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COURT OF APPEALS

STATE OF NEW YORK

NOMURA HOME EQUITY LOAN, INC., SERIES
2006-FM2, BY HSBC BANK USA, NATIONAL
ASSOCIATION,

Respondent,

No. 39

-against-

NOMURA CREDIT & CAPITAL, INC.
(and three other actions)

Appellant.

20 Eagle Street
Albany, New York
March 22, 2017

Before:

ASSOCIATE JUDGE JENNY RIVERA
ASSOCIATE JUDGE SHEILA ABDUS-SALAAM
ASSOCIATE JUDGE LESLIE E. STEIN
ASSOCIATE JUDGE EUGENE M. FAHEY
ASSOCIATE JUDGE ROWAN D. WILSON

Appearances:

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Sara Winkeljohn
Official Court Transcriber

1 JUDGE RIVERA: Last case on for this afternoon,
2 Nomura Home Equity Loan v. Nomura Credit & Capital.

3 Counsel.

4 MR. FRANK: May it please the court, Your Honor;
5 Joseph Frank, Shearman & Sterling, for the Nomura
6 appellants. Your Honor, I'd like to reserve two minutes
7 for rebuttal, if I may.

8 JUDGE RIVERA: Yes.

9 MR. FRANK: The question before the court today
10 is whether or not you should reaffirm long-standing New
11 York precedent that a specific sole remedy provision in a
12 contract can be voided by appealing to a more general
13 provision in that same contract. This court's decision in
14 the Westmoreland Coal case in 2003 is on all fours and is
15 dispositive.

16 JUDGE RIVERA: Can - - - can you explain that
17 argument? Is - - - is it your position that if - - - if we
18 were to agree with the Appellate Department that then there
19 is no basis for seeking relief based on the individual
20 loans because the - - - the claims are all about the
21 individual loans? I'm just not clear as to what your
22 argument is.

23 MR. FRANK: If I may, Your Honor, there are two
24 provisions in the contracts at issue. There's Section 8,
25 which is entitled "mortgage loans" and talks about the

1 characteristics of the mortgage loans. There are reps
2 given. And that provision is subject to a sole remedy
3 provision that was bargained for by the parties that says
4 if that's the kind of breach you've got - - -

5 JUDGE RIVERA: No, no, no. But I - - - no. I'm
6 not understanding the argument that somehow if - - - if we
7 were to agree with the Appellate Division just in - - - in
8 the abstract, that someone in the position of the - - - of
9 the trustee is also foreclosed, because I thought that's
10 where your argument was going, from - - - from pursuing
11 remedies under that other clause, that sole remedy
12 provision.

13 MR. FRANK: That is not our argument.

14 JUDGE RIVERA: Okay.

15 MR. FRANK: The argument is that the sole-ness of
16 the remedy would fall away. In other words, the bargain -
17 - - the parties bargained for a single remedy that applies
18 to Section 8 by saying all of our allegations deal with
19 Section 8, they're all about the loans, and that's what
20 parties carved out and bargained for. You only get this.

21 JUDGE RIVERA: But it's - - - it's sole-ness as
22 to what, right? That's where the rubber hits the road.

23 MR. FRANK: And - - - and the parties answer to
24 that question, Your Honor, in their contract they say the
25 Section 7, which is the part of the agreement, that - - -

1 that the plaintiffs, with respect, kind of scrubbed and
2 said here's another provision we could argue about as a
3 breach. And if you look at the structure of the contract
4 as the court below did - - - and - - - and I think this is
5 an important point, Your Honor, the court below in - - - in
6 the trial court made a legal finding after examining the
7 complaint. What was that legal finding, and it was not
8 disturbed at all by the Appellate Division.

9 And I'm quoting from page 18 of the opinion, the
10 complaint, the plaintiff's complaint, says the trial court,
11 "Does not allege any breach, any breach, of the no untrue
12 provision," that's the broader one from Section 7 that the
13 - - - that the plaintiffs contend doesn't have a sole
14 remedy, "that was not also a breach of the mortgage
15 representations to which the sole remedy provisions apply."
16 Right. So what we have here, Your Honor, is that if you
17 have a breach alleged of two different contractual
18 provisions, Section 8, which has the sole remedy provision
19 the parties bargained for, and Section 7, and it's the same
20 underlying conduct that breaches both and the court says
21 you can pursue damages under the broader provision, then
22 the remedy as to Section 8 is no longer sole.

23 JUDGE RIVERA: If - - -

24 MR. FRANK: And is rendered - - -

25 JUDGE RIVERA: If they have a claim based on

1 conduct that doesn't necessarily result in - - - in a loan
2 going in default, does that survive your argument?

3 MR. FRANK: So the parties agreement - - -

4 JUDGE RIVERA: I know your position is they
5 haven't made such an argu - - - but let's assume - - -

6 MR. FRANK: Sure.

7 JUDGE RIVERA: - - - that they had tried to make
8 such an argument.

9 MR. FRANK: You're - - - first, Your Honor,
10 you're correct. They made no such argument. They made no
11 such allegation. There are circumstances that are Section
12 7 violations that don't have to do with the mortgage loan
13 characteristics. So what is Section 7 about? It's a
14 laundry list of general representations. Nomura's properly
15 organized. Nomura has authority to enter into the
16 contract. The contract does not violate the law.

17 JUDGE ABDUS-SALAAM: But your position, counsel -
18 - -

19 MR. FRANK: And it goes on.

20 JUDGE ABDUS-SALAAM: Your position is those are
21 the only representations that would be subject to the no
22 untrue statement provision that we were talking about in
23 Section 9?

