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COURT OF APPEALS

STATE OF NEW YORK

AMBAC ASSURANCE CORPORATION,

Appellant,

-against-

NO. 79

COUNTRYWIDE HOME LOANS, INC.,

Respondent.

20 Eagle Street
Albany, New York
June 6, 2018

Before:

ASSOCIATE JUDGE JENNY RIVERA
ASSOCIATE JUDGE LESLIE E. STEIN
ASSOCIATE JUDGE EUGENE M. FAHEY
ASSOCIATE JUDGE MICHAEL J. GARCIA
ASSOCIATE JUDGE ROWAN D. WILSON
ASSOCIATE JUDGE PAUL FEINMAN

Appearances:

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Karen Schiffmiller
Official Court Transcriber



1 JUDGE RIVERA: The third appeal on today's
2 calendar, number 79, Ambac Assurance Corporation v.
3 Countrywide Home Loans.

4 MR. SELENDY: May it please the court, Philippe
5 Selendy for Ambac. I'd like to reserve two minutes for
6 rebuttal, if I may?

7 JUDGE RIVERA: You have it.

8 MR. SELENDY: The First Department did not follow
9 the body of insurance law that controls this case.

10 JUDGE RIVERA: Counsel, could you address what,
11 if any, claims you now have, given this court's decision in
12 Nomura?

13 MR. SELENDY: Your Honor, we have all of the
14 claims, in light of the court's decision in Nomura. First
15 of all, it does not speak to the issues of fraud, which
16 I'll address after the contract issues, in light of your
17 question. And secondly, the contract structure in Nomura
18 was entirely distinct from that here. In particular, there
19 was no insurance contract.

20 If you look at the nature of the insurance and
21 the indemnity agreement between Ambac and Countrywide, it's
22 plain that Ambac bargained for a very broad set of
23 insurance warranties as laid out in Article 2. Those are
24 conditions precedent to the liability of Ambac, as provided
25 in Article 3. And there are very sweeping remedies for



1 breaches of those warranties as set forth in Article 5.

2 The RMBS rights issue only comes into play in the
3 twelfth sub-part of Article 2, which imports as an added
4 protection for Ambac the rights available to the RMBS
5 trustee. So Ambac begins with the foundational rights of
6 an insurer, and then goes above and beyond that, seeking,
7 as well, the protections given to the RMBS trustee. Those
8 rights under the sale-and-servicing agreement and the
9 purchase agreement are different. They relate to what the
10 trustee can do, in terms of the loan repurchase protocol,
11 and that's an additive benefit.

12 So when you look at 2.01(1), when it says that if
13 Ambac exercises those rights, then to that extent, it must
14 live by those remedies, what you have is a clear separation
15 of two different contractual structures. One, you have the
16 insurance contract with the insurance warranties and the
17 insurance remedies, as set forth in Article 5. And then
18 you have the distinct body of RMBS rights and remedies,
19 which are entirely within that proviso in Section 2.01(1).

20 JUDGE GARCIA: Counsel, I - - - I see that, but
21 at first when I read this, I thought that repurchase remedy
22 certainly was geared towards the trustee's remedies,
23 holding these securities. But if you look at - - - I
24 looked at your complaint and - - - and the history that's
25 set out there. At first when Ambac was starting to audit



1 these loans, and we're seeing an incredible percentage, it
2 seems, that were - - - violated certain representations and
3 warranties, you went in and took advantage of that remedy
4 or tried to. And part of your complaint is they slow
5 rolled that. And I think it's actually a bad faith claim
6 accounting in your complaint.

7 So it seems you were availing yourself of that
8 remedy - - - that repurchase protocol - - - until that
9 process broke down. And that seemed to counteract my
10 initial impression that that wasn't really a remedy for
11 you.

12 MR. SELENDY: In - - - in fact, Your Honor, the
13 contract specifically contemplates that Ambac can exercise
14 both its insurance remedies and it's repurchase remedies.
15 If you look at Section 5.02(a) of the insurance agreement,
16 it provides that the insurer can exercise any or more of
17 the remedies, and it specifically lists both the sale-and-
18 servicing agreement, and the insurance contract.

19 So in effect, we have alternative pathways to
20 recovery. If Ambac - - -

21 JUDGE GARCIA: It seems, going back to Judge
22 Rivera's initial question, that a lot of that argument,
23 packaged differently because you are a different entity - -
24 - you are not the trustee - - - is really - - - you know,
25 the contract can be read different ways. And the provision



1 may be in this section or in this section. But
2 essentially, your argument is there are certain loan level
3 remedies and there are certain overarching transactional -
4 - - or however you term them - - - remedies. And that to
5 me seems like the exact argument we rejected in Nomura.

