*To Be Argued By:*
Brian S. Weinstein
*Time Requested: 30 Minutes*

APL-2019-00127

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# Court of Appeals

STATE OF NEW YORK

IN RE: PART 60 PUT-BACK LITIGATION

DEUTSCHE BANK NATIONAL TRUST COMPANY, solely in its capacity as Trustee of the MORGAN STANLEY ABS CAPITAL I INC. TRUST 2007-NC4,

*Plaintiff-Respondent,*

*against*

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

*Defendants-Appellants.*

## REPLY BRIEF FOR DEFENDANTS-APPELLANTS

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## PRELIMINARY STATEMENT

Deutsche Bank provides no legitimate basis under New York law for this Court to reach a different outcome here than it did in *Ambac* and *Nomura II* when it held that the sole remedy applied notwithstanding plaintiffs' allegations of "pervasive" breaches in the loans.[1] *Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 31 N.Y.3d 569, 582 (2018) ("*Ambac*"); *Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc.*, 30 N.Y.3d 572, 585 (2017) ("*Nomura II*"). Deutsche Bank's attempt to avoid the sole remedy provision by repackaging these same types of allegations as "gross negligence" and arguing that they render the sole remedy unenforceable as a matter of public policy fares no better under New York law than the previous two attempts.

The public policy exception, which prevents defendants from shielding themselves from liability arising from gross negligence or willful misconduct, does not apply to the sole remedy provision. That provision does *not* immunize defendants or limit their liability for breaching loans, but instead requires defendants to repurchase or cure any loans shown to be in breach, and thereby "make the trust whole" for such breaching loans. (A50 ¶ 3.) Under New York law, which places a high premium on the reliable enforcement of contractual

[1] Capitalized terms not defined herein shall have the meanings set forth in Morgan Stanley's opening brief.

remedy provisions, the sole remedy cannot be treated as void based on the narrow public policy exception.

Deutsche Bank argues that this Court's precedents provide that the public policy exception applies not only to provisions that exonerate a defendant from liability altogether or limit it to a nominal sum, but also to provisions that impose any limitation on a defendant's obligation to compensate plaintiffs for breaches. Deutsche Bank misapplies this Court's precedents. But in any event, this Court need not decide whether other types of limitations on a defendant's obligation to compensate plaintiffs for breaches might also fall within the public policy exception, because the sole remedy does not limit defendants' obligation to *fully* remedy every breaching loan proved by the Trustee. It merely requires the Trustee to provide loan-specific notice of the breaches for which it is seeking relief, and requires Morgan Stanley to cure or repurchase any such breaching loans. Notice requirements or other procedural requirements that a plaintiff must meet as a condition precedent to recovery are distinct from provisions that limit what a defendant must pay to a plaintiff who has proven its claims. *See A.H.A Gen. Constr., Inc. v. N.Y.C. Hous. Auth.*, 92 N.Y.2d 20, 30-32 (1998) ("*A.H.A.*"). Deutsche Bank tries to distinguish *A.H.A.* by arguing that the notice provision there did not prevent the plaintiff from obtaining full relief if it complied with that requirement, but the same is true here.

Deutsche Bank has not identified any basis to conclude that the sole remedy deprives it of the opportunity to make the Trust whole, much less that the sole remedy can be analogized to provisions that eliminate or virtually eliminate a defendant's liability. Indeed, the *only* suggestion by the Appellate Division as to how the sole remedy might fit within the public policy exception would be if the sole remedy deprived the Trust of any remedy for liquidated loans and thereby became "illusory" with respect to those loans. In addition to other problems with this argument described below, the sole remedy, under governing law, does *not* prevent the Trust from obtaining the same complete remedy for both liquidated and non-liquidated loans, as Deutsche Bank concedes. Its speculation that this Court might one day change the law is not a basis to avoid resolving the enforceability of the sole remedy provision under existing law.

