

Ambac Assurance Corp. v First Franklin Fin. Corp.

2016 NY Slip Op 31297(U)

July 8, 2016

Supreme Court, New York County

Docket Number: 651217/2012

Judge: Anil C. Singh

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This opinion is uncorrected and not selected for official publication.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 45

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AMBAC ASSURANCE CORPORATION and
THE SEGREGATED ACCOUNT OF AMBAC
ASSURANCE CORPORATION,

Plaintiff,

DECISION AND ORDER

-against-

Index No.: 651217/2012
Mot. Seq. 013

FIRST FRANKLIN FINANCIAL
CORPORATION, BANK OF AMERICA, N.A.,
MERRILL LYNCH, PIERCE, FENNER & SMITH
INC., MERRILL LYNCH MORTGAGE LENDING,
INC., and MERRILL LYNCH MORTGAGE
INVESTORS, INC.,

Defendants.

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HON. ANIL SINGH:

In this case for *inter alia* breach of contract and fraudulent inducement in connection with a residential mortgage backed securities (RMBS) transaction, defendants move to compel plaintiffs to produce documents related to Ambac’s loss mitigation activity. Ambac opposes this motion. Oral arguments were heard on the motions on May 11, 2016.

Facts

The transaction at issue in this case, First Franklin Mortgage Loan Trust, Series 2007-FFC (the “Transaction”), closed on May 29, 2007, and was sponsored by Merrill Lynch Mortgage Lending, Inc. (“ML Lending”) and marketed by Merrill Lynch, Pierce, Fenner & Smith, Inc. (“MLPF & S”). The loans were originated by

First Franklin Financial Corporation (“First Franklin”) and deposited by Merrill Lynch Mortgage Investors, Inc. (“ML Investors”) into First Franklin Mortgage Loan Trust, Series 2007–FFC Trust (the “Trust”). ML Lending and First Franklin sold 15,812 subprime second-mortgage “balloon” loans with an aggregate principal balance of approximately \$856 million to defendant ML Investors. ML Investors, as the depositor, sold the 15,812 loans to the Trust formed under a Pooling and Servicing Agreement (“PSA”).

To induce Ambac to issue the Policy, the Merrill Lynch Contracting Parties entered into an Insurance and Indemnity contract (“I & I”) and made a series of representations and warranties in addition to those in the MLPAs and the PSA. They represented to the Merrill Lynch Contracting Parties’ compliance with lending and securities law, their financial condition, operations, mortgage-loan portfolios, underwriting, due diligence and quality control practices, and the aggregate characteristics of the loans included in the Transaction. Likewise, in the I & I, Ambac represented its financial soundness and ability to make payments under the policy.

Ambac’s financial condition deteriorated as a result of subprime mortgage loan defaults in 2007 and 2008, and it entered statutory rehabilitation pursuant to Wisconsin Insurance Law in 2010. After a large percentage of loans defaulted, Ambac received and analyzed over 1,750 loan files. It alleges *inter alia*, that the loans were not originated or underwritten pursuant to First Franklin’s ostensible

originating and underwriting guidelines, nor pursuant to prudent lending practices in contradiction to the defendants' previous representations.

Since its loan defaults in 2007 and 2008, Ambac has undertaken significant steps to reduce its claim payments and mitigate its losses across the entire RMBS portfolio. Ambac has accomplished this through the implementation of strategic repurchase of bonds it insured among other loss mitigation activities. During the discovery phase of this case, defendants' have sought documents that relate to these bond repurchases and other activities designed to reduce the amount that Ambac will have to pay under the policies. However, Ambac has allegedly produced limited relevant documents. Defendants' have therefore moved to compel the production of documents related to Ambac's loss mitigation activity.¹