6 MR. SELENDY: I'd - - - I'd have to disagree with
7 respect, Your Honor. What we have are insurance - - -
8 insurance warranties that are categorically different.
9 They go to the nature, for example, of Countrywide as the
10 applicant. They relate to its operations, its financial
11 condition, and its compliance - - -

12 JUDGE GARCIA: Its - - - its underwriting
13 policies.

14 MR. SELENDY: - - - with securities policies.
15 But - - -

16 JUDGE GARCIA: Its underwriting policies.

17 MR. SELENDY: - - - I accept - - -

18 JUDGE GARCIA: - - - which exactly a
19 representation and warranty that's made as to each
20 individual loan.

21 MR. SELENDY: If - - - if we go through the
22 amended complaint, there are both representations that
23 relate to loan level misreps, and representations that
24 concern different areas of shu - - - subject altogether.
25 So for example, in Sections 137 and 143 of the second



1 amended complaint, there are references to Countrywide's
2 representations that it held itself out to be a "prudent,
3 responsible, and financially sound lender, that it had the
4 ability and financial wherewithal to meet commitments."

5 And since this is a record on summary judgment,
6 there are entire bodies of expert proof which go to the
7 breakdown in Countrywide's risk management and internal
8 quality controls.

9 JUDGE RIVERA: Yes, but aren't you back to the
10 Nomura problem that if - - - if you track that to what
11 impact that has on whatever liability you may have, that
12 still boils down to the loans are basically junk.

13 MR. SELENDY: No, Your Honor, for two different
14 reasons. To begin with, the damages that flow from a
15 material breach of those insurance warranties are all
16 claims payments under the policies, consistent with this
17 court's prior holdings as to loss causation for insurance
18 companies.

19 Secondly, the - - - the nature of the insurance
20 warranties are effectively setting forth a threshold set of
21 conditions that Countrywide has to satisfy, regardless of
22 the quality of the defective loans. So these loans could
23 be perfect. It's extremely unlikely given the way in
24 which, as documented by Ambac's expert reports, there were
25 extraordinary breakdowns in the quality control within



1 Countrywide. And yet, Ambac would not have dealt with
2 Countrywide.

3 And not to put too fine a point on it, but Ambac
4 would never have issued insurance to a counterparty that is
5 - - -

6 JUDGE RIVERA: Well, is - - - is - - - is that
7 true or you just would have assessed what premiums you
8 would have charged - - -

9 MR. SELENDY: No, no, Your Honor.

10 JUDGE RIVERA: - - - because of - - - you would
11 have had a better sense or the - - - or an accurate
12 representation of the risk.

13 MR. SELENDY: Ambac would not have transacted
14 with a fraudulent counterparty, period. It would not have
15 transacted with a recklessly mismanaged, liability-ridden,
16 securities violator, like Countrywide, and that's a gating
17 question. That's why Ambac begins as is typical with an
18 applicant, it underwrites the applicant, its counterparty
19 here. Countrywide stands behind those warranties. It has
20 to have both the financial wherewithal to make good on any
21 exercise of warranty breaches, and it has to be prudently
22 managed.

23 In effect - - - and you'll see this if you go
24 through the credit review memoranda of Ambac - - - Ambac
25 was led to believe that Countrywide was a blue-chip, state-



1 of-the-art, gold standard business. And that's the basis
2 on which it transacted. If we look at the proviso in
3 2.01(1) - - -

4 JUDGE RIVERA: Is that - - - is that true because
5 it's a monoline insurance or that - - - that has nothing to
6 do with this?

7 MR. SELENDY: That - - - that - - -

8 JUDGE RIVERA: You just would not have entered
9 this kind of policy agreement with this knowledge.

10 MR. SELENDY: It has to do with the nature of the
11 insurance contract.

12 JUDGE FAHEY: Does - - - does that - - -

13 MR. SELENDY: That was a requirement.

14 JUDGE FAHEY: Does that affect the elements that
15 you have to prove to be successful? In other words, if - -
16 - if you're just relying on an initial material
17 misrepresentation by Countrywide, then does that create a
18 situation where the contract is void ab initio, and you
19 don't have to go forward then to show justifiable reliance
20 or - - - or anything like - - -

21 MR. SELENDY: I appreciate that question. Ambac
22 is standing on the contract and seeking damages, because it
23 is an irrevocable contract. One key part of this - - -
24 since there's no question the general rule in insurance
25 fraud as set forth by more than a dozen court cases of this



1 court, is that the insurer need not show justifiable
2 reliance or loss causation.

3 But that same rule applies, as do other rules
4 that affect property and casualty insurers, to financial
5 guarantee insurers. The legislature mandated that in
6 Article 6908 of the Insurance Law, as confirmed by
7 Oppenheimer. And the reasons - - - the fact that when an
8 insurance applicant describes the subject matter to be
9 represented, that's a factual warranty, the truth of which
10 is a condition precedent to the liability of the insurer,
11 as this court held.

12 JUDGE FAHEY: So there was no contract to begin
13 with, then?

14 MR. SELENDY: There - - - there - - - there was a
15 contract. Ambac performed on it to the tune of two billion
16 dollars and is now properly seeking money damages from the
17 fraudulent applicant. That's the only claim available to -
18 - -

19 JUDGE FAHEY: So - - -

20 JUDGE STEIN: But there - - -

21 JUDGE FAHEY: So back to my que - - -

22 JUDGE STEIN: Go ahead.

23 MR. SELENDY: - - - to financial guarantee
24 insurers.

25 JUDGE FAHEY: I - - - I just - - - just back to



1 my question. Does it change the elements of what you'd
2 have to prove?