Deutsche Bank's other arguments against the enforceability of the sole remedy provision are equally without merit. It argues that being required to prove its case loan-by-loan, as the contract requires, is burdensome, but New York law does not permit unambiguous contract provisions to be treated as void based on the burden of compliance. Moreover, there is no support for treating a remedy provision as void because it imposes conditions on the plaintiff's entitlement to relief, particularly when it then requires the defendant to fully compensate the plaintiff for any demonstrated breaches. Such a position is not only contrary to *A.H.A.*, but would stretch the Court's public policy exception beyond recognition. Deutsche Bank's argument that the sole remedy forecloses rescission is equally meritless, because rescission is unavailable irrespective of the sole remedy provision. Finally, Deutsche Bank's argument that it is premature to determine if the sole remedy is enforceable is baseless, because it is unable to articulate any valid basis for leaving its enforceability in doubt. Leaving the issue up in the air without a legitimate reason is contrary to the principles of certainty and predictability enshrined in New York contract law.

In short, the sole remedy provision is completely distinct from provisions that immunize a defendant from liability, and even from provisions that otherwise limit the defendant's obligation to compensate plaintiff for proven breaches. But in addition, the public policy exception does not apply because the Trustee's allegations, while serious, are still allegations of breach of contract, not of any extra-contractual duty owed to the Trustee. Even an intentional breach of contract, solely for the defendant's financial gain, is not enough to trigger the public policy exception. *See Metro. Life Ins. Co. v. Noble Lowndes Int'l,* 84 N.Y.2d 430, 438 (1994) ("*Metro. Life*"). This Court's precedents, as well as other authoritative sources of contract law, make clear that the public policy exception applies only to conduct that is tortious in nature. Deutsche Bank's argument to the contrary depends upon an overly simplistic reading of this Court's decision in *Abacus Federal Savings Bank v. ADT*

*Security Services, Inc.*, 18 N.Y.3d 675 (2012) ("*Abacus*"), which would incorrectly suggest that *Abacus* overrode long-established principles of contract law *sub silentio*.

Deutsche Bank's failure to identify the breach of any duty that Morgan Stanley owed to it other than its contractual duties likewise makes punitive damages unavailable under New York law. Deutsche Bank's argument that Morgan Stanley "waived" this argument is specious—Morgan Stanley argued at both the trial court and the Appellate Division level that Deutsche Bank could not seek punitive damages because Morgan Stanley's duties to the trustee were purely contractual.

Finally, the PSA does not evidence the necessary clear and unambiguous intent to shift attorney's fees. When the parties to the PSA wanted to express such an intent, they did so (seventeen times) by making explicit references to attorney's fees. But in the section at issue here, the sophisticated and well-advised parties chose not to do so, and instead referred only to "costs" and "expenses"—words that have long been interpreted to *exclude* attorney's fees. This section cannot meet the strict *Hooper* standard for departing from the American Rule that each party bears its own attorney's fees.

## ARGUMENT

### I. THE SOLE REMEDY PROVISION IS NOT AN EXCULPATORY CLAUSE THAT VIOLATES PUBLIC POLICY

It is a fundamental principle of New York law that contracts, including remedial provisions, must be enforced as written. Brief for Defendants-Appellants ("Br.") 19-20. This Court has carved out a narrow public policy exception preventing a party from exonerating itself from liability caused by gross negligence or willful misconduct, which it has applied to provisions eliminating a defendant's liability or limiting damages to a nominal sum. *Id.* at 20-21.

Deutsche Bank mistakenly argues that this Court's precedents establish that this exception sweeps more broadly to cover other, less stringent limitations on a defendant's obligation to compensate plaintiff for proven breaches. Brief for Plaintiff-Respondent ("Resp.") 17. Deutsche Bank relies on the statement in *Abacus* that "exculpatory clauses and liquidated damages clauses in contracts are not enforceable against allegations of gross negligence," 18 N.Y.3d at 683, and argues that this broadened the public policy exception because "liquidated damages clauses need not and frequently do not limit damages to a nominal sum." Resp. 17. But the provision in *Abacus* capped damages at $250. 18 N.Y.3d at 681. There is no reason whatsoever to conclude that the Court intended to dramatically expand the narrow public policy exception, when the actual clause at issue “limited damages to a nominal sum,” *Sommer v. Fed. Signal Corp.*, 79 N.Y.2d 540, 554 (1992), and thus fit squarely within this Court’s precedents. The Trustee also mistakenly argues that *Metro. Life* supports its position, Resp. 17, but *Metro. Life* never applied the public policy exception or addressed its scope. The Court merely addressed what the parties to a contract meant by including “willful acts” in a limitation of remedies provision, and concluded that they intended to incorporate the public policy exception for “willful acts” or “gross negligence,” which requires “tortious” conduct and not merely an intentional breach of contract. 84 N.Y.2d at 88-93. *Metro. Life* provides no support for Deutsche Bank’s effort to render the sole remedy provision void.

