398 (2010) (codified at 12 U.S.C. § 5323 (2012)).

demanded by customers at any time. This leads to a maturity mismatch, whereby the bank's liabilities (the demand deposits) are much more liquid than its assets (the mortgages), potentially creating liquidity problems. Securitizing the mortgages—bundling them together and selling bonds giving investors rights to the mortgage payments—addresses this mismatch by giving banks a lump sum instead of small mortgage payments over the term of the loan. Conversely, investing in MBSs is attractive to investors for several reasons. As an initial matter, the cash flows from mortgages are supposed to be relatively secure, on the theory that people will seldom default on payments for the houses in which they live. Moreover, MBSs are potentially even safer than individual mortgages because the risk of default is diversified across many loans.[7] In the run-up to the financial crisis, securitization of residential mortgages became increasingly appealing as a result of banking rules allowing banks to retain less capital for such securities than for other types of assets.[8] Private-label securitizations put together by Wall Street investment banks took over an increasing share of the secondary mortgage market.[9]

In the 1990s, lenders increasingly expanded into the subprime market, extending mortgages to homebuyers with weak credit scores, assets, and borrowing history.[10] Concurrently, many lenders developed new loan products that not only embraced borrowers with weaker credit, but required little or no verification of important metrics such as income and assets. The non-traditional mortgage market increased from twenty percent of all mortgages in 2003 to fifty percent in 2006.[11] Lenders wrote more than $13.4 trillion in subprime mortgages, and total mortgage debt nearly doubled between 2002 and 2006.[12] Underwriting standards degraded, but high ratings by credit rating agencies and the opaque structure of MBSs and other financial products made it difficult for investors to monitor the quality of the underlying mortgages.[13]

As the issuance of home loans exploded, RMBSs were increasingly used as collateral in short-term funding markets and derivatives positions, creating an enormous interconnected system dependent on the value of these assets. As housing prices began to collapse, borrowers, no longer able to refinance, began to default on their mortgages. The subsequent downward spiral and contagion are well documented; the credit ratings of many RMBSs were downgraded, and

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7. MICHAEL S. BARR ET AL., FINANCIAL REGULATION: LAW AND POLICY 59 (2016).

8. *See* Roberta Romano, *Pitfalls of Global Harmonization of Systemic Risk Regulation in a World of Financial Innovation*, *in* SYSTEMIC RISK IN THE FINANCIAL SECTOR: TEN YEARS AFTER THE GREAT CRASH 7 (Douglas W. Arner et al. eds., forthcoming 2019) ("[D]omestic and foreign banks were incentivized to hold RMBS written on those subprime assets by Basel capital requirements.").

9. Patricia A. McCoy & Susan Wachter, *Representations and Warranties: Why They Did Not Stop the Crisis, in* EVIDENCE AND INNOVATION IN HOUSING LAW AND POLICY 289, 291 (Lee Anne Fennell & Benjamin J. Keys eds., 2017).

10. *See id.* ("[D]uring the boom, there was a substantial increase in nontraditional mortgages, including . . . subprime loans and other Alt-A products . . . .").

11. *Id.*

12. BARR, *supra* note 7, at 60.

13. *Id.*

institutions were forced to recognize billions of dollars in losses.[14] The collapse of giants such as Bear Stearns, Lehman Brothers, WaMu and AIG necessitated unprecedented government intervention, and led to the worst recession since the Great Depression.

And then the lawsuits began.

B. RMBS Contracts: Representations, Warranties, Repurchase, and the Sole Remedy Provision

The litigation in the aftermath of the financial crisis was extensive, and even ten years after the crisis is still far from over. Lawsuits by investors have dwindled because of the relatively short limitations periods imposed by federal securities laws[15] and most state blue sky laws.[16] However, MBSs are creatures of contract, and much of the financial crisis litigation that remains is composed of contract claims, which typically have longer statutes of limitations.[17] To understand the context for this litigation, it is important to understand the structure of a MBS, and the players involved in making one.

To securitize assets like mortgages, the entity seeking to raise cash—typically called the sponsor—transfers the assets to a special purpose entity (SPE).[18] The SPE is often organized as a trust, so that the assets it contains are remote from the potential bankruptcy of the sponsor.[19] Once the SPE owns the assets, it issues certificates that investors can buy.[20] The assets are typically sold to the trust pursuant to a complex set of contracts, which are discussed below. Further, to receive a higher credit rating—and thus a higher price—for the certificates, sponsors may arrange to have the most credit-worthy tranche of the securities insured.[21] Under this arrangement, a third party—called a financial guaranty or monoline insurer—makes payments to investors if the cash flows from the assets underlying the certificates decline below a predetermined amount.[22]

Accordingly, lawsuits based on these contracts involve claims between the trust, the insurer, and the sponsor. The general theme is that trustees—often sued themselves by investors —sue the sponsors on the ground that the mortgages in the pool breached the contractual representations and warranties under which

14. *Id.*

15. *See*, *e.g.*, 15 U.S.C. § 77m (2012) (one- to three-year limitations period for Securities Act claims); Merck & Co. v. Reynolds, 559 U.S. 633, 638 (2010) (two- to five year limitations period for 10b-5 claims).

16. *See* ROGER J. MAGNUSON, SHAREHOLDER LITIGATION § 8:13 (2018).

17. *See, e.g.*, N.Y. C.P.L.R. § 213 (McKinney 2016) (stating that the limitations period on contract claims in New York is six years).

18. STEVEN L. SCHWARCZ ET AL., SECURITIZATION, STRUCTURED FINANCE AND CAPITAL MARKETS 6 (2004). These special purpose entities are sometimes called special purpose vehicles (SPVs).

19. *Id.*

20. *Id.* at 7.

21. *See* Ronald S. Borod, *Belling the Cat: Taming the Securitization Beast Without Killing It*, 31 REV. BANKING & FIN. L. 643, 652 (2012) ([M]onoline guarantors [ran] their own independent stress tests before agreeing to issue financial guarantees of the senior tranches of the securitization structures . . . .").

22. VINOD KOTHARI, SECURITIZATION: THE FINANCIAL INSTRUMENT OF THE FUTURE 219–20 (2006).

they were sold. Insurers were forced to pay out when mortgages defaulted and RMBSs plummeted in value; indeed, most monoline insurers did not survive the crisis.[23] These insurers were third-party beneficiaries to the sponsors' contracts with the trusts, and therefore entitled to sue for the breach of the representations and warranties. Insurers also had their own contracts called Indemnity and Insurance agreements (I&Is) under which they brought claims against the sponsors. A more detailed review of these contracts and the relevant clauses follows.

The primary contracts governing the sale of mortgages to the trust are the Mortgage Loan Purchase Agreement (MLPA) and the Pooling and Servicing Agreement (PSA). The trustee and the sponsor are the parties to both contracts, and insurers may be specifically named as third-party beneficiaries. The meat of these agreements consists of representations and warranties spelling out the required attributes of the mortgage loans underlying the security. These representations and warranties are designed to help address the information asymmetries inherent in the securitization process; inevitably, originators of the mortgages know more about the underlying loans than the trustees and ultimately the investors do.[24] While these representations and warranties vary across securitizations, they often include representations that the loans conform to specified or industry-standard underwriting guidelines; that the properties securing the mortgages have been properly appraised; that no mortgage is in default or seriously delinquent; that the loan is legal, marketable, and enforceable; that no party made any misrepresentations with respect to the mortgage loan; and that the information provided by the seller about the mortgage loans is complete, true, and correct.[25]

These contracts also spell out the mechanism for enforcing the representations and warranties. Once the sponsor or trustee discovered a loan in breach of the representations and warranties, the sponsor had several options. First, if possible, the sponsor could correct or cure the breach within 60 days of notice of the breach. Second, the sponsor could substitute a compliant loan into the pool in exchange for the defective one. Third, and most relevant in the aftermath of the crisis, the sponsor could repurchase the loan.[26] These

23. *See* Barnet Sherman, *Paying for Protection: The Return of Bond Insurers*, FORBES (Jan. 14, 2016), https://www.forbes.com/sites/investor/2016/01/14/paying-for-protection-the-return-of-bond-insurers/#2d5a0ca5082e [https://perma.cc/E926-SHLX] (stating that just two bond insurance companies survived the financial crisis).

24. *See* McCoy & Wachter, *supra* note 9, at 293 (discussing the agency problems resulting from the securitization process).

25. *See id.* at 294–95; *see also* Lewis & Schwartz, *supra* note 3, at t4 n.9 (listing sample representations and warranties).

26. *See, e.g.*, Pooling & Servicing Agreement, SACO I Tr. 2006-5 at 930, SACO I Tr. 2006-5 v. EMC Mortg. LLC, No. 651820/2012, slip op. 31432(U) (N.Y. Sup. Ct. May 29, 2014) ("Upon discovery by either the Company or the Purchaser of a breach of any of the foregoing representations and warranties which materially and adversely affects the value of the Mortgage Loans or the interest of the Purchaser in any Mortgage Loan, the party discovering such breach shall give prompt written notice to the other. The Company shall have a period of sixty (60) days from the earlier of its discovery or its receipt of notice of

mechanisms were designed to be the only means by which trustees could recover for breaches of the representations and warranties.[27] In effect, the agreements established an exchange mechanism once the period expired for cure: the sponsor would tender a contractually agreed-upon repurchase price, and the trustee would return the loan, distributing the repurchase monies to the certificateholders.

C. Loan-By-Loan Repurchase and the Difficulties of Enforcement

The plain language of the repurchase provisions contemplates a remedy to be instituted on a loan-by-loan basis. Several other features of the contracts reinforce this conclusion. First, the applicable representations and warranties themselves refer to individual loans, rather than to the pool as a whole.[28] Second, the PSAs require that breaching loans must be repurchased for a specific repurchase price. That price is defined in terms that are only applicable to individual loans, as each loan has a different value for each component of the repurchase price.[29] Relatedly, the PSAs include detailed provisions for allocating the income from the loans—including repurchase monies—to investors. These provisions break down payments into principal and interest components, which are allocated differently to different classes of certificateholders.[30] However, principal and interest amounts can only be determined loan-by-loan.[31]

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any such breach within which to correct or cure such breach. The Company hereby covenants and agrees that if any such breach is not corrected or cured within such sixty day period, the Company shall, at the Purchaser's option and not later than ninety (90) days of its discovery or its receipt of notice of such breach, repurchase such Mortgage Loan at the Repurchase Price or . . . substitute a Mortgage Loan as provided below.").