24 MR. FRANK: What I'm saying, Your Honor, is that
25 there are two sections of enumerated reps, 7 and 8. Those

1 are the only ones in the contract. 7 contains the no
2 untrue rep, and it's the general representations. The
3 parties bargained for a different remedy for the specific
4 representations of 8. If they were - - -

5 JUDGE STEIN: Okay. But aren't - - -

6 MR. FRANK: I'm sorry.

7 JUDGE STEIN: Aren't there - - - couldn't there
8 be some allegations and - - - and they may or may not have
9 been made here, but I - - - I thought an allegation was
10 made here that - - - that there was a general
11 representation about the percentage of these underlying
12 mortgage loans that were likely to be foreclosed. And - -
13 - and that doesn't go to any individual mortgage loan
14 representation. Would - - - where - - - where does that
15 fall, in your view, on - - - on this line?

16 MR. FRANK: All of the prov - - - all of the
17 representations that the plaintiffs claim in their
18 complaint are either specific Section 8 violations or the
19 aggregation of specific Section 8 violations. So you can
20 do the math, in other words, it all comes down to nothing
21 that they allege is not in Section 8.

22 JUDGE WILSON: Can I ask you a practical ques - -
23 - I'm sorry. Over - - -

24 MR. FRANK: I'm sorry, Your Honor.

25 JUDGE WILSON: Our audio system is new, and it's

1 not exactly working correctly.

2 MR. FRANK: I thought someone was behind me.

3 JUDGE WILSON: Yeah. We're going to try and fix
4 it.

5 MR. FRANK: I apologize.

6 JUDGE WILSON: What is the practical difference
7 to you in terms of damages recoverable if we were to allow
8 the mortgage-related Section 8 claims also to proceed under
9 Section 7 or if we weren't? Is there any economic
10 difference to you?

11 MR. FRANK: So there is a huge difference to the
12 plaintiffs, right. The plaintiffs have gone through
13 gymnastics, frankly, to try to get out of the sole remedy.
14 The proof, the answer to your question, Your Honor, about
15 what the modicum of that would be different is to be proven
16 at trial or through expert witnesses. But, for example,
17 the plaintiffs sought punitive damages. They sought all
18 sorts of different kinds of consequential damages. So
19 although I can't quantify how much it would be different,
20 that it is different is certain and that the parties
21 bargained for certainty in this context is also true. They
22 bargained for the - - - for the - - -

23 JUDGE RIVERA: Well, they also bargained for
24 protocols to be followed, right. So their - - - their
25 argument is there's a whole bunch of protocols and promises

1 that were breached. It just wasn't followed - - - yes.
2 They may have very well resulted in ninety-eight percent of
3 these loans not being of the kind that meet the
4 requirements and the standards and that that's what they
5 want to get to. Isn't that sort of what they bargained for
6 that they are now saying they should be able to assert a
7 claim on and - - - and get damages for?

8 MR. FRANK: Your Honor - - -

9 JUDGE RIVERA: I mean they - - - they certainly
10 didn't enter an agreement thinking ninety-eight percent of
11 these loans are worthless.

12 MR. FRANK: Right.

13 JUDGE RIVERA: Right? I mean you - - - you've
14 flipped it around. Isn't that provision about finding
15 aberrations to the promises? Some of those loans, a small
16 percentage, will be problematic otherwise, you lose the
17 remedy status and the rest of this thing but not that whole
18 cloth these loans are in default or will be in default
19 because they don't meet the standards.

20 MR. FRANK: With respect, Your Honor, there is
21 loan characteristic problems and there are non-loan
22 characteristic problems.

23 JUDGE RIVERA: Okay.

24 MR. FRANK: And the loan characteristic problems
25 are in Section 8, and the plaintiff only makes those

1 allegations. Except on appeal where they include new
2 allegations that are not in their complaint so for - - -
3 for the first time, which, of course, is not permitted.
4 But, for example, page 10 of their brief, Your Honor, they
5 say at the second line from the first full paragraph, "The
6 broader message," and I think this is related to the point
7 you're making, Your Honor, "The broader message of Nomura's
8 statements is that the loan pool at the heart of this
9 transaction was not materially defective." They say that
10 at page 10 of their appellate brief, nowhere in their
11 complaint, no quote, no citation, no nothing because it's
12 not there.

13 Similarly, Your Honor, on page 19, if one were to
14 look at the last five lines of the first full paragraph on
15 that page, they - - - they say, "Taken together," this is
16 the macro point, "Nomura's statement is plainly
17 communicated." I would not as an aside with respect to
18 counsel, we're in trouble if we're arguing about kind of
19 the meta-meaning of statements rather than the statements
20 themselves. "Taken together, Nomura's statement is plainly
21 communicated that the loan pool is viable and that any
22 defects would be few, far between, and efficiently
23 addressed." Now there, again, no quotes but they do cite
24 two paragraphs of the complaint, paragraph 37 and 38. The
25 trial court looked at those as well as all the others. And

1 if one - - - and if this court were to look at them, the
2 answer is that they all have to do with Section 8
3 violations.

4 JUDGE ABDUS-SALAAM: Your - - - your - - -

5 MR. FRANK: It all comes down to that.

6 JUDGE ABDUS-SALAAM: Counsel, your argument is no
7 matter how many of these loans, as Judge Rivera is saying,
8 even if ninety-eight percent of them turned out to be,
9 essentially, for lack of a better term, bad loans, all of
10 the allegations, no matter what the number of loans is, go
11 to the loan documents, not to any other section?