Contrary to Deutsche Bank’s suggestion, this Court has only applied the public policy exception in circumstances where a defendant was exempted from liability or had its liability capped at a nominal amount, which could not be more different from what the sole remedy provides. But in any event, the Court need not decide whether the public policy exception might apply to some other kind of provision that limits a defendant’s liability for breaches, without eliminating it completely or limiting it to a nominal sum, because the sole remedy here provides *full relief* for breaching loans. By requiring Morgan Stanley to cure or repurchase any loan shown to be in breach, the sole remedy “make[s] the trust whole.” (A50 ¶ 3.) Accordingly, the Trustee’s reliance on federal and lower court cases applying the public policy exception to clauses that limit a defendant's liability for breaches to more than a nominal sum is misplaced. Resp. 17-18 & n.3. Those cases misapplied this Court's precedents, *see* Brief of New York Law Professors as *Amici Curiae* ("Law Profs. Br.") 13-15, but in all events, they are distinguishable because the sole remedy provision here does *not* eliminate *any* liability for *any* loan proven to be in breach.[2]

Insofar as the sole remedy does not exonerate defendants from liability, but sets forth a loan-specific notice process that must be complied with before the Trustee is entitled to relief, Br. 26 n.9, the public policy exception does not apply. Indeed, this Court held in *A.H.A.* that remedial protocols setting forth the procedural mechanism for obtaining recovery are fundamentally different from exculpatory clauses. 92 N.Y.2d at 30-31; Br. 24-25. The Trustee attempts to distinguish *A.H.A.* on the grounds that "sole remedy clauses are not 'conditions precedent.' They are a limitation on the *remedies* a trustee can obtain for breach." Resp. 25. This argument is a red herring. The loan-by-loan repurchase protocol *is* a condition precedent, *see ACE Sec. Corp. v. DB*

[2] While the Court, in order to reverse the Decision below, need not decide whether the public policy exception could conceivably apply more broadly than its precedents have stated, for the reasons described by the *amici curiae* contract law professors, this Court should reaffirm the *Sommer* standard because it promotes certainty and predictability in the enforcement of contracts; is consistent with New York's Uniform Commercial Code; and is appropriately limited because other doctrines impose constraints on remedial clauses. *See* Law Profs. Br. 15-18.

*Structured Prods., Inc.*, 25 N.Y.3d 581, 589-91 (2015), and if a trustee complies with it by identifying breaching loans, the sole remedy *fully compensates* the Trust for such loans. The protocol, and the accompanying sole remedy provision, do not limit the Trust's remedies *at all* for any loan proven to be in breach. For that reason, like the notice provisions in *A.H.A.*, the remedial protocol here is not voidable under the public policy exception.

## II. DEUTSCHE BANK'S EFFORTS TO FIT THE SOLE REMEDY PROVISION WITHIN THE NARROW PUBLIC POLICY EXCEPTION FOR EXCULPATORY CLAUSES ARE UNAVAILING

Deutsche Bank makes four arguments to try to shoehorn the sole remedy provision into the narrow public policy exception and leave the enforceability of the provision in limbo, all of which are without merit.

First, Deutsche Bank makes an argument about liquidated loans. As described in Morgan Stanley's opening brief, the Appellate Division concluded that the sole remedy provision could be analogous to provisions eliminating a defendant's liability or limiting it to a nominal sum if it were "illusory." Br. 22-24. The only basis on which it suggested that the sole remedy could be "illusory" is if it provided no remedy for breaching loans that were already liquidated. *Id.* But as Deutsche Bank concedes, currently applicable law permits full recovery for liquidated loans. Br. 22; Resp. 20-21. Deutsche Bank posits that this Court could conceivably reverse that precedent, although no appeal raising that issue is before this Court. Pure speculation about a possible future change in the law is not a basis to defer deciding cases under currently applicable law. Like any litigant, if the law were to change and Deutsche Bank believed it had new arguments based on that change, it could move to renew under CPLR 2221.