3 MR. SELENDY: The - - - the - - - with respect to
4 the contract - - -

5 JUDGE FAHEY: Right.

6 MR. SELENDY: - - - there is a material breach of
7 the insurance warranty that applies even when - - -

8 JUDGE FAHEY: We have - - - we have a contract
9 question and a we have a tort question.

10 MR. SELENDY: Yes, we do.

11 JUDGE FAHEY: Right.

12 MR. SELENDY: With respect to the tort question,
13 there's no requirement of justifiable reliance or a proof
14 as to causation of loss. Both, because of the legislative
15 mandate, which makes this court's law applicable to other
16 insurers, applicable to Ambac, and because of the
17 subsequent warranties confirmed by - - -

18 JUDGE STEIN: What I don't understand is how - -
19 -

20 MR. SELENDY: - - - by Ambac.

21 JUDGE STEIN: - - - how that applies to other
22 than equitable or rescissionary relief.

23 MR. SELENDY: Well, there - - - there is no claim
24 for rescission.

25 JUDGE STEIN: I - - - well, I understand that - -



1 requirement. And then in the analogous area of auto-
2 insurance cases - - -

3 JUDGE STEIN: But - - - but auto - - - in auto
4 insurance cases - - -

5 MR. SELENDY: - - - if you look at Liberty Mutual
6 for example - - -

7 JUDGE STEIN: - - - there's a statute and there's
8 - - -

9 MR. SELENDY: That's right.

10 JUDGE STEIN: - - - there's a policy behind it
11 and the statute says, basically, inhibits your freedom to
12 contract for rescission, okay, and says you can't do that.
13 But here, you had that option. You chose, by matter of
14 contract, not - - - not to have that - - - that - - - that
15 relief.

16 MR. SELENDY: Two points on that. In the auto
17 insurance cases, there's stat - - - a statutory mandate
18 that it's irrevocable insurance. The courts then agreed,
19 since the only remedy is one for monetary damages - - -

20 JUDGE STEIN: Since that was imposed - - -

21 MR. SELENDY: - - - it may be brought.

22 JUDGE STEIN: That remedy was imposed. You - - -
23 you had - - -

24 MR. SELENDY: Correct.

25 JUDGE STEIN: - - - no choice in that.



1 MR. SELENDY: In - - - in - - - in the case of
2 financial guarantee insurance, that is the nature of
3 financial guarantee insurance. It is irrevocable and
4 unconditional.

5 So when the New York Legislature said the same
6 rules apply, all the same rules apply as to property and
7 casualty insurers, that means necessarily that when a
8 financial guarantee insurer brings its only remedy for
9 fraud, which is a remedy for money damages against a
10 dishonest applicant, that there is no different set of
11 burdens in that proof, nor should there be.

12 The applicant's duty of truthfulness, if
13 anything, should be higher when the insurance is
14 irrevocable and the insurer can't walk away. Similarly,
15 the courts holding in Vander Veer that the insurer is
16 harmed on day one through the fraudulent transfer of risk
17 is even more true for irrevocable policies which can't be
18 rescinded because there's an unbroken chain of causation
19 from the wrongful inducement of the risk to all claims
20 policy - - -

21 JUDGE GARCIA: What would the policy reason be
22 for us to remove - - - different arguments, it is or it
23 isn't different types of insurance - - - what would the
24 policy reason be for us to not hold you to a justifiable
25 reliance standard, where you have two sophisticated



1 parties, which, as I understand it, the party writing the
2 insurance has access to this information and you can say, I
3 don't need to justifiably rely. You can tell me this and I
4 can believe you. I'll write this policy; we'll get all
5 these investors, and we have this complete meltdown, but I
6 don't have to show that I justifiably relied on these
7 representations.

8 MR. SELENDY: That's - - - it's the same policy
9 imperative that underlies this court's settled law with
10 respect to insurance fraud generally, which has been made
11 applicable here. And that is, New York State affirmatively
12 does not want insurers to conduct upfront fraud
13 verification. Insurance is about the pooling of risks.

14 JUDGE GARCIA: But you contracted to be able to
15 do that here?

16 MR. SELENDY: But - - - but - - - but, Your
17 Honor, if you require - - -

18 JUDGE GARCIA: And you represented, as I
19 understand it, to your own investors that you were doing
20 that?

21 MR. SELENDY: What - - - what - - - what Ambac
22 represented to its investors was that it was properly
23 analyzing the data as provided by Countrywide - - -

24 JUDGE GARCIA: And that meant we're okay and - -
25 -



1 MR. SELENDY: - - - and modeling it and analyzing
2 it, against the backdrop of the law which governs this.
3 The reason you don't put those burdens on insurers is that
4 since insurers pool risk, the cost will be passed on to the
5 entire market. In effect, what you're doing is shifting
6 costs from the dishonest applicant that here would bear all
7 the - - - all the liability, and saying, instead it goes to
8 the insurer, which drives up premiums for everyone. In
9 addition - - -

10 JUDGE GARCIA: Well, true, your premiums would be
11 less than if you don't have to show justifiable reliance,
12 because in essence, the insured is insuring you by making
13 these representations. And then why do you need a due
14 diligence access clause if you're not going to do it and
15 you're just going to rely?