27. *See, e.g.*, *id.* at 39 ("It is understood and agreed that the obligation under this Agreement of [sponsor] to cure, repurchase or replace any Mortgage Loan as to which a breach has occurred and is continuing shall constitute the sole remedies against [sponsor] (in its capacity as Sponsor) respecting such breach available to the Certificateholders, the Depositor or the Trustee."); *see also* Lewis & Schwartz, *supra* note 3, at t5 n.11 (listing other sample repurchase and sole remedy provisions).

28. *See, e.g.*, *id.* at 927–28 ("The Mortgage creates a valid, subsisting and enforceable first lien . . . ."; "All payments due prior to the related Cut-off Date for such Mortgage Loan have been made as of the related Closing Date . . . there are no material defaults under the terms of the Mortgage Loan . . . ."; "The Mortgage File contains an appraisal of the related Mortgaged Property signed prior to the final approval of the mortgage loan application by a Qualified Appraiser, approved by the Company, who had no interest, direct or indirect, in the Mortgaged Property or in any loan made on the security thereof, and whose compensation is not affected by the approval or disapproval of the Mortgage Loan . . . ."); *see also* Lewis & Schwartz, *supra* note 3, at t4 n.9 (providing further examples of loan-level representations and warranties, with assurances that "[m]any more such citations are available").

29. *See*, *e.g.*, Defendants' Memorandum of Law in Opposition to U.S. Bank's Motion for Partial Summary Judgment at 10–11, SACO I Tr. 2006-5 v. EMC Mortg. LLC, No. 651820/2012 (N.Y. Sup. Ct. Oct. 7, 2015) (stating that the repurchase price equals "the sum of (i) 100% of the outstanding principal balance of the Mortgage Loan as of the date of such purchase plus (ii) accrued interest thereon at the applicable Mortgage Rate reduced by any portion of the Servicing Fee, Servicing Advances and Advances payable to the purchaser of the Mortgage Loan plus (iii) any costs and damages (if any) incurred by the Trust in connection with any violation of such Mortgage Loan of any anti-predatory lending laws").

30. *Id.* at 14.

31. *Id.*

Third, the repurchase remedy contemplates an exchange by which the sponsor pays the repurchase price, and in return *gets back the loan*. The structure of this remedy reflects a reality extensively explored by scholars of the financial crisis: intermediation. When RMBSs are created, loans—often from many different sources—are bought and sold through intermediaries, ultimately to be deposited in the pool underlying the securitization.[32] Many sponsors of such securitizations, while they might originate some loans themselves, bought many or most of their loans from other originators. Along with these purchases came further sets of representations and warranties, accompanied by repurchase remedies.[33] Accordingly, such lawsuits proceeded up and down the intermediation chain; to help make up the losses it incurred when obligated to repurchase loans from a trust, a sponsor might concurrently or subsequently sue the originator from whom it purchased those loans. Such serial repurchase remedies, however, require the return of the actual defective loan.[34]

Finally, and perhaps most importantly, whether a loan "materially and adversely" breached a representation or warranty is a loan-specific inquiry.[35] Under the terms of RMBS contracts, a breach only gives rise to repurchase obligations if it "materially and adversely affects the interests of the Certificateholders in any Mortgage Loan."[36] The definition of "materially and adversely" in this context has not been decisively resolved; trustees argue that any breach increasing the risk of loss is material and adverse, while sponsors maintain that breach is material and adverse only if it results in an actual loss on the loan.[37] But under either definition, the breach must be evaluated in light of the loan's other attributes. For example, a missing verification of employment might impair the value of a loan. However, that impairment might not be material and adverse if the borrower's employment was exactly what he claimed, despite the sponsor's failure to verify it.[38]

Recent scholarship by Lewis and Schwartz has argued that the representations and warranties cannot be enforced because the buyers of loan

32. *See* McCoy & Wachter, *supra* note 9, at 299.

33. *See e.g.*, Defendants' Memorandum of Law in Opposition to U.S. Bank's Motion for Partial Summary Judgment, *supra* note 29, at 13.

34. Further means by which sponsors could mitigate losses from repurchase claims also include, if the loan was not liquidated, benefiting from the remaining cash flow provided by the defective loan, or selling it in the "Scratch and Dent" market. *See id.*

35. *See id.* at 17; *see also* Lewis & Schwartz, *supra* note 3, at t21 ("[T]o enforce the originating bank's input warranty, the portfolio buyer would have to establish for each nonperforming loan the cause of default, and would also have to show that the customary screen would have uncovered that cause.") (emphasis omitted).

36. Defendants' Memorandum of Law in Opposition to U.S. Bank's Motion for Partial Summary Judgment, *supra* note 29, at 17.

37. *Id.*; *see also* Lewis & Schwartz, *supra* note 3, at t6 n.12.

38. MASTR Adjustable Rate Mortgs. Tr. 2006-OA2 v. UBS Real Estate Sec. Inc., No. 12-cv-7322 (PKC), 2015 WL 797972, at *3 (S.D.N.Y. Feb. 25, 2015).

pools "could not observe at acceptable cost how the originating bank created the portfolio loans."[39] To establish breach and enforce the repurchase remedy:

> [T]he portfolio buyer would have to "get behind *each* nonperforming loan to learn how it was made: did the originating bank check the borrower's income and job status? where she lived? what her credit rating was? Because the MBS portfolios that originators purchased contained hundreds of loans, it was not economical for them to check how each defaulting loan was made.[40]

Lewis and Schwartz also point to the difficulty of proving causation and damages on a loan-by-loan basis as is clearly contemplated by the language of the governing contracts.[41]

To make these determinations, litigants must "re-underwrite" the loans at issue. Re-underwriting involves tracking down the loan files for the mortgages, many of which have been moved from custodian to custodian over the years, and may be missing documents.[42] Recall that because of the relatively long limitations period on contract claims, loans at issue could have originally been made over a decade prior to re-underwriting. Usually litigants must then match the loan files to the underwriting guidelines according to which the loan was supposed to be underwritten. Guideline-matching is an expensive and error-prone process. Then, the litigants must hire experts to assess the loan files and re-underwrite them according to the guidelines. This involves sorting through the information available to the original underwriter and re-making the decisions faced by that underwriter. The process is inevitably guided by some subjective judgment. Re-underwriting a single loan file takes an expert roughly two to three hours and costs \$300-\$400.[43] There may be hundreds, or even thousands of loans per securitization, and it is rare that only one securitization is the subject of a lawsuit.[44] Accordingly, as other scholars have pointed out, proving breach and damages on a loan-by-loan basis is formidably—and often prohibitively—costly.[45]

39. Lewis & Schwartz, *supra* note 3, at t5. While I appreciate the gravity of this point, the cost and difficulties of re-underwriting a portfolio of MBS to determine liability and damages, though immense, do not render these contracts *unenforceable*. It is more accurate to say that such contracts are expensive and cumbersome to enforce as written in events of mass breach, such as occurred during the financial crisis.

40. *Id.*

41. *Id.*

42. *See generally*, Richard E. Gottlieb, Brett J. Natarelli & Alexandra N. Hill, *Two Trials and Other Developments as RMBS Litigation Continues Unabated*, 73 BUS. LAW. 497, 500 (2018) ("In most RMBS cases, experts 'reunderwrite' the loans, meaning that they review the documents associated with the loans' origination to determine whether or not the loan originator complied with the applicable underwriting guidelines.").

43. Fed. Hous. Fin. Agency v. JPMorgan Chase & Co., Nos. 11 Civ. 6188(DLC), 11 Civ. 6189(DLC), 11 Civ. 6190(DLC), 11 Civ. 6192(DLC), 11 Civ. 6193(DLC), 11 Civ. 6195(DLC), 11 Civ. 6196(DLC), 11 Civ. 6198(DLC), 11 Civ. 6200(DLC), 11 Civ. 6201(DLC), 11 Civ. 6202(DLC), 11 Civ. 6203(DLC), 11 Civ. 6739(DLC), 11 Civ. 7010(DLC), 11 Civ. 7048(DLC), 2012 WL 6000885 (S.D.N.Y. Dec. 3, 2012). In fact, this estimate is probably conservative.

44. STUART M. SAFT, COMMERCIAL REAL ESTATE WORKOUTS § 5:13 (3d ed. 2019).

45. *See* McCoy & Wachter, *supra* note 9, at 301; Lewis & Schwartz, *supra* note 3, at t5–t6.

III

DEFIANCE OF PLAIN LANGUAGE: MORTGAGE PUT-BACK LITIGATION

The massive costs posed by loan-by-loan repurchase inspired plaintiffs' firms to promote an alternate strategy for recovery: sampling. The basic premise of sampling is that, in order to avoid the time and expense of examining every single loan in one or many securitizations, litigants, usually the plaintiff, draw a random sample large enough to represent the population of at-issue loans, re-underwrite those loans, and extrapolate their findings to the entire population. The appeal of this approach is intuitive: basic statistical theory illustrates that a surprisingly small random sample can generate a very accurate portrait of a much larger population. Thus, plaintiffs under this theory could claim damages for the proportion of breaching loans in the sample without undergoing the expense of re-underwriting every loan in the securitization.

As discussed above, the plain language of the MLPAs and the PSAs clearly contemplates loan-by-loan proof. Defendant sponsors repeatedly asserted this argument, hoping that the burden of re-underwriting every loan in every securitization would simply prove too much for putative plaintiffs, who might abandon their lawsuits or settle for nominal amounts. However, in the years following the crisis, courts declined again and again to hold that the plain language of the contracts prohibited sampling. Accordingly, these lawsuits proceeded, driving up settlement value and permitting trustees—and hence investors—to extract recoveries for the shoddy loans that they held. Beginning around 2015, however, courts began to retrench, finding that the plain language of the MLPAs and PSAs barred sampling. This part explores the progression of these cases.

A. The Brief Rise of Sampling

The progression of these cases can be divided into three phases. The first phase involved monoline insurers, who, in return for a fee paid by the sponsors, insured the highest rated tranches of many RMBSs. These insurers were third-party beneficiaries to the MLPAs and the PSAs. They also were parties to separate I&I agreements with sponsors. Some of these I&I agreements included broader transaction-level warranties that arguably exempted the insurers from the sole remedy provision, and the difficulties it posed to proof by sample. These early cases held that monoline plaintiffs were not precluded by the contracts from proving their claims with samples of loans.