<u>Second</u>, Deutsche Bank argues that the sole remedy provision should be unenforceable because the alleged pervasiveness of the breaches makes compliance with the contract's loan-by-loan repurchase protocol burdensome. Resp. 22-25. This argument goes well beyond the Appellate Division's Decision. While the Appellate Division left open the possibility that the sole remedy could be "illusory" as to liquidated loans if it denied the Trustee recovery on such loans, Deutsche Bank seeks to excise the sole remedy from the contract because of the burden of complying with it.

Under New York law, the burden of marshalling loan-by-loan proof is not a basis for rewriting the parties' contract. As this Court has held, any argument that a contractual provision negotiated by sophisticated parties should be set aside as "commercially unreasonable" is "beside the mark" where, as here, the contract terms are unambiguous. *Fundamental Long Term Care Holdings, LLC v. Cammeby's Funding, LLC*, 20 N.Y.3d 438, 445 (2013). Deutsche Bank's argument is another variant of the arguments in *Nomura II* and *Ambac* that the sole remedy provision should not be applied to allegedly systemic breaches, which this Court rejected. Br. 27-30; *see Nomura II*, 30 N.Y.3d at 585 ("[T]he agreements do not provide a carve-out from the Sole Remedy Provision where a certain threshold number of loan breaches are alleged."); *Ambac*, 31 N.Y.3d at 582 (the sole remedy provision cannot be "nullified by allegations of multiple, systemic breaches" (internal quotation marks and citations omitted)). This latest twist on the argument is equally unavailing. Plaintiffs' burden of *proving* Morgan Stanley's liability, under the express protocol set forth in the contract, is not a valid basis for invoking the public policy against provisions that *exculpate* defendants from liability. *See supra* Point I; Br. 24-27.[3]

Nor can the sole remedy provision be discarded under New York law based on arguments about the burden on the trial court, Resp. 22-25, as distinguished from the burden on plaintiff.[4] The trial courts are capable of

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[3] Trustees in other cases have reunderwritten every loan in the trust, and in some instances have reunderwritten many more loans than the 5,337 in this Trust. *See, e.g.*, *In re Lehman Brothers Holdings Inc*., No 08-13555 (SCC), Dkt. No. 57785 at 134 (Bankr. S.D.N.Y. March 15, 2018) (72,500 disputed loans); *U.S. Bank, N.A. v. UBS Real Estate Sec. Inc.*, 205 F. Supp. 3d 386, 525 (S.D.N.Y.) ("*UBS*") (14,403 loans). The loan-by-loan process has not prevented these trustees from seeking full recovery. Although Deutsche Bank misleadingly suggests this process denied the trustee in *UBS* a remedy for loans with "missing" loan files, Resp. 24, the trustee was actually denied a remedy because it inexplicably chose not to obtain those files. *UBS*, 2016 WL 4690410, at *74.

[4] *See, e.g., MASTR Adjustable Rate Mortgages Tr. 2006-OA2 v. UBS Real Estate Sec. Inc.*, No. 12-CV-7322, 2015 WL 797972, at *4 (S.D.N.Y. Feb. 25, 2015) (trial court does not have "the prerogative of overriding the parties' agreements in order to provide an efficient and economical remedy in the name of a just and fair resolution. When it comes to written,
(continued . . .)

managing their own dockets and providing for the appropriate methods of presenting proof and adjudicating disputes—all of which the courts would need to do even under plaintiff's preferred sampling approach, because the Court still would need to adjudicate hundreds of individual loan disputes in each sample. New York law leaves in its trial judges' capable hands the question of how to adjudicate complex disputes—a question not currently before this Court—but does not permit courts to re-write commercial contracts on this basis. There is no support for the proposition that the burden on the trial court can cause a remedy provision to fall within this Court's public policy exception to the enforceability of contracts.

Third, the Trustee argues that the sole remedy provision could preclude the Trustee from seeking rescission or rescissory damages. Resp. 25-26. This argument is equally flawed. Even if the sole remedy provision were unenforceable, rescission or rescissory damages would still be unavailable under governing law because general contract damages would be available. *See Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc.*, 133 A.D.3d 96, 108 ("*Nomura I*") (1st Dep't 2015) ("With respect to plaintiffs' causes of action for rescission, even if [the sole remedy provisions] did not waive plaintiffs' right to seek such relief, rescission would be

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integrated contracts among sophisticated parties, predictable outcomes in accordance with the expressed intentions of the contracting parties is justice and fairness.").

unwarranted because damages are available." (citing *Rudman v Cowles Communications*, 30 N.Y.2d 1, 13 (1972)). In short, Deutsche Bank's inability to obtain rescission or rescissory damages has nothing to do with the enforceability of the sole remedy provision. And as with liquidated loans, bald speculation that the law regarding the availability of rescission could change, Resp. 26, is not a basis to leave the enforceability of the sole remedy provision in doubt.