12 MR. FRANK: Correct.

13 JUDGE ABDUS-SALAAM: The representation about the
14 loans.

15 MR. FRANK: Correct, Your Honor. And that's the
16 argument that the plaintiffs want to make, this argument of
17 pervasive breach, right. Court after court after court has
18 rejected that that when the parties bargained for this
19 specific remedy for the first violation or the first
20 breach, the same remedy - - - sole remedy for the second
21 breach, the third one for the breach there's no limit - - -

22 JUDGE RIVERA: So - - - so - - -

23 MR. FRANK: - - - after which you become
24 pervasive.

25 JUDGE RIVERA: This all turns on - - - on the

1 contract. May I just ask, is this contract - - - because -
2 - -

3 MR. FRANK: Sure.

4 JUDGE RIVERA: - - - the Appellate Department
5 held differently in another case. Is this contract or the
6 language found in this contract what usually is contained
7 in the MLPA and the PSA, or was this an aberration? I'm
8 trying to find out which is the - - -

9 MR. FRANK: Sure.

10 JUDGE RIVERA: - - - typical, if you will - - -

11 MR. FRANK: Sure.

12 JUDGE RIVERA: - - - MLPA PSA.

13 MR. FRANK: Well, first of all, there are
14 thousands and thousands of securities - - - that are done.

15 JUDGE RIVERA: Yes. Of course.

16 MR. FRANK: And they are done routinely or not -
17 - -

18 JUDGE RIVERA: But amici has argued there's a
19 particular language that's used in these documents and
20 we're going to upset the entire industry - - -

21 MR. FRANK: And - - - and - - -

22 JUDGE RIVERA: - - - if we agree with the
23 Appellate Department.

24 MR. FRANK: And with respect, we agree with the
25 amici. And - - - and the reason is, Your Honor, these are

1 done as form transactions, one after the other after the
2 other. It is true that the language slightly differs in -
3 - - in different transactions. And the Appellate Court
4 distinguished its own prior decision in Ambac, same issue,
5 exact same issue, but they - - - they held our position.
6 And they were faced with how to distinguish this case, and
7 what they did - - - and this is a key error of the
8 Appellate Division, they looked at the central language of
9 the central contract between the parties, the PSA, the only
10 contract between the trustee and Nomura, the pooling and
11 servicing agreement.

12 And in that language, if we look at it, Your
13 Honor, this is on page 24 - - - I'm sorry, 23 of our brief.
14 And it is - - - says, "It is understood and agreed," this
15 is the language from the PSA, "that the obligations under
16 this agreement," which agreement, this PSA, the pooling and
17 servicing agreement, "of the sponsor to cure, repurchase,
18 or replace any mortgage loan as to which a breach has
19 occurred shall constitute the sole remedy against the
20 sponsor respecting such breach."

21 JUDGE FAHEY: All right. So - - -

22 MR. FRANK: Now the only way - - - I'm sorry,
23 Your Honor.

24 JUDGE FAHEY: So - - - take a step back for a
25 second. So - - - so that means that there can never be a

1 pervasive breach under your theory of that content.

2 MR. FRANK: Correct.

3 JUDGE FAHEY: What you're saying is every
4 individual loan, whether it is, like Judge Abdus-Salaam
5 said, ninety-two percent of them, it doesn't matter, each
6 one, you litigate each one, you put proof in on each one,
7 each breach is individual. And there's never a - - - ever,
8 ever. So - - - so what do you mean, then, by cumulative
9 remedy?

10 MR. FRANK: So, Your Honor, there - - - the
11 Section 13 - - -

12 JUDGE FAHEY: Right.

13 MR. FRANK: - - - which is the language of the
14 agreement - - -

15 JUDGE FAHEY: Right.

16 MR. FRANK: - - - that talks about remedies are
17 cumulative is a one-sentence provision along with, you
18 know, severability, et cetera.

19 JUDGE FAHEY: I - - - I get it.

20 MR. FRANK: And - - - and that provision, that
21 provision, relates in the same section to the transfer of
22 the loan subject to a lien where they're going from
23 different places, and obviously, this is all real property.
24 And what the parties intended there was not that their - -
25 - that their liens would somehow be invalidated or the

1 mortgagees would come back and say well, you only have the
2 - - - you know, a repurchase obligation, our liens are no
3 longer valid. That is - - - does not mean that when the
4 parties bargain for a specific remedy as to certain things
5 and a different remedy as to other things that somehow you
6 get both. That's not what cumulative means.

7 JUDGE WILSON: While we're on the PSA, I wanted
8 to ask you a question about it and then another question
9 about Section 9 and - - - of the agreement, and hopefully,
10 Mr. Shuster will address the same questions. Section 2.01
11 of the PSA provides that the - - - and I - - - the suit's
12 here by the trustee, that the trustee - - - I'm sorry.
13 That, "The depositor assigns to the trustee all of its
14 rights and interests under the mortgage loan purchase
15 agreement to the extent of the mortgage loans" - - -

16 MR. FRANK: Correct.

17 JUDGE WILSON: - - - "sold under the purchase
18 agreement." So presumably there are some other rights that
19 are not to the extent of the mortgage loans that have not
20 been assigned to the trustee.

21 MR. FRANK: Correct, Your Honor.

22 JUDGE WILSON: So that - - - and that's the first
23 thing that I wanted you to address. The second, which is
24 related, is that Section 8 contains, I think, sixty-two
25 different loan-specific representations. Section 9 governs

1 the repurchase obligation for breaches of those - - - any
2 of those sixty-two representations. And Section 9 says
3 that the representations and warranties in Section 8 "inure
4 to the benefit of any assignee, transferee, or designee
5 including the trustee."