In the first of these cases, *MBIA Insurance Corp. v. Countrywide Home Loans*,[46] defendants argued, among other things, that MBIA, a monoline, was precluded by the transaction agreements from proving its case through sampling, and that it must prove that each individual loan breached the representations and

46. No. 602825/08, 2010 WL 5186702, at *5 (N.Y. Sup. Ct. Dec. 22, 2010).

warranties to enable Countrywide to repurchase that particular loan.[47] Although MBIA's I&I contained broader transaction-level warranties that arguably extended its remedies beyond the sole remedy provision,[48] the court's decision did not seek to interpret the language in the contract. Indeed, the decision did not even mention the language in any of the transaction agreements. It merely held "Plaintiff's proposed methodology of statistical sampling may be used at trial."[49] Similarly, in *MBIA Insurance Corp. v. Credit Suisse Securities (USA) LLC*,[50] a later court granted the monoline plaintiff's partial motion for summary judgment, holding that the plaintiffs may prove their case by using statistically significant random sampling representative of the mortgage pool for liability and damages.[51] The court declined to address whether the transaction-level warranties exempted MBIA from the sole remedy provision.[52]

Another case, *Syncora Guarantee Inc. v. EMC Mortgage Corp.,*[53] provides somewhat more satisfactory reasoning. In that case, Judge Crotty of the Southern District of New York held that although the MLPAs and SSAs restricted parties to loan-by-loan proof, monoline Syncora, a third-party beneficiary to these agreements, was not limited to these remedies. Rather, restraints on Syncora's remedies were provided by the I&I. The I&I included broader transaction-level warranties, and permitted Syncora to "take whatever action at law or equity as may appear necessary" to collect on amounts or performance it was owed under the agreements.[54] Based on the language in the I&I, the court held that Syncora was not subject to the remedial limitations of the MLPA and PSA and could "seek a pool-wide remedy based on sampling and extrapolation."[55] As *Syncora* illustrates, the decisions upholding sampling in this first phase could be grounded in a potentially reasonable—if not always explicit—contractual interpretation based on transaction-level warranties. The second phase in these decisions consists of cases involving both monolines and trusts where courts declined to hold that the sole remedy provision, even if applicable, barred sampling. Any focus on contractual interpretation was all but abandoned in these decisions. In

47. *See* Defendants' Memorandum of Law in Opposition to Plaintiff's Motion In Limine Regarding Sampling at 14–15, MBIA Ins. Corp. v. Countrywide Home Loans, No. 602825/08, 2010 WL 5186702 (N.Y. Sup. Ct. Dec. 22, 2010) ("In this case, the Transaction Documents negotiated by the parties, which form the basis of Plaintiff's breach of contract claim, provide that Plaintiff's sole remedy for any alleged breach is loan-by-loan repurchase or substitution . . . . MBIA has failed to explain how it can use sampling to establish, as to each loan for which it asserts damages, that the loan breached a particular representation or warranty.") (emphasis and footnote omitted).

48. Plaintiff's Reply Memorandum of Law in Further Support of its Motion In Limine Regarding Sampling at 11, MBIA Ins. Corp. v. Countrywide Home Loans, 2010 WL 5186702 (N.Y. Sup. Ct. Dec. 22, 2010) (No. 602825/2008).

49. MBIA Ins. Corp. v. Countrywide Home Loans, 2010 WL 5186702, at *5.

50. 927 N.Y.S.2d 517 (N.Y. Sup. Ct. 2011).

51. Order Granting Plaintiff's Motion for Partial Summary Judgment Approving Sampling, MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC, 927 N.Y.S.2d 517 (N.Y. Sup. Ct. 2011) (No. 603751/2009).

52. *Id.*

53. No. 09 Civ. 3106(PAC), 2011 WL 1135007 (S.D.N.Y. March 25, 2011).

54. *Id.* at *2 (emphasis omitted).

55. *Id.* at *4.

another monoline case, *Assured Guaranty Municipal Corp. v. Flagstar Bank*, Judge Jed Rakoff held that Assured, a monoline plaintiff, was bound by the sole remedy provision and that no language in the I&I mitigated this result.[56] However, two years later, he held that Assured did not need to prove its losses loan-by-loan because the loans at issue had defaulted, and Flagstar would therefore "receive nothing back on defaulted loans."[57] Similarly, in *Assured Guaranty Municipal Corp. v. DB Structured Products, Inc.*, the court held as a matter of law that the insurer need not submit loan-by-loan proof, and confusingly declared that whether Assured was bound by the sole remedy provision was a "red herring" in resolving this question.[58] Citing no basis in the text of the contract, the court held that "forcing [the insurer] to re-underwrite all of the loans is commercially unreasonable and that sampling may be used to compute damages."[59]

During this second phase, courts began to apply the results from the original monoline cases to cases involving trusts as plaintiffs. While at least some monoline insurers were plausibly not bound to the repurchase remedy under the transaction agreements, the same is not true of the trusts, which were not party to the I&I and thus could not benefit from its potentially broader remedies. Nonetheless, courts extended the reasoning, or lack thereof, in monoline cases to hold that trusts could prove liability and damages by sample. Perhaps unsurprisingly, these cases generally do not involve detailed assessments of the contractual language. For instance, in *Ace Securities Corp. 2007-HE-1 v. DB Structured Products*, the court found on a motion to dismiss that the repurchase remedy "does not mean sampling cannot be used . . . . It is commercially unreasonable to effectively re-underwrite the balance of the trust."[60]

Similarly, the same court in *Ace Securities Corp. 2006-SL2 v. DB Structured Products* stated in passing that the "parties must come up with a sampling mechanism that meaningfully reflects the PSA's damages calculation."[61] Subsequent orders allowing sampling in trustee repurchase litigation are even more perfunctory.[62] One of the few courts to elaborate on its reasoning allowing

56. No. 11 Civ. 2375(JSR), 2011 WL 5335566, at *5 (S.D.N.Y. Oct. 31, 2011).

57. Assured Guar. Mun. Corp. v. Flagstar Bank, 920 F. Supp. 2d 475, 514 (S.D.N.Y. 2013). However, this is unsatisfactory reasoning as even defaulted loans have value for the sponsor, who can enforce repurchase rights further up the intermediation chain. *See supra* text accompanying notes 32–34.

58. No. 650705/2010, 2014 WL 3282310, at *3–4 (N.Y. Sup. Ct. July 3, 2014).

59. *Id.* at *6.

60. No. 650327/2013, 2013 WL 6153206, at *2 (N.Y. Sup. Ct. Nov. 21, 2013).

61. 965 N.Y.S.2d 844, 851 (N.Y. Sup. Ct. May 13, 2013).

62. *See, e.g.*, Judge Baer's Response to Letter from Scott D. Musoff, Assured Guaranty Muni. Corp. v. UBS Real Estate Secs. Inc., No. 12-cv-1579 (S.D.N.Y. Apr. 1, 2013) ("I will allow sampling."); Interim Order, Home Equity Mortg. Tr. Series 2006-1 v. DLJ Mortg. Capital, Inc., No. 156016/2012, slip op. 50011(U) (N.Y. Sup. Ct. Jan. 9, 2019), NYSCEF Doc. No. 236 ("After review of plaintiffs' November 11, 2013 correspondence, the court agrees that plaintiffs' use of statistical sampling to prove liability and damages would streamline the trial, promote judicial economy, and conserve the resources of the parties and the court."); Part 60 RMBS Put-Back Litig., No. 652001/13 at 6. (N.Y. Sup. Ct. Aug. 26, 2015) ("[T]he courts have overwhelmingly endorsed statistical sampling and this Court concurs with that approach.").

sampling in a case involving trusts bound by the repurchase remedy relied heavily on the general consensus that

> [A]llowing the use of sampling is well-accepted by courts in RMBS cases . . . . [T]he overwhelming majority of courts with RMBS cases that have considered sampling have permitted it as a means to present proof at trial . . . . The Court adopts this consensus reasoning here. Accordingly, Plaintiffs' motion for partial summary judgment seeking a ruling that 'the use of statistical sampling to prove liability and damages on their claims is consistent with the terms of the contract governing the transactions, including but not limited to the PSAs' is therefore granted.[63]

These rulings occurred in many procedural postures, including on motions to dismiss, motions in limine, motions for interim orders, and motions for summary judgment. As with any complex civil litigation, very few of these cases were ultimately tried. Settlement figures are often not publicly available, but those that are suggest a high settlement value for these cases; many settled for hundreds of millions, even billions, of dollars.[64] Accordingly, these decisions had significant real-world effects, and enabled sizeable recoveries despite the facially prohibitive plain language of the contracts.

B. Sampling's Decline

Defendants protesting that the plain language of their contracts prohibited sampling shouted into the wind for several years. Only recently, however, after the miasma of the financial crisis had cleared, has this argument actually affected litigation outcomes. During this third phase of RMBS repurchase litigation, the tide turned, and courts began to bar sampling on the ground that it was prohibited under the plain language of the transaction agreements.

Although some slightly earlier cases expressed skepticism regarding sampling,[65] the first decisions prohibiting it outright did not appear until 2015. In *MASTR Adjustable Rate Mortgages Trust 2006-OA2 v. UBS* (*MARM-2006-OA2*), Judge Castel of the Southern District of New York bucked the dominant

63. Order Granting Plaintiff's Motion for Partial Summary Judgment at 15–17, SACO I Tr. 2006-5 v. EMC Mortg. LLC, No. 651820/2012 (N.Y. Sup. Ct. Nov. 30, 2015), NYSCEF Doc. No. 564.

64. *See, e.g.*, *$4.5 Billion Settlement With JPMorgan on Behalf of 21 Institutional Investors*, GIBBS & BRUNS LLP (Dec. 26, 2018), https://www.gibbsbruns.com/timeline/4-5-billion-settlement-with-jpmorgan-on-behalf-of-21-institutional-investors/ [https://perma.cc/U884-DN5N] ($4.5 billion in global settlement with trustees); Kathryn Brenzel, *UBS Pays $358M to Settle Assured's RMBS Suit*, LAW360 (May 6, 2013), https://www.law360.com/articles/438788 [https://perma.cc/W3GA-TGPB] ($358 million); Karen Freifeld, *JPMorgan Pays $400 Mln to Settle with Syncora Over Toxic Loans*, REUTERS (Mar. 3, 2014), https://www.reuters.com/article/jpm-syncora-settlement-idUSL1N0M01D320140303?feedType/=RSS&feedName=bondsNews [https://perma.cc/JZY5-N7BS] ($400 million); Brian Mahoney, *MBIA, BofA Strike Major $1.7B MBS Settlement*, LAW360 (May 6, 2013), https://www.law360/.com/articles/438947 [https://perma.cc/SRS4-C28T]; Nate Raymond, *Flagstar Bancorp to Pay Assured Guaranty $105 Mln Settlement*, REUTERS (June 21, 2013), https://www.reuters.com/article/flagstar-assured/flagstar-bancorp-to-pay-assured-guaranty-105-mln-settlement-idUSL2N0EX1PN20130621 [https://perma.cc/2ZDW-8ZRJ] ($105 million).