Motion to Compel

On a motion to compel, "CPLR 3101(a) provides for 'full disclosure of all matter material and necessary in the prosecution or defense of an action, regardless of the burden of proof.' The words 'material and necessary' have been interpreted broadly and cover any good faith request for information that will assist in the preparation for trial." Fortis Bank (Nederland) N.V. v Abu Dhabi Islamic Bank, 32 Misc.3d 1232(A) (Sup. Ct. N.Y. Cnty. 2010). However, the purpose of discovery

¹ Specifically, Defendants' have moved for the Court to compel Ambac to comply with Request Nos. 62-69 of Defendants' Fourth Requests for Production. Request Nos. 62-65 involve Ambac's repurchases of bonds in the Transaction; Request No. 66 involve Ambac's additional loss mitigation efforts with respect to the Transaction; Request Nos. 67-69 involves Ambac's repurchases of bonds and loss mitigation efforts across its entire insured RMBS portfolio.

must be to sharpen the issues thus reducing delay and prolixity, rather than provide undue attention to any collateral matter to the detriment of the main issue. Blittner v Berg and Dorf, 138 A.D.2d 439, 440-41 (2d Dept 1988).

Defendants' Request for Discovery Regarding the Transaction

Defendant's motion compelling plaintiff to comply with Request Nos. 62-66 regarding Ambac's repurchases of bonds and additional loss mitigation efforts with respect to the Transaction is granted.

The scope of discovery will extend to "any fact[] bearing on the controversy." Rivera v. NYP Holdings Inc., 63 A.D.3d 469, 469 (1st Dept 2009). The test of whether matter should be disclosed is "one of usefulness and reason." Allen v. Crowell-Collier Publ. Co., 21 N.Y.2d 403, 406 (1968); see e.g. Osowski v. AMEC Constr. Mgt., Inc., 69 A.D.3d 99, 106 (1st Dept 2009); see also City of New York v. Maul, 118 A.D.3d 401 (1st Dept 2014).

Plaintiffs' argument that they have already provided ample discovery into its investments in First Franklin Bonds is unavailing. The documents produced by Ambac regarding its loss mitigation with respect to the RMBS portfolio shows that

Ambac has engaged in loss mitigation strategies.² Ambac has failed to provide sufficient information to defendants' regarding these forms of loss mitigation.

Ambac has also failed to produce documents that suggest Ambac is continuing to develop ways to mitigate its RMBS losses. In October 2015, Ambac introduced a "pilot program to invest in residential real estate owned properties within Ambac insured transactions." Miller Aff. Exh. G at 3. The documents that Ambac have already provided do not enable defendants to calculate the appropriate mitigation offset. For example, the data table that Ambac argues that it has provided to defendants are mostly redacted, including the amounts that Ambac recouped from its insurance payment obligations as a result of its bond repurchases.

Ambac argues that the repurchases of bonds related to the Transaction do not constitute loss mitigation because Ambac had the "subjective intent" to buy the bonds regardless of the alleged contractual breaches. However, other than the policy documents that were produced by Ambac, there are further documents relating to the transaction bonds that Ambac is hereby ordered to produce. Ambac's argument

² The ALCO Loss Mitigation Investments Policies and Procedures shows eight varying methods of loss mitigation that Ambac may have engaged in. These include: (1) negotiated settlements with insured holders, issuers or other transaction counterparties which result in the full or partial termination of Ambac's insured obligations; (2) Negotiated settlement with one or more insured policy holders which eliminated a portion of the insured obligation while the underlying policy remains in full force and effect; (3) Purchase of Ambac insured securities in the open market. Purchased securities may be permanently held, held for future sale, or repackaged and sold as uninsured instruments; (4) The termination of reinsurance agreement or entering into new reinsurance agreements; (5) Tender offers which either fully or partially eliminate insured exposure on underlying transactions; (6) External capital provider purchases Ambac insured securities with the option of selling in insured cash flows to Ambac; (7) Hedging techniques principally through derivative instruments which effectively target and reduce existing Ambac obligations; and (8) Contractual full or partial transfers of Ambac insured obligations to third parties resulting in a new payment or receipt of funds.

that these documents are not transaction-specific is without merit, as any document that refers to the Transaction, whether by name or not, is material and necessary to defendants' inquiry as to Ambac's loss mitigation activity.