16 MR. SELENDY: In practice, there is extraordinary
17 due diligence done by the insurer. It is focused primarily
18 on the counterparty itself, on the applicant, as it should
19 be, because the applicant bears that duty of truthfulness.
20 Again, if you shift those costs - - -

21 JUDGE GARCIA: But what due diligence was done
22 here that didn't reveal the pervasive fraud that was going
23 on in Countrywide that you're now complaining about?

24 MR. SELENDY: The - - - the - - - the record is
25 replete with the analysis of Countrywide's operations, its



1 financial condition, its statements as to its underwriting
2 protocols, its very specific warranties, which this court
3 has previously held for example under DDJ - - -

4 JUDGE GARCIA: Again, that's - - - they told us
5 this. You told me just now that you do this due diligence
6 at a company level. What due diligence was done at a
7 Countrywide company level that didn't reveal this pervasive
8 fraud at the company level?

9 MR. SELENDY: Well, Your Honor, the - - - the
10 nature of obtaining those warranties is precisely to
11 augment the due diligence. So there were not just
12 statements, but factual warranties. In addition to the
13 factual warranties, which an insurance applicant's
14 statements always are, Ambac got this whole suite of
15 protections in the insurance contract, plus the loan-level
16 warranties that were made to the RMBS trustee.

17 And if I could briefly pause for a moment here,
18 if this court decided that it would carve out a special
19 exception for financial guarantee insurance, contrary to
20 the mandate of the legislature, and said that, entities
21 like Ambac would have to prove justifiable reliance and
22 loss causation, what you're doing is creating an
23 extraordinary incentive for applicants to lie.

24 As the court held in Ginsburg, what you create is
25 an opportunity for the applicant to freely misrepresent the



1 facts and still recover if the causal connection can't be
2 traced. And this very case is a good illustration of that.
3 Under the First Department rule, Countrywide can commit
4 fraud, materially breach the contracts, and still get
5 transaction insurance across every single deal.

6 JUDGE GARCIA: But I guess the answer to that
7 might be that you still have to show - - - you can show you
8 justifiably relied. You don't want to have any showing, so
9 it's not an issue. But it's doesn't prevent an Ambac or
10 another insurance company from coming in and saying, they
11 represented these things in this context, and we
12 justifiably relied on it.

13 MR. SELENDY: Well, to be clear, we do believe
14 Ambac justifiably relied, but that's not the question. The
15 question is, who bears the risk for that? Who owns the - -
16 -

17 JUDGE GARCIA: So they're really gambling you
18 won't justifiably rely as you legally - - -

19 MR. SELENDY: It's - - - it's no - - - it's no
20 gamble at all. It's a - - - it's a - - - a settled course
21 of business based on who owns the duty, and it's the
22 applicant. The reason - - -

23 JUDGE GARCIA: So - - - so - - - so - - -

24 MR. SELENDY: - - - as this court held in
25 American Surety is to make sure that the entity which knows



1 the most about the subject matter of what is to be insured,
2 describes it exactly.

3 JUDGE RIVERA: So - - - so even though you're - -
4 - you've really taken the position you don't have to bear
5 this burden of relying, the - - - the reality is, the
6 essential point you make is you're justifiably relying - -
7 - you justifiably relied and that's the law, based on their
8 statements to you. You could do some checks of the
9 statements, but you're not going to drill down. Am I
10 understanding this argument?

11 MR. SELENDY: I would say, Your Honor, that
12 because the statements are factual warranties as this court
13 held in American Surety, Ambac is entitled to rely as a
14 matter of law. There isn't a second burden of proof - - -

15 JUDGE RIVERA: So in other words - - - let me
16 just take an example - - -

17 MR. SELENDY: Yes.

18 JUDGE RIVERA: They come in and they say, this is
19 the protocol for us to confirm the risk of the loan, and
20 they set out what their protocol is. That's what you're
21 calling the factual assertions, what they do.

22 MR. SELENDY: That's among the factual
23 assertions.

24 JUDGE RIVERA: Okay, let me just stop there.

25 MR. SELENDY: Yes.



1 JUDGE RIVERA: So then your position is, if they
2 say, that's what they do, you don't have to then confirm
3 that that is indeed what they do.

4 MR. SELENDY: That's correct.

5 JUDGE RIVERA: Correct, okay.

6 MR. SELENDY: There is no fraud verification.

7 JUDGE RIVERA: I just wanted to understand that,
8 thank you.

9 MR. SELENDY: I - - - I agree with that.

10 JUDGE RIVERA: Thank you, counsel.

11 MR. SELENDY: Thank you, Your Honor.

12 JUDGE RIVERA: Okay.

13 MR. MCLAUGHLIN: May it please the court, Joseph
14 McLaughlin for the Countrywide respondents.

15 JUDGE RIVERA: Counsel, good afternoon. Let me -
16 - - let me ask you the same question I started with him.

17 MR. MCLAUGHLIN: Yes, Your Honor.

18 JUDGE RIVERA: How does Nomura now change this
19 case? What - - - what if any claims do they have
20 remaining?

21 MR. MCLAUGHLIN: I will begin with No - - -
22 Nomura, Your Honor. We - - - Nomura is dispositive of the
23 sole remedy appeal, because the First Department correctly
24 applied, even though it did it before Nomura, it correctly
25 applied the exact same contract analysis this court



1 prescribed in Nomura.