65. *See* Ret. Bd. of the Policemen's Annuity & Benefit Fund of the City of Chi. v. Bank of N.Y. Mellon, 775 F.3d 154, 162 n.6 (2d Cir. 2014) (stating that a "sampling proposal fundamentally misses the point"); *In re* Lehman Brothers Holding Inc., No. 08-13555 at 54–55 (SCC) (Bankr. S.D.N.Y. Dec. 10, 2014) ("[S]ometimes folks agree on some aspects of the use of statistical sampling and sometimes they don't.").

trend, holding that whether a breach "materially or adversely affected" the value of a loan was inescapably a loan-by-loan inquiry that could not be squared with sampling methodology.[66]

Other cases further rejecting sampling in the repurchase context soon followed. A series of cases following the *MARM 2006-OA2* decision appeared in 2016 and 2017, all of them prohibiting sampling on the ground that the repurchase remedy and the sole remedy clause required loan-by-loan proof.[67] By and large, these cases do not discuss the previous decisions permitting sampling in trustee litigation, and focus primarily on the contractual language; the sole exceptions are twin opinions issued by Magistrate Judge Sarah Netburn in *BlackRock Allocation Target Shares v. Wells Fargo Bank*[68] and *Royal Park Investments SA/NV v. HSBC Bank*.[69] These opinions were issued in the course of discovery disputes (hence their resolution by a magistrate judge), and distinguish some of the cases permitting sampling, such as the monoline cases which involved transaction-level warranties.[70] However, the opinions do not address the trustee cases in which sampling was permitted.

IV

CRISIS CONSTRUCTION

The cases permitting sampling despite the plain language of the transaction agreements represent an exercise in "crisis construction." In this part, I argue that the courts in these cases based their decisions not on the traditional tenets of

66. No. 12-cv-7322 (PKC), 2015 WL 797972, at *3 (S.D.N.Y. Feb. 25, 2015). In rejecting sampling, Judge Castel reversed the order of his predecessor in this and a companion case, *Assured v. UBS, supra* note 62. The court commented that "[i]t is a core function of a district court to manage cases. But that function does not give the judge the prerogative of overriding the parties' agreements in order to provide an efficient and economical remedy in the name of a just and fair resolution." 2015 WL 797972, at *4.

67. *See, e.g.*, Homeward Residential, Inc. v. Sand Canyon Corp., No. 12 Civ. 5067 (JFK), 2017 WL 5256760, at *10 (S.D.N.Y. Nov. 13, 2017) ([T]he Governing Agreements, as relevant here, call for loan-by-loan proof of breaches of representations and warranties . . . ."); BlackRock Allocation Target Shares v. Wells Fargo Bank Nat'l Ass'n, Nos. 14-CV-09371 (KPF)(SN), 14-CV-09764 (KPF)(SN), 14-CV-10067 (KPF)(SN), 14-CV-10102 (KPF)(SN), 15-CV-10033 (KPF)(SN), 2017 WL 953550, at *5 (S.D.N.Y. Mar. 10, 2017) (holding "that breaches be proven on a loan-by-loan basis"); U.S. Bank, Nat'l Ass'n v. UBS Real Estate Sec. Inc., 205 F. Supp. 3d 386, 424 (S.D.N.Y. 2016) ("[T]he PSAs provide for 'sole remedies' that apply to breaches on an individualized loan-by-loan basis"); Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc., 30 N.Y.3d 572, 585 (2017) ("[Plaintiff] is expressly limited to the more specific Sole Remedy Provision negotiated by the parties, however many defective loans there may be . . . .").

68. Nos. 14-CV-09371 (KPF)(SN), 14-CV-09764 (KPF)(SN), 14-CV-10067 (KPF)(SN), 14-CV-10102 (KPF)(SN), 15-CV-10033 (KPF)(SN), 2017 WL 953550, at *1 (S.D.N.Y. Mar. 10, 2017), *order clarified sub nom.* BlackRock Allocation Target Shares: Series S Portfolio v. Wells Fargo Bank, Nat'l Ass'n, Nos. 14 Civ. 9371 (KPF)(SN), 14 Civ. 9764 (KPF)(SN), 14 Civ. 10067 (KPF)(SN), 14 Civ. 10102 (KPF)(SN), 15 Civ. 10033 (KPF)(SN), 2017 WL 3610511 (S.D.N.Y. Aug. 21, 2017).

69. Nos. 14-CV-08175 (LGS)(SN), 14-CV-09366 (LGS)(SN), 14-CV-10101 (LGS)(SN), 15-CV-02144 (LGS)(SN), 15-CV-10032 (LGS)(SN), 15-CV-10096 (LGS)(SN), 2017 WL 945099, at *1 (S.D.N.Y. Mar. 10, 2017).

70. *See BlackRock Allocation Target Shares*, 2017 WL 953550, at *6; *Royal Park Invs. SA/NV*, 2017 WL 945099, at *6.

contract construction, but on the desire to reassure investors. Many scholars have argued that the law should change in response to economic panics and recessions.[71] Other scholars have addressed how courts, in particular, should respond to such crises.[72] Although some contend that courts were largely unresponsive to the financial crisis,[73] others have identified highly strategic judicial responses to some of the crisis' tensest moments,[74] and still others have argued that the law itself should be different in times of economic crisis to accommodate results seemingly at odds with standard doctrine.[75] A related scholarly proposal argues that the law, including courts, should promote demand when interest rates are at or near zero because under these circumstances, the economy functions differently.[76] Under this theory, legal decisions, including judicial ones, should aim to reassure investors such that they are more inclined to reenter the market, thus helping to stabilize the economy. But no literature has gone so far as to advocate for the abandonment of a contract's plain language during times of crisis.

In the aftermath of the financial crisis, however, this is exactly the approach some courts took. At the time, the demand for MBSs had virtually collapsed, and could not be meaningfully revived for years despite herculean government efforts. This paralysis was in part a crisis of investor confidence in the enforceability of MBS contracts; investors were reluctant to buy MBSs when it seemed that sponsors could not be induced to stand behind the warranties they had made. I argue that for several years—until interest rates and the market for

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71. For example, Schwarcz has proposed a normative balancing framework for determining when changes in financial markets should drive legal changes. *See* Steven L. Schwarcz, *Changing Law to Address Changing Markets: A Consequence-Based Inquiry*, 80 LAW & CONTEMP. PROBS., no. 1, 2017, at 163, 164. Other literature assesses more specific areas of the law, such as tax, employment, and bankruptcy. *See, e.g.*, Brian Galle & Jonathan Klick*, Recessions and the Social Safety Net: The Alternative Minimum Tax as a Counter-Cyclical Fiscal Stabilizer*, 63 STAN. L. REV. 187 (2010); Zachary Liscow, *Counter-Cyclical Bankruptcy Law: An Efficiency Argument for Employment Preserving Bankruptcy Rules*, 116 COLUM. L. REV. 1461 (2016); Jonathan S. Masur & Eric A. Posner, *Regulation, Unemployment, and Cost-Benefit Analysis*, 98 VA. L. REV. 579 (2012).

72. For instance, some scholars have argued that courts actually make decisions supporting government programs in times of crisis, while punishing legislators for economically unsuccessful initiatives during normal times. *See, e.g.*, Thomas Brennan et al., *Economic Trends and Judicial Outcomes: A Macrotheory of the Court*, 58 DUKE L.J. 1191, 1194–95 (2009) (arguing that the Supreme Court makes decisions supporting government programs in times of crisis, while punishing legislators for economically unsuccessful initiatives during normal times).

73. *See* David Zaring, *Litigating the Financial Crisis*, 100 VA. L. REV. 1405, 1415 (2014).

74. *See* Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713, 756 (2009); Yair J. Listokin & Inho Andrew Mun*, Rethinking Corporate Law During a Financial Crisis*, 8 HARV. BUS. L. REV. 349, 369–74 (2018).

75. Listokin & Mun, *supra* note 74.

76. S*ee* Listokin, *supra* note 1, at 793. In ordinary economic times, when the interest rate is meaningfully above zero, economic output is determined by the ability to supply goods and services. *Id.* at 793–94. When demand is less than this capacity, interest rates fall and restore equilibrium by incentivizing people to spend rather than save. *Id.* at 794. These mechanisms fail, however, when interest rates are at the "lower bound," and cannot fall further. *Id.* at 816.

MBSs began to recover—courts stepped into this breach, stabilizing investor confidence by allowing trustees to prove their losses by sample.

While not suggested by previous scholarship, courts appear to have quietly engaged in crisis construction for centuries. In *Savile v. Savile*,[77] the Lord Chancellor discharged the defendant from a contract to pay an excessive price for a property on the ground that at the time the contract was made, there was a "general delusion [of] the nation . . . when there was thought to be more money in the nation than there really was, which induced people to put imaginary values on estates . . . ."[78] The contract was formed during the investment frenzy surrounding the meteoric rise of the South Sea Company; the bubble's explosion reportedly "ruined" the British credit markets.[79]

More recently, many Depression-era contracts contained boilerplate "gold clauses" which required payment either in currency, in specie, or in the value of the currency in gold at the time the contract was made. President Roosevelt abolished the gold standard with the objective of deflating the dollar and thus stimulating the economy; however, such deflation triggered the gold clauses, payment of which would have bankrupted many American businesses. Recognizing the problem, Congress passed a joint resolution abrogating these clauses, which was tenuously upheld by the Supreme Court.[80] However, in other countries, where the abandonment of the gold standard was not accompanied by a similar statute, some courts nullified these clauses on their own.[81]

In this section, I first discuss the repurchase cases, and the evidence that courts disregarded the sole remedy provision in consideration of investors and the market. I then assess the legal basis for the decisions permitting sampling.

77. (1721) 745, 24 Eng. Rep. 596.

78. *Id.*

79. *See* HELEN J. PAUL, THE SOUTH SEA BUBBLE: AN ECONOMIC HISTORY OF ITS ORIGINS AND CONSEQUENCES 106 (2011).

80. *See* David Glick, *Conditional Strategic Retreat: The Court's Concession in the 1935 Gold Clause Cases*, 71 J. OF POL. 800, 800 (2009); Georg Vanberg & G. Mitu Gulati, *Financial Crises and Constitutional Compromise*, 22 (Duke Law Sch. Pub. Law & Legal Theory Series, No. 2017-59), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3033393 [https://perma.cc/UMQ3-RH36].

81. *See generally* Arthur Nussbaum, *Comparative and International Aspects of American Gold Clause Abrogation*, 44 YALE L.J. 53, 56 (1934) (discussing cases implying a gold value clause).