Finally, Ambac's production related to ESI is insufficient. The documents that Ambac produced on February 19, 2016 consisted of substantially redacted spreadsheets, which has rendered them unusable by defendants. The emails produced by Ambac are similarly unusable as they consist almost exclusively of transmissions for the spreadsheets and do not contain any substantive insight into the decision-making surrounding Ambac's repurchases of the bonds related to the Transaction. The court finds that discovery into these types of loss mitigation activities are material and necessary to understanding Ambac's loss mitigation strategies as it relates to the Transaction.

Therefore, defendants motion compelling plaintiff to comply with Request Nos. 62-66 regarding Ambac's repurchases of bonds and additional loss mitigation efforts with respect to the Transaction is granted.

Defendant's Request for Discovery Regarding Ambac's Repurchases of Bonds and Loss Mitigation Efforts Across its Entire Insured RMBS Portfolio.

Defendant's motion compelling plaintiff to comply with Request Nos. 67-69 regarding Ambac's repurchases of bonds and additional loss mitigation efforts with

respect to its entire insured RMBS portfolio is granted as to the LMI Memos produced by Ambac and denied as to all other discovery regarding Ambac's efforts to mitigate its losses from other RMBS deals.

In determining the scope of a discovery request, the court has broad discretion to impose appropriate limitations. See Ferguson v. City of N.Y., 280 A.D. 2d 382 (1st Dept 2001); Saratoga Harness Racing Inc. v. Roemer, 274 A.D.2d 887 (3d Dept 2000). Litigants may not demand any and all documents in a discovery request and a court may limit disclosure where the discovery request is overly broad and unnecessarily burdensome and concerns collateral matters. Haller v. North Riverside Partners, 189 A.D.2d 615, 616 (1st Dept 1993); see also Albert v. Time Warner Cable, 255 A.D.2d 248 (1st Dept 1998).

In determining whether a party acted reasonably in mitigating its damages, the court must apply an objective standard test. Williams v. Bright, 230 A.D.2d 548 (1st Dept 1997) (reaffirming the settled law that the injured party has a duty to "use means that a reasonably prudent person would have used" to mitigate damages "under the circumstances"). Defendants' assert that in order to properly apply this objective standard, this court should look to a party's mitigation activities in comparable commercial transactions. See Granite Partners L.P. v. Merrill Lynch, Pierce, Fenner & Smith Inc., No. 96 Civ. 7874, 2002 WL 826956, at *5 (S.D.N.Y.

May 1, 2002); see also Aristocrat Leisure Ltd. V. Deutsche Bank Trust Co. Americas, 262 F.R.D. 293, 295 (S.D.N.Y. 2009).

In Aristocrat Leisure, the court granted defendant's request for discovery into both the mitigation efforts of plaintiffs that held open their short positions and into loss mitigation efforts of plaintiffs with comparable closed positions. Id. at 296. In determining that plaintiffs had failed to mitigate damages by holding their short positions in the defendant's company open after the alleged breach, the court held that "in resolving the mitigation issue, the trier of fact should consider all of the evidence *related to the [plaintiff's] strategies.*" Id. (emphasis added). The court added, "where there is no clear, established market practice applicable to this particular set of circumstances, and each Bondholder adhered to a different course of action with respect to its short positions, evidence relating to the...hedging *strategies is particularly probative* of the reasonableness of the...parties' actions." Id. at 298 (emphasis added). Contrary to defendant's assertions, the court in Aristocratic Leisure did in fact limit the scope of its discovery only to those strategies that were probative of the parties' actions.