Finally, Deutsche Bank adopts the Appellate Division's position that, even if the sole remedy is designed to provide full relief for any breaching loans identified by the Trustee, it is premature to determine whether something might, in practice, prevent the Trust from being made whole. There are several critical flaws in that argument. First, there is no support for the proposition that a remedy clause plainly designed to allow the plaintiff to obtain full relief could nonetheless be deleted from the contract because, in practice, it somehow fell short of complete relief. Deutsche Bank cites *Abacus* for the argument that "[t]his Court determines the enforceability of limitations of liability based on their effect, not their intent," because in *Abacus* the Court did not inquire into intent. Resp. 27. But in *Abacus*, as in the other relevant cases decided by this Court, both the intent and the effect were obvious, because the provisions eliminated liability or limited it to a nominal sum. Here, it is similarly obvious, as Deutsche Bank admitted in the Complaint, that the sole remedy provision was intended to "make the trust whole." (A50 ¶ 3.)[5] *Abacus* in no way supports the conclusion that a remedy provision designed to allow plaintiff to be made whole could nonetheless be deemed void as a matter of public policy. Indeed, this Court held in *A.H.A.* that the condition precedent in that case could not be treated like an exculpatory clause, even if the defendant acted with gross negligence and even if the *effect* was to leave the plaintiff without a remedy at all. *A.H.A.*, 81 N.Y.2d at 31. Treating the sole remedy like an exculpatory clause because of speculation that it might somehow fall short of "complete relief," despite being structured to provide precisely that, would reflect a radical expansion of the public policy exception as previously articulated by this Court.[6] Even if the sole remedy somehow fell short of complete relief, it would, at a minimum, still be a reasonable remedy chosen by the parties, which the courts are required to enforce. *See* Br. 19-20.

[5] Further, the clear intent was to do so in a way that adhered to the letter of the tax law to protect the Trust's REMIC status. *See* Br. 10-12. The after-the-fact and non-precedential IRS letter-rulings cited by Deutsche Bank, Resp. 28 n.10, have no bearing on the parties' intent when they drafted the sole remedy provision in 2007.

[6] *Sokoloff v. Harriman Estates Dev. Corp.*, 96 N.Y.2d 409 (2001), relied on by Deutsche Bank, Resp. 26-27, is entirely inapposite. That case concerned whether the architectural plans defendant was supposed to deliver to plaintiff were so unique that money damages would be an inadequate substitute for specific performance. *Sokoloff*, 96 N.Y.2d at 415. There is no similar issue here: the losses on a loan cannot be greater than its unpaid principal balance plus unpaid interest, which are both included in the Repurchase Price.

## III. PLAINTIFF HAS NOT ALLEGED THE TYPE OF CONDUCT NECESSARY TO INVOKE THE PUBLIC POLICY EXCEPTION

Deutsche Bank's effort to engineer a different outcome than in *Nomura II* and *Ambac*, based on fundamentally the same types of allegations, fails for a second reason. Even if the sole remedy provision were analogous to an exculpatory clause, Deutsche Bank's allegations are not the type of "gross negligence" or "willful misconduct" covered by the public policy exception. They are allegations that Morgan Stanley knowingly and pervasively breached the express terms of the contract (alleged breaches for which the contract makes a complete remedy available). The "gross negligence" or "willful misconduct" necessary to trigger the public policy exception to the enforcement of contractual remedies requires the breach of a duty owed to plaintiff that is separate from the express terms of the contract. Br. 31-37. Deutsche Bank fails to allege the breach of any such duty owed to it by Morgan Stanley.