A. Repurchase Decisions: A Case Study in Judicial Market-Calming

The series of decisions essentially reading the repurchase remedy out of RMBS contracts by permitting sampling illustrates that in times of economic crisis, judges may decide cases to reassure market participants and stabilize the market. While it is impossible to know whether jurists sat down intending to stimulate demand because interest rates were at zero—indeed, such specific motivation seems unlikely—these decisions appear to reflect the sentiment that perilous economic times called for unusual measures, and that judges should produce decisions that would make investors whole, increase investor confidence, and thus stabilize and ultimately help stimulate the battered economy.

As an initial matter, the timing of these decisions—illustrated in Table 1—suggests that judicial decision-making may be different in times of crisis. Cases interpreting the repurchase remedy and the sole remedy provision arose in the aftermath of the crisis; the statute of limitations in New York on such claims is six years, and runs from the date that the mortgages were sold,[82] so claims continued to be brought into 2013 and have been working their way through the courts through 2019. Courts interpreting the repurchase remedy and the sole remedy provisions to allow sampling achieved momentum amounting to consensus in the years following the crisis; the first decisions squarely contradicting this interpretation did not appear until early 2015.[83] Even then, courts continued to hold that the provisions allowed plaintiffs to prove their case by sample until late 2015,[84] which is when the economic recovery began in earnest.[85] More recent decisions reiterating the requirement of loan-by-loan proof under the PSAs and MLPAs did not appear until 2016 and 2017,[86] when the economy was thriving and the private label-MBS market had begun a slow but measurable revival.[87]

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82. ACE Sec. Corp., Home Equity Loan Tr., Series 2006-SL2 v. DB Structured Prods., Inc., 25 N.Y.3d 581, 599 (2015).

83. *See* 2015 WL 797972 at *3.

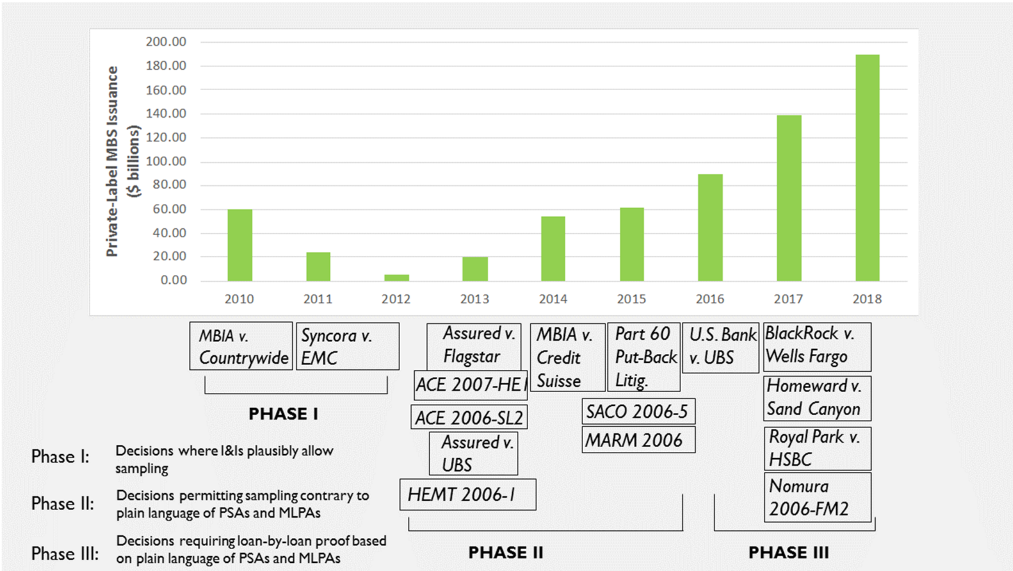
84. *See* Order Granting Plaintiff's Motion for Partial Summary Judgment, *supra* note 63, at 15–17; Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc., 19 N.Y.S.3d 1, 8–9 (App. Div. 2015), *aff'd as modified*, 30 N.Y.3d 572, 92 N.E.3d 743 (2017).

85. *See* Listokin, *supra* note 1, at 811 ("[Short-term interest rates] stayed near zero through late 2015 or afterwards.").

86. *See supra* notes 65–66 and accompanying text.

87. Joe Light, *Market for Private-Label Mortgage Bonds is Recovering, But Slowly*, WALL ST. J. (Jan. 18, 2016), https://www.wsj.com/articles/market-for-private-label-mortgage-bonds-is-recovering-but-slowly-1453152533 [https://perma.cc/G958-7DBD].

Table 1.



Second, these decisions occasionally appeared to be calculated with the intent to restore investor confidence. During the financial crisis, the market for MBSs seized up, necessitating unprecedented government action.[88] Despite this intervention, demand for MBSs, particularly private-label MBSs, remained extremely low for years in the wake of the crisis.[89] One reason for this extended paralysis was that investors did not trust banks to honor the contracts for the assets they sold. For example, Randy Robertson, the managing director of the investment management corporation BlackRock, opined in 2012 that the MBS market would not revive until the lion's share of repurchase litigation had been resolved.[90] The reason was that "investors simply don't believe that MBS issuers . . . complied with contractual commitments. 'Does a contract mean what the contract says?' Robertson said. 'If you change the rules on me and I can't rely on a private contract, how do I invest?'"[91]

88. *See* Tae Yeon Kim, *Pay It Back (TARP Developments)*, 30 REV. BANKING & FIN. L. 538, 538 (2011) (stating that TARP, among other goals, was intended to "restart credit markets [and] restore confidence").

89. *See H.R. ____, The Private Mortgage Market Investment Act, Part 1: Hearing Before the Subcomm. on Capital Mkts. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 112th Cong. 126 (2011) (statement of Janneke Ratcliffe, Senior Fellow, Ctr. for Am. Progress Action Fund, Exec. Dir. of Ctr. for Cmty. Capital, U.N.C.) ("Four years after the housing crisis began, investors are still slow to re-enter the [private-label securities] market.").

90. Alison Frankel, *BlackRock: MBS Market Won't Revive Until Litigation is Resolved*, REUTERS (June 13, 2012), http://blogs.reuters.com/alison-frankel/2012/06/13/blackrock-mbs-market-wont-revive-until-litigation-is-resolved/ [https://perma.cc/98QA-QE4L].

91. *Id.*

The rare courts that expressed their reasoning took a similar tack in endorsing sampling:

> It is no secret that the current RMBS market is desperate for new private capital . . . . Even more threatening to the future of the RMBS market is the lack of respect given to the repurchase protocol. Banks need to give investors sufficient assurances that, if loans are actually non-conforming, banks will promptly make good on their repurchase obligations . . . .[92]

Paradoxically, the mechanism that the courts used to enforce part of the contracts most critical to investor confidence—the representations and warranties—was to hold that the provisions inhibiting recovery—the repurchase remedy and sole remedy provision—did *not* mean what they said. However, these decisions put enough teeth in the representations and warranties that the cases had significant settlement value, enabling trustees, and through them, the bondholders, to shift losses to the sponsors who had contracted to bear them. Such decisions may have sent a signal to nervous investors, helping eventually to restore investor confidence. Accordingly, these decisions also arguably helped securitization sponsors as well, even though they were forced to pay out to trusts and monolines; they themselves were mass holders and producers of MBSs, and would benefit from resuscitation of the market.

B. Alternative Explanations for the Rise and Fall of Sampling

It is, of course, impossible to say with certainty that judges who permitted sampling were motivated by the desire to reassure investors and calm the market, and there are several competing explanations that seem, on their faces, equally likely. In this subpart, I lay out some alternatives, and explain why investor reassurance nonetheless appears to be the most plausible explanation.

First, judges may have permitted sampling not out of a desire to help investors, but to punish sponsors. Judges in the aftermath of the crisis were as outraged as anyone by the heedless risks taken by banks that imposed such high costs on the rest of the country, and were in a unique position to force the banks to internalize some of those costs. However, it seems unlikely that this is the sole explanation for the allowance of sampling. As further bad facts came to light in various proceedings and helpful precedent accumulated for vindictive judges to use, judges solely motivated by a desire to punish the sponsors would have continued to allow sampling. Instead, the courts largely reversed course in 2016.

Second, it is possible that judges allowed sampling for efficiency reasons. The high volume and complexity of RMBS cases in the aftermath of the crisis imposed great demands on the courts, and judges may justifiably have sought procedural mechanisms to reduce these demands. However, it also seems unlikely that this is the only explanation. Judges simply looking for a way to resolve these cases efficiently had a bulletproof option for doing so: enforcing the contracts as written. Under these circumstances, most plaintiffs would probably have settled

92. Assured Guar. Mun. Corp. v. DB Structured Prods., Inc., No. 650705/2010, 2014 WL 3282310, at *6 (N.Y. Sup. Ct. July 3, 2014).

promptly, albeit for much smaller amounts, because the costs of re-underwriting all of the loans at issue were untenable.

It is likely that the judges who allowed sampling had mixed motives, and that the explanations above did impact those decisions. However, only an interest in reassuring investors and making them whole accounts for the timing of these decisions. During the period that judges allowed sampling, the economy was still in a degree of disarray, the public was still recovering from the long period of unemployment, home foreclosure, and other harms that the crisis engendered, and the government kept interest rates extremely low to aid recovery. As the recovery progressed and these harms faded from the public consciousness, the urgency of reassuring investors likely faded as well.

C. Legal Bases for Crisis Construction: Contract Law and the "Echo Chamber"

If courts have a meaningful role in stabilizing the market,[93] what is the best mechanism for fulfilling it? Courts' decisions are not traditionally guided by economic policy considerations, but by the content of the law as expressed in cases and statutes. Resolution of the repurchase cases following the crisis required the application of contract law. It seems intuitive that contract law, with its inherent flexibility, should lend itself naturally to more fluid interpretation in times of crisis. And indeed, some scholarship has explored this possibility in connection with the financial crisis.[94] However, classic contract doctrine was seldom argued and was never the basis for any decision allowing sampling in the aftermath of the crisis.