6 MR. FRANK: Correct.

7 JUDGE WILSON: But Section 7, which is what's at
8 issue here, doesn't have that similar provision.

9 MR. FRANK: Precisely, Your Honor.

10 JUDGE WILSON: So what do you make of those two?
11 Do they fit together? How do you interpret those?

12 MR. FRANK: So this is a - - - this is a
13 principle argu - - - argument of the amici, and we also
14 advance this that there's a difference between the PSA and
15 the MLPA. The PSA, the pooling and servicing agreement, is
16 the direct contract between us. It governs the parties'
17 rights. And I note parenthetically that when you look at
18 it, there's an ellipses in - - - in the plaintiffs' brief
19 that - - - that leaves out the operative fact, it's the
20 same language as in Ambac. So there's no difference there.
21 The - - - the rub of the road, then, hits when the
22 plaintiffs want to assert rights under the second
23 agreement, the master loan purchasing agreement, to which
24 they are not a party but instead merely an assignee. And
25 although they suggest that they're a generalist assignee,

1 they're actually a limited assignee.

2 And the language that Your Honor references, "to
3 the extent of the mortgage loans," is precisely what we're
4 talking about, Section 8. We don't dispute that they have
5 rights as a limited assignee under Section 8, but even if
6 Section 7 meant what they say it means, which it does not,
7 it cannot be that they also then have those rights bec - -
8 - for the reasons that Your Honor points out, that they are
9 not an assignee as to those remedies under Section 7.

10 The last point in would make, Your Honor, I know
11 my time is limited, is that the parties intent is clearly
12 stated in the PSA language I talked about. The second
13 point that is dispositive here - - - and we - - - and we
14 live in the world of the real with respect to these
15 transactions - - - all of these transactions, thousands of
16 them, every single one of them is a REMIC transaction, a
17 real estate tax-favored transaction. The parties'
18 agreements, which are before the court in the record and
19 are undisputed, that they were done for the purpose of
20 getting that tax advantage income. Without it, the - - -
21 the transactions would not have occurred. And what does
22 the REMIC statute say, 860, Section 860, is the REMIC safe
23 harbor that says you - - - it is a REMIC transaction if and
24 only if you have a sole remedy of repurchase substitution -
25 - -

1 JUDGE STEIN: Not to sound like a broken record,
2 but did you raise that argument below?

3 MR. FRANK: Your Honor, we certainly raised - - -
4 I raised at the trial court the argument that these are
5 REMIC transactions, that that's at the heart of the - - -
6 of the understanding of the parties' contractual language.
7 The plaintiffs below argued the same thing, that they were
8 REMIC transactions, and that was key. The language in the
9 agreements themselves include all sorts of representations.
10 These are REMIC transactions. Watch out if they're not.
11 Don't do anything to disqualify the REMIC - - - the REMIC
12 nature of the transactions.

13 We need letters of counsel to make sure that
14 they're REMIC, and the - - - the key point here, Your
15 Honor, is that it requires the sole remedy to be cure,
16 repurchase, or substitution, and the language of Section 9,
17 the sole remedy, is the language drawn from the safe
18 harbor. And so what the plaintiffs want to do here is say
19 that's not right. You also get damages and get to run into
20 the fields with Section 7 violations and essentially render
21 meaningless the parties bargained for sole remedy in
22 Section 8.

23 JUDGE RIVERA: Thank you.

24 MR. FRANK: And that's not the law in New York.

25 JUDGE RIVERA: Thank you, counsel.

1 MR. FRANK: Thank you, Your Honor.

2 MR. SHUSTER: May it please the court, Michael
3 Shuster for the respondent trustees.

4 JUDGE STEIN: Would you address the assignment of
5 rights question that Judge Wilson asked - - -

6 MR. SHUSTER: Sure.

7 JUDGE STEIN: - - - first?

8 MR. SHUSTER: Yes. So let me start with the lang
9 - - - the express language of the agreements, and I'll - -
10 - I'll focus initially on - - - on that particular
11 language. The reason that clause is in there, "to the
12 extent of the mortgage loans sold," is not to circumscribe
13 the scope of the assignment that was done to the trustee.
14 The reason that's there is because loans are identified for
15 purposes of the mortgage loan purchase agreement but some
16 of the loans that end up in the trust can change. The
17 depositor under the mortgage loan purchase agreement and
18 the trustee under the mortgage loan purchase agreement both
19 have the right to reject loans after they've been selected
20 for securitization but prior to the closing of the
21 transaction and prior to depositing those loans into the
22 individual REMICs that comprise the overall trust.

23 So specifically the language, Section 13 of the
24 MLPA expressly provides that the - - - that the transfer of
25 loans are "subject to the purchaser's right prior to the

1 closing date to reject any mortgage loan to the extent
2 permitted by this agreement. Any mortgage loan rejected by
3 the purchasers shall concurrently herewith be released from
4 the security interest created hereby." There is equivalent
5 language with respect to the trustee in Sections 5(C) and
6 5(D). So the purpose of that limitation in the PSA is to
7 make clear that for loans that are not sold purs - - -
8 pursuant to the MLPA even though they were originally in
9 the list of loans, that the - - - that were intended to be
10 sold and were sold to the depositor, the trustee acquires
11 no rights pursuant to the assignment with respect to those
12 loans.

13 JUDGE FAHEY: Can - - - can - - -

14 MR. SHUSTER: That's the meaning of that
15 language. That's why it's in there.

16 JUDGE FAHEY: Can I just focus in for - - - for a
17 second on what I see as defendants' strongest argument, and
18 - - - and maybe you could address that directly is - - - is
19 plaintiffs' complaint doesn't seem to state any violation
20 of the no untrue statement provision, Section 7, that's not
21 also a breach of the representations and warranties in
22 Section 8. That seems to be the nub of what we have in
23 front of us today. I want you to address that.