2 JUDGE STEIN: I'm going to ask you the same
3 question I asked in Nomura. Can you give me an example of
4 a misrepresentation under 2.01(j) or (k) for which Ambac
5 could seek compensatory damages?

6 MR. MCLAUGHLIN: Absolutely, Your Honor. If
7 Ambac is able to identify a false statement by Countrywide,
8 that is not about defective mortgage loans - - -

9 JUDGE STEIN: Give me an example.

10 MR. MCLAUGHLIN: And I'll give an ex - - - I'll
11 give you multiple examples, Your Honor. For example, in
12 Section 2.01(k) is about the securities laws, and the
13 offering documents being in compliance with the securities
14 law and containing no false statement. Those offering
15 documents are subject to a no untrue statement provision,
16 and they contain numerous representations, that have
17 nothing to do with the quality and characteristics of
18 mortgage loans. And if you go to page 1828 of the re - - -
19 of the record, there are descriptions of the RMBS
20 certificates. There are overcollateralization provisions,
21 including how excess cash flow will be distributed to
22 certificate holders. And then descriptions of how LIBOR
23 will be calculated; that's at page A1837. Those are just
24 three that come to mind.

25 But keep in mind, Section 2.01(l)'s broad plain



1 language sole remedy provision also ap - - - applies across
 2 Section 2.01(1). So you might also just as fairly ask, is
 3 there anything else in Section 2.01 that would not be
 4 subject to the sole remedy, and to that I would answer as
 5 Your Honors, I believe, noted in the - - - I think, you
 6 wrote the decision, Your Honor - - - in Nomura, that the
 7 fact that Countrywide is organized under Delaware law, and
 8 it's - - - it's in good standing; it has the authority to
 9 enter into the transaction. 2.01(g) speaks of financial
 10 statements being prepared in accordance with GAAP. Nothing
 11 to do with the quality of mortgage loans. So clearly,
 12 there - - - there is a - - - a purpose and nonsuperfluous -
 13 - -

14 JUDGE STEIN: Why would Ambac - - -

15 MR. MCLAUGHLIN: - - - role.

16 JUDGE STEIN: - - - be cha - - - challenge any of
 17 that, unless there were - - - they ran into a problem with
 18 the underlying mortgages?

19 MR. MCLAUGHLIN: Well, some - - - some day they -
 20 - - you know, you never know what the next case may bring.
 21 But the important point here, Your Honor, is that - - -

22 JUDGE RIVERA: Well, no, the important point is
 23 none of that matters, unless these loans default and
 24 they've got to pay the piper. So it always tra - - -

25 MR. MCLAUGHLIN: Correct.



1 JUDGE RIVERA: Right? Isn't - - -

2 MR. MCLAUGHLIN: Yeah.

3 JUDGE RIVERA: - - - wasn't that the Nomura view?

4 MR. MCLAUGHLIN: Yeah - - -

5 JUDGE RIVERA: That is always traces back to
6 these loans.

7 MR. MCLAUGHLIN: That is one hundred percent
8 correct. Here, as in Nomura, it's - - - Ambac's only
9 theory of injury depends on "defective mortgage loans"
10 which this sophisticated party contracted to run through
11 the sole remedy provision.

12 JUDGE FEINMAN: But my - - - my - - -

13 MR. MCLAUGHLIN: - - - So if they - - -

14 JUDGE FEINMAN: - - - Nomura, though, you know,
15 it's - - - it's a breach of contract. And - - - and I
16 don't recollect it as having this fraudulent inducement
17 aspect to the complaint.

18 MR. MCLAUGHLIN: Different claim, Your Honor.

19 JUDGE FEINMAN: Right.

20 MR. MCLAUGHLIN: Yes.

21 JUDGE FEINMAN: So does that change the analysis
22 here?

23 MR. MCLAUGHLIN: It does not, Your Honor, because
24 as counsel conceded for - - - in exchange for millions of
25 dollars in premium, they issued an irrevocable and



1 nonconditional policy, so they can't seek - - -

2 JUDGE FEINMAN: So - - - so they can't rescind
3 the contract - - -

4 MR. MCLAUGHLIN: They cannot rescind.

5 JUDGE FEINMAN: - - - but does that mean that
6 they've also waived their right to a measure of rescissive
7 - - - rescission-type damages?

8 MR. MCLAUGHLIN: Absolutely, Your Honor. That's
9 what the First Department held here, that they've done, and
10 it's every single court in the nation that's considered
11 that question - - -

12 JUDGE GARCIA: Can I ask you just a follow up on
13 that question as you're answering it. I'm a little
14 confused on the compensatory damages discussion and
15 rescissionary and you know, the payments made under the
16 contract. That - - - assume just for this purpose that we
17 accept that the repurchase protocol is the remedy under - -
18 - for the contract violations.

19 MR. MCLAUGHLIN: Yes.

20 JUDGE GARCIA: On the tort claim, damages then
21 would be compensatory and that's where this compensatory
22 analysis comes in?