Why was this? The mechanisms that contract doctrine provides for non-enforcement of the sole remedy provision are not bulletproof. Rather than risk

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93. It is worth asking why the courts, rather than Congress, should undertake the project of restoring investor confidence in the aftermath of the crisis. While much of this discussion is beyond the scope of this Article, I note that the courts, unlike Congress, specialize in resolving contract language retroactively, rather than prospectively; that they are more flexible and can act more quickly than Congress in resolving the cases before them; that the courts engaged in these cases were repeat players in RMBS litigation and decide some of the most sophisticated business litigation in the country; and finally, that Congress launched many programs designed to restart the MBS market, with very limited success. Accordingly, in this narrow instance, it does seem that courts have some advantages over Congress in restoring investor confidence. Moreover, the problems associated with these clauses appear not to have been detected by other policy-makers. By contrast, where similarly problematic clauses prevented the modification of mortgages to help stem the tide of foreclosures in the aftermath of the crisis, courts did not step in. *See, e.g.*, George M. Cohen, *The Financial Crisis and the Forgotten Law of Contracts*, 87 TUL. L. REV. 1, 3–4 (2012); Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL L. REV. 1075, 1076 (2009); John D. Gianakoplos and Susan P. Koniak, *Matters of Principal*, N.Y. TIMES (March 4, 2009). This may be because the executive branch recognized the problem, and the Treasury enacted the Home Affordable Modification Program to help borrowers modify their loans. *See* U.S. TREASURY, MAKING HOME AFFORDABLE (2017), https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/mha/Pages/overview.aspx [https://perma.cc/8GYA-FDY8]. It may be that courts are less inclined to intervene when a political branch has taken ownership of the problem.

94. For instance, Cohen argues that courts should have used traditional contract doctrines, such as excuse and unconscionability, to modify loans and mitigate the soaring foreclosures that exacerbated the recession. Cohen, *supra* note 93, at 3.

well-publicized reversal or disagreement from commentators, the courts permitting sampling reached their results by omitting their reasoning entirely, or relying on previous cases—even when those cases were poorly reasoned or inapplicable. Though these decisions created confusing precedent, they quietly facilitated substantial settlements that reassured investors during a period when the market for MBSs was virtually paralyzed. In this subpart, I first address possible contractual mechanisms for allowing sampling, and explain why the courts did not use these tools. I then discuss how contract doctrine has been incorporated into very recent repurchase decisions.

Although courts have broad discretion to fashion remedies for contract breach,[95] in the repurchase context, the sponsors and trusts—both sophisticated parties—constrained that discretion with the sole remedy provision. Traditional doctrines of excuse, such as commercial impracticability[96] and frustration of purpose,[97] seem facially appropriate, and indeed, some decisions even couch their rulings in language reminiscent of these doctrines.[98] But these doctrines apply when a party is seeking excuse for nonperformance. The trustees had performed their part of the bargain by paying for the loans; it was the sponsors who were in breach.

One notable tool that courts plausibly could have engaged to permit sampling despite the plain language of the agreements is the public policy exception. Under this exception, courts may choose not to enforce a term where public policy outweighs the interest in enforcement.[99] In making this determination, courts must consider the interest in enforcing the term and weigh it against the public interest against enforcement.[100] In assessing this public interest, the court must consider the strength of the public policy as expressed by legislative and judicial decisions; the likelihood that refusal to enforce the term would actually further public policy; whether any misconduct was involved, and its seriousness; and whether there was a direct link between the misconduct and the term.[101] A court may derive public policy precluding the enforcement of a term from either legislation to prevent such a policy, or the need to protect some aspect of public welfare.[102]

It does not seem farfetched to speculate that courts, had they wished to do so, could have barred enforcement of the sole remedy provision on the ground that it posed a substantial barrier to an important policy concern: economic

95. *See* RESTATEMENT (SECOND) OF CONTRACTS § 345 (AM. LAW INST. 1981).

96. *Id.* § 261.

97. *Id.* § 265.

98. *See* Assured Guar. Mun. Corp. 2014 WL 3282310 at *6 (N.Y. Sup. Ct. July 3, 2014) (finding loan-by-loan proof "commercially unreasonable" for trustees and therefore allowing sampling).

99. RESTATEMENT (SECOND) OF CONTRACTS § 178.

100. *Id.*

101. *Id.*

102. *Id.* § 179.

recovery.[103] It seems equally plausible to speculate that courts may have allowed sampling on the public policy basis that parties engaged in misconduct—here, the RMBS sponsors—should not benefit from the expectation that their contract terms will be enforced.[104]

But the courts permitting sampling in the aftermath of the crisis did not do this. Instead, they essentially turned to a blunt-instrument application of precedent. As discussed, the earliest cases permitting sampling involved monoline insurers, which, as well as being third-party beneficiaries to the MLPAs and PSAs enacted by the trustees and issuers, had their own agreements—the I&Is—with the sponsors.[105] These I&I agreements frequently contained *transaction-level* warranties in addition to loan-by-loan warranties, and specifically allowed the insurer to take any action to recover on amounts owed by the sponsor.[106] Accordingly, it would have been quite plausible to hold that the monolines were not bound by the loan-by-loan repurchase remedy, as several courts did.[107] However, these early decisions were cited by plaintiffs[108] and courts[109] in later decisions allowing sampling where no such exemptive provisions existed. Many plaintiffs exploited the fiery rhetoric provided by earlier decisions without following the legal reasoning of those opinions. For example, in *Syncora,* the Southern District of New York permitted sampling on the ground that this approach was permitted by the plaintiff monoline's I&I.[110] The court also included a blistering footnote:

> The repurchase protocol is a low-powered sanction for bad mortgages that slip through the cracks. It is a narrow remedy ("onesies and twosies") that is appropriate for individualized breaches and designed to facilitate an ongoing information exchange among the parties. This is not what is alleged here . . . . Accordingly, [the sponsor] cannot reasonably expect the Court to examine each of the 9,871 transactions to determine whether there has been a breach, with the sole remedy of putting them back one by one.[111]

Plaintiffs in subsequent cases pointed to this scathing language to argue that the repurchase remedy simply had not been intended for the scale of breach that

103. *See id.* § 178 cmt. e. ("[T]he court will also weigh any interest that the public or third parties may have in the enforcement of the term in question.").

104. *Id.* §§ 195–96.

105. *See supra* Part III(A).

106. *See id.*

107. *See, e.g*., Assured Guar. Mun. Corp. v. Flagstar Bank, FSB, No. 11 Civ. 2375(JSR), 2011 WL 5335566, at *4–5 (S.D.N.Y. Oct. 31, 2011); Syncora Guarantee Inc. v. EMC Mortg. Corp., No. 09 Civ. 3106(PAC), 2011 WL 1135007, at *5 (S.D.N.Y. March 25, 2011).

108. *See, e.g*., Plaintiffs' Letter to Justice Schweitzer at 1–2, Home Equity Mortg. Tr. Series 2006-1 v. DLJ Mortg. Capital, Inc., No. 156016/2012, slip op. 50011(U) (N.Y. Sup. Ct. Jan. 9, 2019), NYSCEF Doc. No. 229 (citing *MBIA v. Countrywide*, *Assured v. Flagstar*, and *Syncora v. EMC*); Plaintiffs' Reply Memorandum in Further Support of Motion for Partial Summary Judgment at 4, SACO I Tr. 2006-5 v. EMC Mortg. LLC, No. 651820/2012 (N.Y. Sup. Ct. Oct. 19, 2015), NYSCEF Doc. No. 521 (citing *MBIA v. Countrywide*).

109. *See, e.g.*, Order Granting Plaintiff's Motion for Partial Summary Judgment, *supra* note 63.

110. *Syncora*, 2011 WL 1135007, at *7.

111. *Id.* at *6.

occurred during the crisis.[112] Without addressing the reasoning of *Syncora* and its reliance on the I&Is, the courts receiving these arguments permitted sampling. And many decisions permitting sampling cited no authority at all.

These courts built on each other's opinions to create a line of jurisprudence that, for several years, unanimously approved sampling in RMBS cases; indeed, several cited the judicial "consensus" on the issue as the main reason for the decision.[113] These decisions created an echo chamber whereby courts built momentum for a position that, while textually untenable, promoted the interests of investors and sent a signal to the market that contracts related to these assets would be enforced.[114]

Why did courts rely on inapplicable or nonexistent reasoning to allow sampling when they could have reached the same results by voiding the sole remedy provisions on public policy grounds? Possibly because the stakes were simply too high for failure. Courts across the country are cautious in applying the public policy exception to void contractual provisions, and are particularly reluctant to do so where the legislature is silent, or where there is any doubt about the policy interest to be served.[115] While the policy interests served by allowing sampling are compelling, it is not clear that they would be immune from

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112. *See, e.g.*, Plaintiff's Memorandum of Law In Support of Their Motion for Partial Summary Judgment at 8, SACO I Tr. 2006-5 v. EMC Mortg. LLC, No. 651820/2012 at 8 (N.Y. Sup. Ct. Sept. 1, 2015), NYSCEF Doc. No. 460; Plaintiffs' Letter to Justice Schweitzer, *supra* note 108, at 2. In both cases, the courts allowed sampling.

113. *See, e.g.*, Order Granting Plaintiff's Motion for Partial Summary Judgment, *supra* note 63, at 15–16 ("[A]llowing the use of sampling is well-accepted by courts in RMBS cases . . . . [T]he overwhelming majority that have considered sampling have permitted it as a means to present proof at trial . . . . The Court adopts this consensus reasoning here"); Part 60 RMBS Put-Back Litig., *supra* note 62 ("[T]he courts have overwhelmingly endorsed statistical sampling in the RMBS litigation and this Court concurs with that approach.").

114. This echo chamber provides an excellent example of the "butterfly effect" in boilerplate contract interpretation. *See* John F. Coyle, *Interpreting Forum Selection Clauses*, 104 IOWA L. REV. 1791, 1797 n.17 (2019) ("To speak of the 'butterfly effect' in boilerplate contract interpretation . . . is to describe the effect that a single interpretive decision can have on the interests of far-flung parties not involved in the litigation at hand.").