24 MR. SHUSTER: Okay. So let me start with the
25 language that counsel read from the trial court's decision

1 is from - - - not from the trial court's decision in these
2 four cases but in a case called NAAC 2006-S4, which the
3 trial court then used as the predicate, at least
4 analytically, for the decisions that were rendered here.
5 But the trial court actually here does not engage in any
6 kind of meaningful analysis of the allegations in the
7 complaint to determine whether the - - - and that - - - the
8 allegations for purposes of the no untrue statement
9 provision overlap - - -

10 JUDGE FAHEY: Leaving that aside - - -

11 MR. SHUSTER: Okay.

12 JUDGE FAHEY: Let's - - - I don't care if they
13 didn't do an analysis. What I want to know is I'm asking
14 you - - -

15 MR. SHUSTER: Yes.

16 JUDGE FAHEY: - - - tell me today - - -

17 MR. SHUSTER: Okay.

18 JUDGE FAHEY: - - - what the violation is that's
19 separate in 7 from 8.

20 MR. SHUSTER: All right. So first of all, there
21 are allegations in the complaint, I'm reading from one of
22 the complaints, the - - - the NHELI 2007-2 complaint.

23 JUDGE FAHEY: And these are not covered by the
24 representations and warranties. So I'm assuming that it
25 wouldn't be an individual mortgage, but okay. You go

1 ahead.

2 MR. SHUSTER: "Nomura performed due diligence on
3 the mortgage loans before acquiring them for the
4 securitization." Okay. So let's stop there for a moment.

5 JUDGE FAHEY: Okay.

6 MR. SHUSTER: We know factually - - - we know
7 from the NHELI 2006-S4 decision I just mentioned that in
8 the course of performing due diligence, Nomura engaged
9 external due diligence providers, in this case, a company
10 called Clayton Holdings. We know that because that was
11 found by the - - - by the congressional Financial Crisis
12 Inquiry. It's part of the public record.

13 JUDGE FAHEY: Okay.

14 MR. SHUSTER: They engaged Clayton Holdings.
15 Clayton Holdings did due diligence for Nomura. Clayton
16 Holdings developed the - - - identified a high percentage
17 of loans that were not suitable for securitization. Nomura
18 had a practice of so-called waiving those loans into these
19 securitizations notwithstanding the findings of its own
20 external due diligence - - -

21 JUDGE ABDUS-SALAAM: Counsel, I - - - I'm sorry.
22 Maybe I'm missing something, but it seems to me that even
23 what you just said relates to mortgage loans.

24 MR. SHUSTER: Your Honor, the mere fact that it
25 relates to mortgage loans is not enough. The sole remedy

1 provision, on its terms, is absolutely crystal clear and
2 express that it applies only to claims on the
3 representations and warranties that are set forth in
4 Section 8. Things - - -

5 JUDGE RIVERA: But - - - but how are you going to
6 prove the claim that you're talking about? Aren't you just
7 going to drill down into these loans and - - -

8 MR. SHUSTER: Not - - - no.

9 JUDGE RIVERA: - - - show that they breached
10 these warranties and guarantees?

11 MR. SHUSTER: For - - - for example, this - - -
12 this is why I'm focusing on this due diligent point as an
13 example. The - - - the representation, the no untrue - - -

14 JUDGE RIVERA: I guess what does it matter if it
15 doesn't affect the loans? Aren't you back to the loans?

16 MR. SHUSTER: Because not - - - not - - - there
17 are losses in - - - across the pool that are not
18 necessarily attributable to a breach of one of the Section
19 8 representations and warranties. There were practices
20 that Nomura engaged in that led to the entire pool being
21 more risky than it represented it to be.

22 JUDGE RIVERA: But isn't that, again, back to
23 each of those loans?

24 MR. SHUSTER: No. Because we don't have to prove
25 - - - we could have sued on the no untrue statement

1 provision, said that the - - - that the loan pool was
2 riskier - - -

3 JUDGE STEIN: But have - - -

4 JUDGE WILSON: Then you're - - - then you're sort
5 of reading out of the specific representations any meaning.
6 Because what you're - - - you're effectively saying is
7 there's sixty-two specific representations, but there's
8 some other things that Nomura could - - - that could have
9 done that injured us that caused the loan pool to be
10 worthless, and those are captured by Section 7 despite the
11 fact that they're listed among the sixty-two the parties
12 bargained for.

13 MR. SHUSTER: Well, there's two aspects to it.
14 One is there are, in fact, representation - - - the matters
15 respecting the loans that are not embodied in the Section 8
16 representations but that are in the documentation that are
17 covered by the no untrue statement provision. For example
18 - - -

19 JUDGE WILSON: When you say the documentation
20 covered by, what do you mean?

21 MR. SHUSTER: Well, the no untrue statement
22 provision applies to all documents prepared or furnished -
23 - -

24 JUDGE WILSON: Doesn't it say prepared and
25 furnished?

1 MR. SHUSTER: It says all - - - it may say
2 prepared and furnished, but regardless, I don't think - - -

3 JUDGE WILSON: The documents in the mortgage
4 files aren't prepared by Nomura, right?

5 MR. SHUSTER: Right.

6 JUDGE WILSON: So they're not prepared and
7 furnished by Nomura.

8 MR. SHUSTER: I'm not referring to the mortgage
9 files now, though. I'm referring to statements that Nomura
10 makes, for example, in the prospectus supplement. That's a
11 document prepared and furnished by Nomura in connection
12 with the transaction. In that document, Nomura, for
13 example, describes its - - - its underwriting practices but
14 it doesn't mention that it has a practice of waiving in
15 loans its own external due diligence provider had
16 identified as not suitable for securitization. In the
17 prospectus supplement, Nomura provides aggregate
18 characteristics not - - - not loan by loan, but aggregate
19 characteristics concerning loan-to-value ratios across the
20 pool.