23 MR. MCLAUGHLIN: Your Honor, they are
24 compensatory in name and label only. What's going on here,
25 and the First Department was square on in pointing - - -



1 putting its finger on this, is that what Ambac is doing is
2 that by doing away with loss causation, Ambac wants to turn
3 a common law fraud claim into the rescission remedies it
4 knowingly gave up.

5 JUDGE GARCIA: I understand - - - I understand
6 the point they made. My - - - my question, though, is so
7 there is some measure of compensatory damages that wouldn't
8 be tied to the repurchase protocol, nor would it be all the
9 payments, two billion, or whatever they've made under the
10 contract, that would available to them under the tort
11 claim?

12 MR. MCLAUGHLIN: The appropriate measure of
13 damages for the tort claim is that which this court has
14 prescribed for decades and decades, which is the out-of-
15 pocket loss standard. That's not what they're going for
16 here.

17 JUDGE GARCIA: And what would that be here?

18 MR. MCLAUGHLIN: Here, it would be - - - it would
19 - - - it would be damages that are attributable, as this
20 court said in the Reno case, like a hundred years ago, that
21 "indemnity for the actual pecuniary loss as a direct result
22 of the wrong." So they have to identify nonconforming
23 loans that breached a specific covenant in a fraud - - - in
24 fraudulent - - - in a fraudulent manner, and then they
25 would have to have someone - - - an expert come in and



1 calculate what the damages are.

2 But what they're doing here, Your Honor, and this
3 is the key point, they want to throw causation aside, and
4 change the bargain they made, and have Countrywide pay for
5 every loss on every mortgage in seventeen securitizations,
6 including mortgages that conformed in every way to the reps
7 and warranties, and defaulted for reasons having nothing to
8 do with any alleged - - -

9 JUDGE RIVERA: But they say they never would have
10 entered this arrangement.

11 MR. MCLAUGHLIN: Well - - -

12 JUDGE RIVERA: They would never have - - - never
13 had issued the policy.

14 MR. MCLAUGHLIN: That's - - - Your Honor, that's
15 the key difference. That's "but for" causation. That is
16 not proximate causation. This court has forever noted the
17 difference between - - - we're all here, Your Honor, for
18 example, because we passed the bar exam. That's but for
19 causation. If we had not, we wouldn't be here. But this
20 court has said boundaries are appropriate when it comes to
21 damages, when it comes to fraud. We're not just going to
22 have this, you know, oh, it could have been - - - it all
23 started here and they - - - and the snowball effect. No.
24 It - - - as the court - - - as the First Department
25 correctly cited Your Honor's decision saying it has to be a



1 direct result, as this court has said over years, time and
2 time again, you have to show a direct, immediate, and
3 proximate causal connection - - -

4 JUDGE FEINMAN: So what if - - -

5 MR. MCLAUGHLIN: - - - between the misstatement
6 and the loss.

7 JUDGE FEINMAN: What - - - what - - -

8 JUDGE RIVERA: But what - - - what if - - - if
9 that's not direct, if that's too much "but for", what about
10 my question regarding the premiums? Or do you think that's
11 a red herring? That's really not something that we should
12 think about.

13 MR. MCLAUGHLIN: I don't think the premiums - - -
14 I mean, it - - - it's something that - - -

15 JUDGE RIVERA: I know that you've argued that - -
16 -

17 MR. MCLAUGHLIN: That was part of the - - -

18 JUDGE RIVERA: - - - that - - - that a lot of the
19 premiums were paid, so they - - - they've done very nicely.
20 I understand that argument, right.

21 MR. MCLAUGHLIN: Sure.

22 JUDGE RIVERA: My question was whether or not one
23 can really ever say that they would not have issued even
24 this monoline policy, because they would have just
25 requested a lot higher premium to back this up.



1 MR. MCLAUGHLIN: It's possible, but they have - -
2 - you know, I'm happy to con - - - agree with my contrary
3 counsel when I can, and we do agree that because these
4 policies are irrevocable and unconditional, they cannot
5 walk away from them.

6 JUDGE FEINMAN: So - - - so what about the
7 cumulative remedies clause in Section 502(b) of the
8 indemnification - - -

9 MR. MCLAUGHLIN: Yeah, Your Honor, it's - - - I'd
10 call it Nomura plus. This court in - - - in Nomura said
11 that a catchall cumulative remedy is a general provision
12 and it was not intended to displace a more specific
13 provision. But we have a better provision, frankly, and I
14 thank the people who drafted it. Our provision, unlike
15 Nomura, says - - - it stipulates that remedies are
16 cumulative and you can go outside - - - you can get all the
17 remedies in the bucket, unless expressly provided
18 otherwise.

19 Here, the repurchase protocol in 2.01(1)
20 expressly otherwise provides. It's a specific carveout
21 from Section 5.02(b)'s generic preservation of other
22 remedies.

23 JUDGE STEIN: Can I - - - can I go back for a
24 moment to the - - - to the fraud claims? The fraudulent
25 inducement claims? I just want to be clear on one thing.



1 There - - - there is a - - - there is a long body of law
2 regarding, you know, fire and property insurance and that
3 sort of thing, that says that it's not necessary to - - -
4 for the insurer to prove justifiable reliance.