115. *See, e.g.*, Santisas v. Goodin, 951 P.2d 399, 413 (Cal. 1998) ("Historically, this court has been reluctant to declare contractual provisions void or unenforceable on public policy grounds without firm legislative guidance."); Oronoque Vill. Condo. Ass'n, Inc. v. Bargas, No. CV126030490S, 2013 WL 6334111, at *7 (Conn. Super. Ct. Oct. 31, 2013) ("Generally, however, courts have approached the prospect of invalidating a contract on the ground that it violated public policy with great caution."); In re Guardianship of Huseman, 831 N.E.2d 1147, 1152–53 (Ill. App. Ct. 2005) ("The courts are reluctant to restrict the freedom of citizens to make their own agreements. Declaring a contract void and unenforceable is a power the courts therefore exercise sparingly."); 720–730 Fort Washington Ave. Owners Corp. v. Utica First Ins. Co., 893 N.Y.S.2d 426, 431 (N.Y. Sup. Ct. 2009) ([W]hen statutes and . . . regulations are silent, we are reluctant to inhibit freedom of contract by finding . . . clauses violative of public policy.") (quoting Slayko v. Sec Mutual Ins. Co., 774 N.E.2d 208, 212 (N.Y. 2002)); Huey v. Brand, 92 S.W.2d 505, 508 (Tex. Civ. App. 1936), *aff'd sub nom.* Borger v. Brand, 118 S.W.2d 303 (Tex. Comm'n App. 1938) ("Public policy permits the utmost freedom of contract between parties of full age and competent understanding . . . and this freedom should not lightly be interfered with by holding that a contract is contrary to public policy.") (citation omitted); Wellington Power Corp. v. CNA Sur. Corp., 614 S.E.2d 680, 686–87 (W. Va. 2005) ("Our rule . . . provides that the power of this Court to void a contract as contravening public policy should be exercised only in cases free from doubt.").

challenge. First, stabilizing the economy is not among the standard public policy interests that courts traditionally defend, which include restraints on trade, impairment of family relations, and promises involving the commission of a tort or breach of fiduciary duty.[116] Further, these interests diverge in an important respect from facilitating economic recovery: they are constant, and consistently require the same kinds of rulings. Calming the market, by contrast, is not a policy interest that consistently requires defense,[117] and it is difficult to predict when non-enforcement of a contractual term would promote it.

Second, an alternative route to allowing sampling via the public policy exception would be to void the sole remedy provisions based on the sponsors' misconduct. In applying this permutation of the public policy exception, courts consider (1) "the seriousness of any misconduct involved and the extent to which it was deliberate," and (2) "the directness of the connection between the misconduct and the term."[118] This may be difficult, because even where evidence of misconduct exists, it is not clear that the term at issue—the sole remedy provision—is directly related to it. Similarly, sections 195 and 196 of the Restatement specifically allow avoidance, on public policy grounds, of provisions that purport to exempt parties from liability for harms caused intentionally, recklessly, or as the result of misrepresentation.[119] It is arguable that the sole remedy provision is such a clause. But the provision does not purport to exculpate the sponsors from liability, or even to severely constrain the amount of damages; rather, it imposes a procedure for collecting those damages that, in crisis circumstances, turned out to be extremely costly.

To be sure, these public policy-based arguments might have carried the day, had judges permitted sampling on that basis. But they almost certainly would have drawn scrutiny from courts and other commentators, particularly in light of the general judicial reluctance to void contractual provisions on public policy grounds. By contrast, the echo chamber provided a quiet, flexible medium for judges to stabilize investor confidence. These opinions were not front-page news; they were not facially based on controversial theories, and thus did not draw the ire of scholars and other commentators. With few exceptions, the consequences were not on display to the public in the form of a trial; rather, the only effect was a probable increase in settlement values. This redistributive effect was likely the assurance that trusts and investors needed to feel that they had been made whole for the sponsors' breaches.

These effects could have been much harder to achieve if the courts had been transparent in basing their decisions on policy grounds. A cumbersome, slow, and

116. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 186–93.

117. Note that the Restatement generally requires that the public policy interest barring enforcement of the term exist at the time the contract was made. *Id.* § 179 cmt. d. This would seem to preclude judges from barring enforcement of the sole remedy provision in order to promote economic recovery when the securitizations at issue were created before the economy collapsed.

118. *Id.* § 178.

119. *Id.* §§ 195–96.

expensive appellate process would likely have led to reversal and a deflation of settlement values. If courts had stated that they were writing provisions out of contracts in view of the economy or the sponsors' misconduct, scholars and other commentators likely would have taken note, and dragged the issue into public debate. While this would certainly support vigorous examination of law and policy, it likely would not have given peace of mind to the trusts and investors whose contracts were at issue; rather, it would likely have promoted greater and more visible uncertainty in the market about the enforcement of MBS representations and warranties, further eroding market confidence, and thus undermining the goal of these decisions. Accordingly, greater transparency may not have been the optimal tool for judges to use to restore confidence to battered markets.

This conclusion is reinforced by the continuing narrative of RMBS repurchase litigation as the market recovered. In 2017, the New York Court of Appeals held that the sole remedy provision required loan-by-loan repurchase.[120] But this was not the end of sampling. In 2018 and 2019, two further decisions validated sampling, relying on the line of crisis construction cases from the aftermath of the crisis.[121] But these decisions also both included analysis based on the public policy exception voiding provisions exculpating a party for liability from gross negligence.[122] The reasoning here is suspect—the sole remedy provision does not purport to exempt sponsors from liability for anything, nor does it unduly constrain the amount that the trusts may recover for breaching loans. Moreover, both opinions rely on somewhat strained parallels to New York precedent on this issue.[123] Finally, both cases also involve extreme instances of alleged bad conduct by the sponsors; the breach rates alleged are 93% and 100%.[124]

Could the courts permitting sampling in the aftermath of the crisis have made their decisions on similar grounds? Perhaps. But although apples-to-apples comparisons are difficult due to varying sampling methodology, it appears that not all of the earlier cases in which sampling was permitted involved such egregious misconduct by sponsors; breach rates appear to vary much more widely.[125] This reinforces the idea that the courts' purpose in permitting sampling

120. Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc., 30 N.Y.3d 572, 603–04 (2017).

121. *In re* Part 60 Put-Back Litig., 169 A.D.3d 217, 224–26 (N.Y. App. Div. 2019); Deutsche Bank Nat'l Tr. Co. for Morgan Stanley Structured Tr. I 2007-1 v. Morgan Stanley Mortg. Capital Holdings LLC, 289 F. Supp. 3d 484, 504–05 (S.D.N.Y. 2018).

122. *See supra* note 119 and accompanying text (discussing RESTATEMENT §§ 195–96).

123. *See* Sommer v. Fed. Signal Corp., 593 N.E.2d 1365, 1370–71 (N.Y. 1992) (involving a clause that purported to limit damages to $55.50); Kalisch-Jarcho, Inc. v. City of New York, 448 N.E.2d 413, 416 (N.Y. 1983) (involving a "no-damage-for-delay" clause by a construction company).

124. *Deutsche Bank Nat'l Tr. Co. for Morgan Stanley Structured Tr. I 2007-1*, 289 F. Supp. 3d at 500 (93% alleged breach rate); *In re Part 60 Put-Back Litig.*, 169 A.D.3d at 220 (100% alleged breach rate).

125. *See, e.g.*, Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc., 133 A.D.3d 96, 104 (N.Y. App. Div. 2015), *aff'd as modified*, 92 N.E.3d 743 (2017) (noting that at-issue trusts alleged breach rates of 45% and 83%); Complaint at 1–2, ACE Sec. Corp. v. DB Structured Prods.,

in those early cases was to reassure investors rather than solely to punish the sponsors. Moreover, it is unclear whether the public policy reasoning in these cases will prove durable, for the reasons discussed above. The decisions explicitly citing public policy grounds were made once the economy had largely recovered; the urgency of pressuring meaningful settlements by any means necessary to bring investors back to the market had faded. Accordingly, the stakes of being reversed or publicly criticized for transparent but strained reasoning were lower, and the opacity of the echo chamber approach less appealing.

V

WHY IS THE REPURCHASE REMEDY STICKY?

Despite the problems they seem to engender, the repurchase protocol and sole remedy provision appear to have persisted in MBS contracts.[126] This part assesses why these provisions seem to have endured. The loan-by-loan repurchase remedy likely has not been revised because the costs of the revisions and the assets they create are high. In light of developments after the crisis, the problems of the provisions are simply not perceived to be sufficiently severe to incur these costs. Accordingly, trusts may regard the existing provisions as "good enough."[127] I describe here why the costs of revision are high, and proceed in subparts V.A and V.B to show why potential benefits of revision are low.

To begin with, a more broadly or easily enforceable remedy would undoubtedly be costly to sponsors, and this would be reflected in the cost of the assets themselves. Such a remedy could take the form of transaction-level warranties enforceable by any means necessary, such as those found in some I&Is. Recall that these warranties currently apply only to insured securities, typically the top-rated tranche. The sponsors pay the monolines to insure these securities, and pass that cost, along with the increased diligence costs associated with the more comprehensive warranties, along to the investors. Giving transaction-level warranties to the trusts for entire securitizations would mean incurring these increased diligence costs for uninsured, less credit-worthy securities, which investors might not have the appetite to absorb. Similarly, Lewis and Schwartz have proposed that rather than warranting that the loans underlying the securities meet certain criteria, sponsors simply warrant the

Inc., No. 650327/2013, 2013 WL 6153206 (N.Y. Sup. Ct. Nov. 21, 2013) (alleging a 45% breach rate); MASTR Adjustable Rate Mortgs. Tr. 2006-OA2 v. UBS Real Estate Sec. Inc., No. 12-cv-7322 (PKC), 2015 WL 797972, at *2 (S.D.N.Y. Feb. 25, 2015) (37% for trusts at issue in *Assured v. UBS*).

126. Lewis & Schwartz, *supra* note 3, at t7 ("The second question we ask is why sophisticated market agents made, and continue to make, unenforceable MBS portfolio contracts.").

127. *See* MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN 37–39 (2012) (describing a theory of "satisficing" contracts, under which parties choose not to revise existing contracts that are "good enough to serve [their] primary goals."); *see also* Patrick Bolton & Antoine Faure-Grimaud, *Satisficing Contracts,* 77 REV. ECON. STUD. 937, 938 (2010).

performance of the portfolios that they sell.[128] In either case, sponsors would likely incur increased diligence and repurchase costs to perform under these contracts, and these increases would be reflected in the price of the mortgages and MBS.[129]

Secondarily, the process of actually revising the term could be costly. The buying and selling of asset-backed securities is a bulk business which requires significant infrastructure to set up, but can generate large transactions at a high volume once in place.[130] An important component of this infrastructure is the form contracts used to create these transactions.[131] If trusts imposed revision of the repurchase remedy in these form contracts, sponsors and investors would have to exert further efforts to price the import of any replacement term on securities which did not previously carry transaction-level warranties to insurers. These comprise the majority of the securities, and are less credit-worthy than the top-rated tranches which may be insured. Assessing the litigation risk for these securities under transaction-level warranties would likely add friction to a process designed to market MBSs quickly, at high volume.[132]

Accordingly, the costs of altering the loan-by-loan repurchase remedy are potentially high. It is true that the financial crisis graphically illustrated the problems with these terms; trusts, and through them, investors, had a much harder time enforcing warranties against sponsors than they likely anticipated, and were forced to contend with the risk and losses from bad loans that they had not bargained for. However, in light of developments following the crisis, it appears that the problems with these provisions are simply not severe enough to incur the costs involved in changing them. This is likely due to two factors: (1) provisions in the Dodd-Frank Act that make specific breaches that proved problematic less common; and (2) the "crisis construction" jurisprudence holding that trustees and monolines need not prove breach loan-by-loan.