21 JUDGE STEIN: But doesn't that practice of
22 waiving the loans get - - - have to get you down to the
23 fact that the loans themselves were noncompliant? How else
24 do you prove this practice - - -

25 MR. SHUSTER: You prove - - -

1 JUDGE STEIN: - - - without showing that - - -
2 that, in fact, the loans that they - - - that were in due
3 diligence identified as not being appropriate loans, then
4 don't you have to show that they weren't appropriate loans?

5 MR. SHUSTER: So let - - - let me just finish the
6 point on - - - on the loan-to-value ratios and the weighted
7 average credit scores. For example, Nomura makes
8 representations concerning the weighted average credit
9 ratios in the loan pool concerning loan-to-value ratios in
10 the loan pool. Those are representations, those are
11 statements, along with others, it chose to make in the
12 prospectus supplement, that it prepared and furnished in
13 connection with the transaction. Those are not embodied in
14 specific representations in Section 8. What Section 8 does
15 not permit Nomura to do is to lie about everything that's
16 not embodied in a representation of Section 8. Section 8
17 does not encompass the entire universe of things that
18 Nomura said or could say - - -

19 JUDGE RIVERA: Right. But aren't - - - aren't we
20 back to the only reason you care about things is the impact
21 on the loan? I mean I hate to put it crassly, but at the
22 end of the day, isn't it whether or not that affects these
23 loans?

24 MR. SHUSTER: It - - - it affects whether the
25 loans - - -

1 JUDGE RIVERA: I mean would you really care if
2 they didn't follow the protocols if the loans weren't, as
3 you say, ninety percent or whatever it is, in default?

4 MR. SHUSTER: Well, it - - - it affects whether
5 the loans - - - whether this loan pool should have been
6 securitized at all, whether it was riskier and less stable
7 overall than it was represented to be, whether - - - and
8 whether, for example, what you have several thousand
9 breaching loans. So what I'm saying is there are - - -

10 JUDGE WILSON: Each of which you have a right to,
11 under Section 8 - - -

12 MR. SHUSTER: Well, but - - -

13 JUDGE WILSON: - - - to get recompense for.

14 MR. SHUSTER: But I'm - - - I'm focusing on,
15 first, the fact that - - -

16 JUDGE RIVERA: Maybe it's a foolish question, but
17 - - - but if the loans aren't bad loans, what - - - why
18 would you pursue - - -

19 MR. SHUSTER: Loans - - -

20 JUDGE RIVERA: - - - these claims?

21 MR. SHUSTER: Loans can be riskier than they're
22 represented to be without violating one of the specific
23 representation in Section 8. That's why Nomura makes pool-
24 wide representations about loan-to-value ratios, about
25 average credit weighting, even though those matters are not

1 embodied in Section 8 because they're rel - - - they're
2 relevant to an evaluation of the loan pool overall - - -

3 JUDGE ABDUS-SALAAM: And where - - - where in the
4 agreement, either the - - - the mortgage loan purchase
5 agreement or in the PSA does it say anything like pool
6 level loans versus loan level loans?

7 MR. SHUSTER: So where it says that for - - -
8 among other places, but where it does say it is in the
9 prospectus supplement, and there is express allegations in
10 the complaints here that there are false statements and
11 material omissions in the prospectus supplement. That's
12 where it said those are documents prepared and furnished by
13 Nomura pursuant to the MLPA or in connection with the
14 securitization. So those statements are there. That - - -
15 the no untrue statement provision is a blanket promise that
16 Nomura chose to make. It's not present in all sellers and
17 sponsors securitization.

18 JUDGE STEIN: The question is is what did it
19 cover.

20 MR. SHUSTER: Right. The - - - but - - -

21 JUDGE STEIN: And it clearly made that.

22 MR. SHUSTER: So - - - but what we - - -

23 JUDGE STEIN: And it covers something. We agree
24 it cover - - -

25 MR. SHUSTER: Exactly.

1 JUDGE STEIN: And - - - and they say it covers a
2 very defined - - -

3 MR. SHUSTER: They don't say what it covers.
4 What - - - they make no real attempt. We - - - we know - -
5 -

6 JUDGE STEIN: Well, yeah. Well, they - - - they
7 talk about the representations in Section 7.

8 MR. SHUSTER: Well, but Section - - -

9 JUDGE STEIN: Which are general representations
10 about their - - - their, you know, license and their
11 qualifications - - -

12 MR. SHUSTER: Well - - -

13 JUDGE STEIN: - - - and their makeup and their -
14 - - and all that kind of stuff.

15 MR. SHUSTER: So one thing I know as a matter of
16 contract construction, the - - - the Section - - - the
17 Section 7 no untrue statement provision has to mean
18 something.

19 JUDGE STEIN: Right.

20 MR. SHUSTER: And I can also say what it doesn't
21 mean is that all the other Section 7 representations are
22 true. It doesn't mean that because those other Section 7
23 representations say they're true. You don't make ten
24 representations that you say are true and then make another
25 one saying nothing I'm saying is untrue and I'm disclosing

1 everything I have to disclose that applies only to other
2 express representations.

3 JUDGE RIVERA: So can I ask perhaps - - -

4 JUDGE FAHEY: Isn't - - - isn't that your
5 strongest point that if Section 8 covers everything what's
6 the point of Section 7, right?