In applying the Aristocratic Leisure court's limitation on discovery to material and necessary strategies used by Ambac, this court finds that the LMI memos³

³ The ALCO Policies and Procedures expressly require a party seeking approval for any loss mitigation activity to submit an LMI Memo comparing the requested loss mitigation proposal against a base case, a stress case, and four other comparable loss mitigation transactions.

produced by Ambac are material and necessary to defendant's discovery request. However, defendant's request for discovery regarding information regarding Ambac's portfolio-wide bond repurchase and loss mitigation programs is denied. Defendant's seek these documents in order to determine whether Ambac bought other Ambac-insured RMBS at less-discounted prices rather than using those funds to purchase additional Transaction securities at deeper-discounted prices, the decision-making processes surrounding any prioritization of Ambac's RMBS repurchases, and whether Ambac's actions in this regard were reasonable.

However, how the other transactions are mitigated is not material and necessary to this Transaction. Defendants' concede that if this court were to grant their discovery request into all of Ambac's transactions, which number in the many hundreds, that they will likely assert that Ambac should have invested its money differently so as to purchase additional First Franklin bonds. See Oral Argument, pg. 26. This would lead to multiple mini-trials in order to determine the reasonableness of the loss mitigation strategy used for each of the transactions that Ambac engaged in. This type of inquiry is not material and necessary as to whether Ambac's loss mitigation strategies were reasonable in this particular Transaction. Nor are these requests within the spirit of the commercial rules which encourage "proportionality in discovery" to effectively resolve matters. Uniform Civil Rules for the Supreme Court and the County Court, § 202.70(g).

Plaintiff's Request to Postpone Decision on Defendants' Motion to Compel

Plaintiff's request to postpone decision on defendants' motion to compel is denied. Plaintiff has requested that this court postpone a ruling on the motion until the First Department issues a decision in the pending appeal of Ambac Assurance Corp. v. Countrywide Home Loans, Inc., Index No. 651612/2010, Do. No. 1672 (Sup. Ct. N.Y. Cnty. Oct. 27, 2015). Ambac states that it expects the case to be heard in the September term and in order to spare the parties the need to engage in additional discovery, this court should postpone its ruling. However, as defendants' point out, it is unclear as to when the First Department will hear this case and it is likely that a ruling will not be given until the end of the year or even 2017.

Furthermore, the justice in Ambac v. Countrywide declined to address whether the information sought was material and necessary. See id. The court held that Countrywide had failed to make out a prima facie case on mitigation because the only evidence Countrywide presented was the understanding of one of its experts that Ambac repurchased bonds in RMBS at issue in that case. Id. Additionally, the court held that the discovery request was untimely. Id. Finally, Countrywide's argument that the information was critical to determining mitigation was not considered. Id. Therefore, it is not clear whether the First Department will address whether Ambac's RMBS purchases constitute loss mitigation. Accordingly, plaintiffs' request to postpone a decision on the motion is denied.

It is hereby

ORDERED that defendants' motion to compel plaintiffs to provide documents and communications related to Ambac's bond repurchase program with respect to bonds in the Transaction is granted (requests 62 – 65); and it is further

ORDERED that defendants' motion to compel plaintiffs to provide documents and communications concerning Ambac's additional loss mitigation efforts with respect to the Transaction is granted (request 66); and it is further

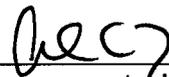
ORDERED that defendants' motion to compel plaintiffs to provide documents and communications concerning Ambac's repurchases of bonds across its insured RMBS portfolio is denied (requests 67 – 69); and it is further

ORDERED that defendants' motion to compel plaintiffs to provide documents and communications related to Ambac's loss mitigation efforts with respect to its insured RMBS portfolio is denied, except as this decision and order pertains to the LMI Memos (requests 67 – 69); and it is further

ORDERED that plaintiffs request to postpone a decision on defendants' motion to compel is denied; and it is further

ORDERED that plaintiffs have 45 days to comply with this decision and order.

Date: July 8, 2016
New York, New York



Anil C. Singh