5 MR. MCLAUGHLIN: I'm glad Your Honor brought that
6 up.

7 JUDGE STEIN: Are - - - are you - - - are you - -
8 - you're not saying that we should change that body of law
9 - - -

10 MR. MCLAUGHLIN: No.

11 JUDGE STEIN: - - - are you? Okay.

12 MR. MCLAUGHLIN: The legislature certainly has
13 not seen fit here to relieve insurers of proving
14 justifiable reliance and loss causation. Their position is
15 misguided to the core.

16 Rescission is a remedy for misrepresentation
17 under the law of contract, not tort. That's a restatement
18 level point of black letter law. Rescission, a contract
19 remedy, has never altered the elements of a common law tort
20 claim. This court in American Shorty - - - Surety, that
21 Your Honors discussed a moment ago, specifically pointed
22 out that courts in equity and courts in law evaluate
23 fraudulent statements under different rules.

24 So cases addressing rescission, like the Ginsburg
25 case he mentioned, American Surety, aren't relevant for two



1 reasons. Number one, Ambac is seeking damages at common
2 law; it's not asserting and admits it can't seek
3 rescission. And number two, it issued irrevocable policies
4 and a financial guarantee.

5 They have not cited a single case anywhere in the
6 world that relieved a - - - an insurer alleging common law
7 fraud from having to show justifiable reliance or
8 causation. Its cases all involve insurers proceeding in
9 equity, seeking rescission, returning the premium that they
10 were allowed to and did - - - and get people back to square
11 one. The status quo ante, it's basic equity law. Our
12 legislature hasn't made a decision to do that.

13 I see that I'm now a tenant at sufferance, Your
14 Honor, so if I may conclude, I'd like to do that, but if
15 Your Honors - - -

16 JUDGE RIVERA: You have a generous reading of the
17 red light, but okay. Not really a tenant at sufferance.
18 Go ahead. Close up quickly, please.

19 MR. MCLAUGHLIN: Your Honors, in Ambac's world a
20 sophisticated monoline insurer can ignore known risk
21 factors and conduct no due diligence, collect tens of
22 millions in premium, and then if the securities can perform
23 - - - perform poorly, it can comb through perspective
24 supplements, years after the transaction, and assert a
25 misstatement. Even if Ambac didn't rel - - - read it, let



1 alone rely on it, and even if that misstatement had nothing
2 to do with why Ambac made payments under its irrevocable
3 policies, yet in Ambac's world, Ambac should nevertheless
4 prevail - - -

5 JUDGE RIVERA: But in Ambac's world, he's trying
6 to disincentivize your fraud. And doesn't your rule
7 incentivize your fraud?

8 MR. MCLAUGHLIN: No, the - - -

9 JUDGE RIVERA: Or alleged fraud, not - - - not
10 your fraud or your client's.

11 MR. MCLAUGHLIN: Alleged fraud, yes, Your Honor.
12 Thank you for that clarification. The - - - you know, I -
13 - - I would say that this court has already struck
14 precisely the right balance. The common law already
15 provides that a plaintiff who's taken reasonable steps to
16 protect itself against deception, won't be summarily out of
17 court merely because in hindsight maybe it could have done
18 better. Ambac's discom - - -

19 JUDGE RIVERA: So why isn't it reasonable to say
20 you have to warrant to me a set of facts that I will treat
21 as true and if it turns out that you lied, then I'm no
22 longer going to pay.

23 MR. MCLAUGHLIN: Because that would be
24 rescission, Your Honor. We would be back to square one.
25 Ambac's - - -



1 JUDGE RIVERA: Well - - -

2 MR. MCLAUGHLIN: - - - discomfort at having to
3 explain to a trier of fact its decision not - - - to fly
4 blind in - - - in the fact face of clear risk isn't a valid
5 reason to create a new insurer-only rule that the
6 legislature has declined to create.

7 JUDGE RIVERA: Thank you, counsel.

8 MR. MCLAUGHLIN: Thank you, Your Honors.

9 MR. SELENDY: Your Honors, if I may, what Ambac
10 seeks is the same rule to be applied to financial guarantee
11 insurers as to all other insurers. The fact that the
12 insurance is irrevocable does not change the risk
13 allocation between the applicant and the insurer. The
14 applicant has the same duty of candor, the same incentive
15 to lie, the same asymmetry of information of greater
16 knowledge - - -

17 JUDGE STEIN: Yeah, but it - - - but it - - -

18 MR. SELENDY: - - - and the insurer - - -

19 JUDGE STEIN: - - - seems like you - - - what
20 you're - - - you're calling damages really is the
21 rescission that you contracted away.

22 MR. SELENDY: Well, again - - -

23 JUDGE STEIN: And that's - - - that - - - that -
24 - -

25 MR. SELENDY: That's not right, Your Honor. What



1 - - - what Ambac agreed to do was to continue to perform
2 for the benefit of the innocent beneficiaries, like pension
3 funds, retirement funds, the RMBS holders.

4 JUDGE STEIN: Okay, so - - -

5 MR. SELENDY: Ambac never agreed to waive its
6 rights against Countrywide, the guilty and dishonest
7 applicant.

8 JUDGE STEIN: That - - - that may be, but - - -
9 but that - - - doesn't that put you into the common law-
10 fraud realm.