7 MR. SHUSTER: What is the point of that provision
8 is - - -

9 JUDGE FAHEY: That - - - that's your strongest
10 point.

11 MR. SHUSTER: Yes.

12 JUDGE FAHEY: Yeah.

13 MR. SHUSTER: That it has to mean something. It
14 has - - -

15 JUDGE RIVERA: So - - -

16 MR. SHUSTER: It has to have content.

17 JUDGE RIVERA: So if I'm trying to understand
18 this in the simplest way I can, and perhaps it's not a good
19 example and you'll correct me if that's the case. So your
20 argument then it's one thing to say individual loans don't
21 satisfy these warranties and promises that are in Section
22 8, and it's a different thing to say, well, maybe they do
23 partially or maybe they do mostly but overall, the pool is
24 riskier and I've lost something of value because the pool
25 is riskier. Maybe I don't make as much money off these

1 loans as I would have otherwise. Is that what you're
2 getting to?

3 MR. SHUSTER: Well, that - - - that's - - -

4 JUDGE RIVERA: Or am I misunderstanding the
5 argument?

6 MR. SHUSTER: That's part of it. That's part of
7 it. That the - - - that the loan pool is riskier than it
8 was represented to be.

9 JUDGE RIVERA: But - - - but riskier meaning
10 what?

11 MR. SHUSTER: Riskier meaning that it had higher
12 loan-to-value ratios than was represented. Riskier meaning
13 that - - - that there were lower average credit scores than
14 there should - - - than were represented. But - - -

15 JUDGE RIVERA: Is that different from the - - -

16 MR. SHUSTER: Those are not representations in
17 Section 8. Risky - - -

18 JUDGE RIVERA: And - - - yes. I understand.

19 MR. SHUSTER: Okay.

20 JUDGE RIVERA: But do they not end up - - -

21 MR. SHUSTER: They don't.

22 JUDGE RIVERA: What you just described doesn't -
23 - - are you arguing that it doesn't necessarily end up with
24 something that ends up being a breach of the warranties and
25 promises in Section 8?

1 MR. SHUSTER: It doesn't. It - - - it may not be
2 - - -

3 JUDGE RIVERA: They can be separate and apart?

4 MR. SHUSTER: - - - a breach of Section 8. It -
5 - -

6 JUDGE RIVERA: And they constitute some value to
7 your client?

8 MR. SHUSTER: Well, they - - - they resulted in a
9 loan pool that had massive defaults, right. And - - -

10 JUDGE RIVERA: Well, now we're back to the loans,
11 right?

12 MR. SHUSTER: Well, no. No. I'm talking - - -
13 no. But - - - but just because you're back to the loans
14 doesn't mean you're within the ambit solely of the Section
15 8 representations and warranty. This is, after all, a
16 securitization of loans. Everything you're talking about
17 in some way - - - in some way relates to the mortgage
18 loans, but that is not the defined scope of the sole remedy
19 provision. The defined scope is representations and
20 warranties in Section 8.

21 Two more points, quickly. One the - - - there's
22 a different standard in the no untrue statement provision
23 than there is in the Section 8 reps. In Section 8, if
24 there's a breach, there's a breach, and the loan is subject
25 to repurchase. In Section 7, the - - - there's a

1 materiality standard that applies across the transaction.
2 You can have dozens or scores of breaches of Section 8
3 representations and warranties that don't trigger a breach
4 of the Section 7 no untrue statement provision. The reason
5 we're here having this discussion is because there are so
6 many breaches that they rise up to the level of a
7 transaction-wide - - - of a - - -

8 JUDGE STEIN: How many is so many, fifty percent,
9 forty percent, sixty percent?

10 MR. SHUSTER: Well, fifty percent as - - - as
11 Your Honor mentioned, the - - - the sole remedy provision
12 was never intended to go this far out to sea. It was
13 intended for individual loan breaches in these
14 securitizations. It wasn't intended for thousands of loan
15 breaches. I'm not saying it doesn't apply and can't apply
16 on a loan-by-loan basis, but I'm saying there are so many
17 breaches here - - -

18 JUDGE ABDUS-SALAAM: But I think what Judge Stein
19 - - -

20 MR. SHUSTER: - - - that it's - - -

21 JUDGE ABDUS-SALAAM: - - - has asked, counsel, is
22 you say fifty, sixty percent, but we may be faced with
23 cases where it might be ten, twenty percent. Where do we
24 draw the line on how many is too many?

25 MR. SHUSTER: Well, the line is materiality. The

1 question the - - -

2 JUDGE STEIN: And wouldn't be - - - we'd be in a
3 different place if the parties - - - the very experienced
4 parties who formed this contract defined what materiality
5 was and said if - - - if it rises to this level, then, you
6 know, why don't you stay - - -

7 MR. SHUSTER: We know only that they use the word
8 "materiality" and that materiality is often used in
9 commercial agreements and that it can't be defined by a
10 bright-line test for all purposes.