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128. Lewis & Schwartz, *supra* note 3, at t30–31. In making this proposal, Lewis and Schwartz acknowledge that it would require an overhaul of current accounting standards and bankruptcy law. Currently, MBS are appealing to sponsors because they are permitted to book portfolio sales as current revenue. But if the sponsor guaranteed the portfolio, it would have to account for the potential liability it would incur as a result. *Id.* at t30. Further, if sponsors guaranteed the assets they sold, the buyers might be treated as creditors in the event of the sponsor's bankruptcy under current bankruptcy law. This would make the assets informationally sensitive, in that buyers would need to investigate the creditworthiness of the sponsors before purchase, threatening the liquidity of these products. *Id.* Accordingly, this proposal entails costs much higher and broader than an increase in the cost of MBS.

129. *See id.* at t34.

130. *Id.*

131. *Id.* at n.70.

132. Historically, the repurchase remedy also likely benefit from "network externalities;" under this theory, more commonly used terms are priced by a larger number of market actors, and therefore the pricing for these terms is more accurate. *See* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or "The Economics of Boilerplate")*, 83 VA. L. REV. 713, 726 (1997) ("[Contractual network benefits] . . . include the availability of a large number of investors and securities analysts who will learn how to price a firm's securities at later public offerings and on the secondary market."). However, following the jurisprudence permitting sampling, the meaning of the repurchase may no longer have a meaning that is sufficiently settled to confer this benefit.

A. The Impact of Dodd-Frank

Breaches of fraud and appraisal-related representations and warranties were exceedingly common in loans that were contested in the aftermath of the crisis. Dodd-Frank took measures to address both, potentially limiting the number of these breaches likely to occur in the future.[133] Accordingly, the odds of litigating events of mass breach may appear to trusts to be sufficiently diminished such that revising the repurchase remedy is unnecessary.[134]

It is well known that the housing crisis was driven in large part by lax underwriting. Not only did banks lower their standards for borrowers, but they created loan products requiring vastly less information than conventionally underwritten loans. Many loan types did not require verification or even assessment of borrowers' income or assets, and some did not even require employment verification.

The low- and no-verification loans types practically invited borrowers to misstate their incomes and other relevant characteristics in order to procure larger loans. Such misstatements almost invariably constituted a breach of the MLPAs and PSAs. First, in many, though not all, transaction agreements, sponsors warranted specifically against borrower fraud. Even where an agreement omitted that warranty, virtually all contracts contained a "no default" representation, warranting that at the time the loans were sold, no circumstance existed that would constitute a "default" of the mortgage note.[135] Standard mortgage contracts include a clause defining borrower misstatements in procurement of the loan as an event of default. Accordingly, a loan procured by a lying borrower would breach a "no borrower fraud" warranty (if there was one), and a "no default" warranty (which there nearly always was). Such loans were pervasive in the aftermath of the crisis.

Dodd-Frank reduced the opportunity for these types of breaches. Under Dodd-Frank, "no creditor may make a residential mortgage loan unless the

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133. Lewis and Schwartz, *supra* note 3, argue that Dodd-Frank does not mitigate the problems of the loan-by-loan repurchase remedy in that trustees and investors seeking to put back loans to the sponsor must still demonstrate that the characteristics of individual loans did not live up to the warranties. This is quite true. However, it was the *scale* of these breaches that made this provision so problematic. Where there are fewer breaches to begin with, the loan-by-loan remedy is less odious to enforce. Dodd-Frank provides several provisions likely to lessen the number of breaches in the first instance.

134. One strand of contract scholarship has assessed the use of vague terms or standards where the front-end cost of drafting the term is low, and the back-end cost of litigating the term, though high, is discounted by the remote probability that it will occur. *See generally* Richard A. Posner, *The Law and Economics of Contract interpretation*, 83 TEX. L. REV. 1581 (2005); Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814 (2006); Steven Shavell, *On the Writing and the Interpretation of Contracts*, 22 J. L. ECON. & ORG. 289 (2006). Other literature has clarified that vague terms are subject to this calculus because they are costly to verify in court. *See generally* Albert Choi & George Triantis, *Strategic Vagueness in Contract Design*, 119 YALE L.J. 848, 852 (2010). The historical prevalence of the repurchase remedy likely made it inexpensive to draft, and though it is a hard-to-verify term in events of mass breach, Dodd-Frank reduced the likelihood of breach. Accordingly, the expense of litigation is likely discounted.

135. *See, e.g.*, Pooling & Servicing Agreement, SACO I Tr. 2006-5, *supra* note 26, at 927 ("[T]here are no material defaults under the terms of the Mortgage Loan . . . .").

creditor makes a reasonable and good faith determination based on *verified and documented information* that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan . . . ."[136] To determine a borrower's ability to repay, lenders must assess the borrower's

> credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling or real property that secures repayment of the loan.[137]

To assess these characteristics, the lender must rely on "Internal Revenue Service Form W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets."[138] Under regulations by the Consumer Financial Protection Bureau, certain "plain vanilla" mortgages with no exotic features and relatively low debt-to-income ratios presumptively satisfy the "ability to pay" requirement, but even these loans require verification of debts and income.[139] Under these rules, which require verification and documentation of borrower attributes, it is much harder for borrowers to lie about those attributes. Accordingly, breaches involving borrower fraud, which were so pervasive during the crisis, are likely to be far fewer post-Dodd-Frank.

Similarly, many MLPAs and PSAs made representations regarding the process by which properties securing the loans were appraised.[140] Many also warranted loan-to-value ratios, or for second-lien loans, combined loan-to-value ratios (LTVs or CLTVs) of the loans in the securitization.[141] An LTV is the amount of the loan divided by the value of the property; the value is determined by an appraisal. In the run-up to the crisis, appraisers were notoriously pressured by lenders to inflate property values.[142] Such pressure and subsequent inflation would breach warranties of appraiser independence, and any LTV reported as a result of such appraisals would be artificially low, thus violating LTV warranties. Again, these particular breaches were pervasive in mortgages leading up to the financial crisis.

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136. 15 U.S.C. § 1639(a)(1) (2012) (emphasis added).

137. 15 U.S.C. § 1639(a)(3).

138. 15 U.S.C. § 1639(a)(4).

139. 12 C.F.R. § 1026.43(e)(2) (2018).

140. *See, e.g.*, Pooling & Servicing Agreement, SACO I Tr. 2006-5, *supra* note 26, at 928 ("The Mortgage File contains an appraisal of the related Mortgaged Property signed prior to the final approval of the mortgage loan application by a Qualified Appraiser, approved by the Company, who had no interest, direct or indirect, in the Mortgaged Property or in any loan made on the security thereof, and whose compensation is not affected by the approval or disapproval of the Mortgage Loan.").

141. *See, e.g.*, *id.* at 929 ("In the event the Mortgage Loan had an LTV at origination greater than 80.00%, the excess of the principal balance of the Mortgage Loan over 75.0% . . . was insured as to payment defaults by a Primary Mortgage Insurance Policy. . . . No Mortgage Loan has an LTV over 95%.").

142. *See, e.g.*, Joe Eaton, *The Appraisal Bubble,* CTR. FOR PUB. INTEGRITY (Apr. 14, 2009), https://publicintegrity.org/environment/the-appraisal-bubble [https://perma.cc/L5L9-BVQ2].

Dodd-Frank took steps to address these problems by stiffening appraiser independence requirements.[143] Among other things, the provision prohibits "seeking to influence an appraiser or otherwise to encourage a targeted value in order to facilitate the making or pricing of the transaction" and withholding timely payment for appraisals.[144] The provision also requires anyone involved in a real estate contract who has reason to believe unethical appraisal practices have occurred to report them to state authorities governing appraiser certification and licensing.[145] The increased emphasis on appraiser independence likely reduces the instance of these kinds of breaches.

It is possible that diminishing the probability of certain types of breaches that were common during the mortgage crisis affected the calculus parties undertook in deciding whether to change or retain the loan-by-loan repurchase remedy. When breaches infected thousands of loans in each securitization, this provision was severely problematic. However, if regulation constrains the scale of breach in the first instance, putting loans back to the sponsor one at a time may not seem like an unreasonable remedy.

B. The Impact of Crisis Construction

The other post-crisis development that may have influenced the decision to retain the loan-by-loan repurchase remedy is the line of jurisprudence that virtually ignored it. The persistence of the repurchase remedy suggests that courts, at least to some extent, restored confidence in the enforceability of the representations and warranties notwithstanding the language of the repurchase provision. The willingness of judges to depart from the language of the PSAs in order to allow trustees to enforce representations and warranties suggests that they might do so again. This may lessen the urgency for trustees to attempt revisions. While later cases indeed interpreted the language of the PSAs to prohibit sampling, the existence of these cases does not prevent litigants and courts from making use of earlier cases to lessen the sting of the repurchase remedy, and as discussed above, some courts have already done so.[146]

The availability of such precedent may provide reassurance to trustees, investors, and the market generally that courts may soften this facially draconian remedy, and are more likely to do so in times of crisis, or where there has been particularly egregious misconduct by sponsors. This possibility, combined with the lower likelihood of breach resulting from Dodd-Frank, may have affected parties' calculus regarding the retention of the loan-by-loan repurchase remedy. On the front end, it appears that many of the most pervasive breaches are unlikely to recur. Even granting the possibility that un-preempted breaches arise on a pervasive scale, it may appear to parties and the market at large that the courts would take unusual measures to enforce the representations and

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143. 15 U.S.C. § 1639e(b) (2012).

144. *Id.*

145. *Id.*

146. *See supra* note 121 and accompanying text.

warranties in such an event. Accordingly, the perceived costs of retaining the provision, even in light of the problems to which it gave rise, are less than the costs of changing it.

Thus, the loan-by-loan repurchase remedy is likely to be sticky because the crisis construction cases give trusts some assurance of recourse in courts.

VI

CONCLUSION

The repurchase cases demonstrate that in moments of economic upheaval, certain contractual provisions may do more harm than good, and conventional contract doctrines are not always up to the challenge of mitigating these effects. Under these circumstances, courts may take matters into their own hands, at least for the duration of the crisis. Though unusual, ignoring contractual language in times of crisis is not unheard-of, and may be beneficial in a narrow set of circumstances. In the case of RMBS contracts, such interpretations may help explain why the repurchase remedy has endured after the financial crisis.