11 MR. SELENDY: Well, yes, Your Honor, but it's - -
12 -

13 JUDGE STEIN: Of - - - of - - -

14 MR. SELENDY: - - - but it's insurance common law
15 fraud. And specifically, it's the ability to assert the
16 same duties - - -

17 JUDGE STEIN: We're sort of going circular,
18 because I think - - -

19 MR. SELENDY: Well, but - - -

20 JUDGE STEIN: - - - insurance common law fraud
21 really talks about rescission. So - - -

22 MR. SELENDY: Well, but, again, that's because
23 typically an insurer is trying to avoid performance or to
24 rescind. In this context, it's different. The insurer's
25 performing.



1 JUDGE FEINMAN: I have - - - I have a particular
2 - - -

3 MR. SELENDY: Yes.

4 JUDGE FEINMAN: - - - problem for me, that I
5 don't think applies to the rest of the bench, which is - -
6 - and this relates to what Judge Stein was just talking to
7 you about - - - how can I get to your position without
8 disagreeing with myself in the First Department decision in
9 MBIA v. Countrywide, where we said that, when I was on the
10 First Department, that because it was noncancelable you
11 can't get rescissory damages?

12 MR. SELENDY: We're not seeking rescissory
13 damages. We're seeking compensation for amounts already
14 paid. So we're performing on the contract. It is not a
15 rescission. In fact, Ambac continues to perform.

16 JUDGE FEINMAN: I know you're not seeking a
17 rescission, but aren't you really rescin - - - seeking some
18 measure of rescissory damages?

19 MR. SELENDY: No, we're seeking compensation for
20 the wrongfully induced performance. In other words, for
21 the dollars that are paid out by Ambac to the innocent
22 beneficiaries. Countrywide, in effect, is the indemnitor
23 for that, since it's the dishonest applicant.

24 JUDGE RIVERA: But - - - but how doesn't that end
25 up putting you in the same place you would be as an insurer



1 who's arguing for a rescission? Aren't you both on the
2 same footing?

3 MR. SELENDY: The same - - -

4 JUDGE RIVERA: And seeking to be placed exactly
5 in the same position, by the relief you're requesting?

6 MR. SELENDY: No, Your Honor, because unlike the
7 insurer that seeks rescission, Ambac continues to protect
8 the innocent beneficiaries. And - - -

9 JUDGE RIVERA: Yes, I understand, you're not - -
10 - I understand. You're not seeking, in that sense - - -

11 MR. SELENDY: The quantum of damages - - -

12 JUDGE RIVERA: - - - avoidance of the transaction
13 or the contract.

14 MR. SELENDY: I agree.

15 JUDGE RIVERA: I get that. But all you seem to
16 be doing is saying, yes, yes, yes, the insurance policy
17 stands, but we're not going to pay for it. They've got to
18 pay for it.

19 MR. SELENDY: And we are paying for it.

20 JUDGE RIVERA: And in that sense, aren't you
21 being put exactly in the place - - -

22 MR. SELENDY: We are paying for it - - -

23 JUDGE RIVERA: - - - of someone who seeks
24 rescission?

25 MR. SELENDY: They - - - the quantum of damages



1 may be the same, but we are paying for it. And indeed,
2 that follows from the fact that - - -

3 JUDGE RIVERA: And how does that impact you
4 differently? Help me here understand that.

5 MR. SELENDY: Be - - - because - - - well, Ambac,
6 in fact, the parent company went bankrupt as a result of
7 the liabilities of performing. It was a - - - a - - - a
8 terrific loss for the company. The idea that there is a
9 windfall to Ambac is - - - is preposterous. In fact, what
10 Ambac is trying to enforce are the same rights, holding the
11 dishonest applicant accountable, in the same way for the
12 statements which were made, since those are factual
13 warrantees.

14 And I wanted to highlight, Countrywide itself
15 conceded, when we look at these warranties, they conceded
16 that if Ambac asserted claims about the broader Countrywide
17 operations, that that would be not remediable by this loan
18 level repurchase protocol. That's at page 47 of the - - -
19 of their opposition brief.

20 And it's the same with the securities compliance
21 warrantees. They can't fix that through the repurchase
22 protocol, and that's because this 2.01(1) set of RMBS
23 rights was never intended to fix the problems relating to
24 the far broader insurance warrantees. That's why we're
25 seeking to use the - - - the insurance remedies, and it's



1 not just a matter of 502(b), the cumulative remedies
2 provision, which is not within a grant of securities
3 interest; it's an independent provision.

4 Article 5 itself on defaults and remedies, has no
5 analog to what's in Nomura. If we look at 502(a) though,
6 it's very plain, the insurer gets all of the rights at law,
7 and at equity. Both under the contract, and separately.
8 And that's - - -

9 JUDGE RIVERA: Okay, thank - - - thank you,
10 counsel.

11 MR. SELENDY: Thank you - - - thank you, Your
12 Honor.

13 JUDGE RIVERA: Thank you, counsel.

14 (Court is adjourned)

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

I, Karen Schiffmiller, certify that the foregoing transcript of proceedings in the Court of Appeals of Ambac Assurance Corporation v. Countrywide Home Loans, Inc., No. 79 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.



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