11 JUDGE STEIN: But that's in Section 7. There - -
12 - there's - - - as you say, there's no materiality
13 requirement or standard in Section 8. And so if - - - if
14 that was going to somehow change the rules about the sole -
15 - - the sole remedies provision wouldn't you think that the
16 contract would - - -

17 MR. SHUSTER: There's a - - -

18 JUDGE STEIN: - - - would say that more clearly?

19 MR. SHUSTER: There's a materiality standard on
20 an individual loan basis in Section 8. It's not elaborated
21 there, either. It's just material. If it's a material
22 breach of an individual loan. But - - - but we - - -

23 JUDGE ABDUS-SALAAM: We could also interpret - -

24 -

25 MR. SHUSTER: But - - -

1 JUDGE ABDUS-SALAAM: Counsel, we could also
2 interpret these documents as - - - this contract as there
3 is a bright-line, a sole remedy, which is provided for and
4 that is either replace the loan or repurch - - - or
5 purchase - - - repurchase it or - - -

6 MR. SHUSTER: Your Honor, the difficulty with
7 that - - - and - - - and counsel mentioned the Westmoreland
8 case, and they rely on the Noble Lowndes case and on
9 Giancontieri. In all of those cases, the court made an
10 effort to reconcile the competing provisions that were at
11 issue. With all due respect, that was not done here at the
12 trial court level. The trial court at no point said here
13 is Section 7.5, the no untrue statement provision, here's
14 what I think it means, I'm delineating the scope, here are
15 your allegations, do they or don't they make out a claim
16 under the no untrue statement provision. Here's how the no
17 untrue statement provision and the Section 8 reps interact.

18 So you - - - you could rule that way, but,
19 respectfully, that would be reading the no untrue statement
20 provision entirely out of the agreement. It's there. It's
21 a representation Nomura chose to make. It controlled these
22 documents. It made sweeping representations that there are
23 no untrue facts and there are no material omissions. Those
24 are important statements and there is no basis under the
25 sole remedy provision to read those out of the agreement

1 because the sole remedy provision by its expressed terms
2 does not apply to that entire section of the mortgage loan
3 purchase agreement.

4 JUDGE RIVERA: Thank you, counsel.

5 MR. SHUSTER: Thank you.

6 MR. FRANK: May it please the court, briefly,
7 Your Honor, I'd like to talk about four issues that are
8 responsive to questions that were raised by - - - by the
9 panel. Before I do so, however, I'd direct the court to
10 page 6 of our brief, which goes through, line by line, the
11 different ways that these allegations were made. In two of
12 the complaints, they just alleged that here are the
13 problems with the loans and they violate Section 7 and
14 Section 8. In another one, they did it in two separate - -
15 - or the other two they did it in two separate sections.
16 But the trial court's decision that everything related to
17 the mortgage loans that was alleged is correct in this
18 case. First of the four points, Your Honor - - -

19 JUDGE RIVERA: Why isn't he right that your
20 argument leads, inevitably, to reading out Section 7 from
21 the agreement that it's meaningless?

22 MR. FRANK: Well, first of all, Your Honor, it
23 doesn't, and that was precisely the point I was going to
24 make in - - - in an answer to a question from another
25 member of the panel. Section 7 has a lot in it that is not

1 related to mortgage loans. I talked about them on the
2 principle argument. I don't need to repeat them here. I'm
3 sure the court remembers. But there's also more in the
4 agreement than Section 7 and Section 8, things like Section
5 13 that talks about the transfer of security interest,
6 Section 2 and 3 that talks about title, Section, I believe,
7 4 where they - - - they talk about we're going to transfer
8 by a certain date. There's all sorts of reps that were
9 made that don't have to do with the characteristics of the
10 mortgage loans that are not in either Section 7 or Section
11 8. And indeed Section 7 talks about the things we talked
12 about before. So the no untrue statement does not - - - is
13 not - - - Section - - - of Section 7 is not read out of the
14 agreement. This court could give it a fact.

15 The second point that I would make, which is in
16 response to a question that was asked, was there's no
17 mention of pool level representations. That's - - - that's
18 the pervasive reach. That's one plus one plus one equals
19 sixty-four. The loan level diligence point that was made,
20 the allegations in the complaint, there are allegations
21 about loan level diligence in the complaint, but they are
22 always - - - always linked to specific Section 8 breaches.
23 This rep in Section 8 was wrong because this type of
24 diligence was not done or done.

25 The third point that I would make, Your Honor, is

1 that the reading of Section 7, the operative language, is
2 documents taken in the aggregate, that's the language,
3 taken in the aggregate. Not contain any untrue statement
4 of material fact. Essentially, that the - - - that the
5 documents that you're given are not materially defective.

6 JUDGE ABDUS-SALAAM: Does that include the
7 prospectus?

8 MR. FRANK: It does. It does. The - - - they
9 are not materially defective. And Mr. Shuster argues that
10 that then is not governed by the sole remedy limitation
11 that's in Section 9 but references Section 8. The one
12 thing that he does not note, however, Your Honor, is that
13 there are three parts to Section 9, which is the sole
14 remedy provision. And it's in the disjunctive. It talks
15 about what you do, how you cure or repurchase or - - - or
16 substitute. It says, "On discovery" - - - and obviously,
17 I'm - - - I'm leaving some things out that are not
18 material. But, "On discovery of any materially defective
19 document" - - - that's the first. So there's one within
20 the statement. "On discovery of missing documents," that's
21 the second. Or "A breach of the reps and the warranties
22 contained in Section 8."

23 So it's simply not true that the parties thought
24 there would be no remedy here. The entire - - - they took
25 the entirety of the remedies and they divided them up. And

1 they did so not at random but after bargaining with one
2 another and informed by the REMIC statute that says that if
3 they had done it another way none of this would happen.
4 With respect, Your Honors, we ask that you affirm or
5 reinstate the decision the trial court, reverse the
6 Appellate Division, and grant judgment for Nomura on
7 revision.

8 JUDGE RIVERA: Thank you, counsel.

9 (Court is adjourned)

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C E R T I F I C A T I O N

I, Sara Winkeljohn, certify that the foregoing transcript of proceedings in the Court of Appeals of Nomura Home Equity Loan, Inc. v. Nomura Credit & Capital, Inc., No. 39 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.



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Date: March 28, 2017