This understanding of the public policy exception is reflected not only in this Court's *Metro. Life* decision, but in the Restatement of Contracts and other authoritative sources of contract law. Br. 31-36. The Trustee wrongly suggests that *Abacus* upended this long-standing exception, *see* Resp. 33-34, because the Court concluded that the defendant's alleged grossly negligent failure to monitor its alarm system rendered the contract's exculpatory clause unenforceable, even though the nature of its services did not also give rise to tort liability. 18 N.Y.3d at 682-85. But *Abacus* should not be understood to have changed, *sub silentio*, the well-established standard of conduct necessary to render an exculpatory clause unenforceable. Quite the contrary, *Abacus* is consistent with this body of law, and does not support the Trustee's position.

What the Trustee ignores is that, unlike the alleged breaches in this case, the alleged contractual breach in *Abacus* was that the defendant was negligent or grossly negligent in fulfilling a duty of care owed to the plaintiff—in particular, the duty of care associated with its provision of alarm services. *See id.* at 681-83. *Abacus* thus involved the type of claim—described in Morgan Stanley's opening brief, Br. 34-36—that "falls in the borderland between tort and contract . . . where the parties' relationship initially is formed by contract, but there is a claim that the contract was performed negligently." *Sommer*, 79 N.Y.2d at 550-51; *see also id.* at 552 (defendant's duty of care is a product of both the contract and "the nature of its services"). In these types of cases, the breach of an implied duty of due care arising from the contractual relationship may be actionable as "a breach of contract, a tort, or both." *Id.* at 550-51. If it amounts to a grossly negligent breach of that duty, it also may render an exculpatory clause in the parties' contract unenforceable, regardless of whether—because of the nature of the services provided or otherwise—the plaintiff can also recover in tort. *See* Br. 34-35.

The Trustee argues that it is not necessary to show the breach of a duty separate from the express contract terms because, in *Abacus*, this Court held that there was no "duty independent of the contractual relationship." Resp. 35 (quoting *Abacus*, 18 N.Y.3d at 684-85). That holding, however, was based on *Clark-Fitzpatrick, Inc. v. Long Island Railroad Co.*, 70 N.Y.2d 382 (1987), which addressed these borderland situations and held that alleged breaches of a *duty of due care* in the context of a contractual relationship are generally treated as breaches of "'implied' contractual obligations," absent special circumstances that would permit recovery in tort. *Id.* at 390, *cited in Abacus*, 18 N.Y.3d at 684-85. Thus, *Abacus* did involve the breach of a *duty of due care*—a typical tort duty—but because the "failure to act with due care [did not] affect[ ] a significant public interest independent of [defendants'] contractual obligations" like the breach in *Sommer* did, this Court applied the *Clark-Fitzpatrick* rule and concluded that the breach did not "give rise to separate liability in tort." *Abacus*, 18 N.Y.3d at 684-85 (citing *Sommer*, 79 N.Y.32d at 551-53). *Abacus* therefore did not overrule *Metro. Life sub silentio* and hold that any intentional or grossly negligent breach of contract can invoke the public policy exception to the enforcement of limitations on liability. Rather, *Abacus* addressed the same type of conduct alleged in *Sommer* and simply concluded that certain *remedies* were not available to the plaintiff because the *Abacus* defendant's burglary alarm services did not have the same public impact as the *Sommer* defendant's fire alarm services. *See id.*

Cases like *Sommer* and *Abacus* are completely different from cases like this one, where the allegations are that the defendant "fail[ed] to deliver goods as promised," which "clearly [sound in] contract." *Sommer*, 79 N.Y.2d at 550. The only relevant inquiry in such situations is whether the goods conform to the contractual promises; the defendant's state of mind and the reasonableness of the defendant's actions are not relevant to the quantum of damages available. *See Metro. Life*, 84 N.Y.2d at 435 ("Generally in the law of contract damages, as contrasted with damages in tort, whether the breaching party deliberately rather than inadvertently failed to perform contractual obligations should not affect the measure of damages. . . . An intention not to perform [a contract] does not bring on heavier damages than actual nonperformance." (alteration in original) (emphasis omitted) (internal quotation marks and citation omitted)).

Deutsche Bank argues that distinguishing between contracts that make representations about goods, and contracts that give rise to an ongoing duty of care, "makes no sense." Resp. 34-35. But that is precisely the distinction drawn by this Court in *Sommer*. The former clearly sound in contract, whereas the latter are in the borderland between contract and tort. If a defendant acts with a sufficiently culpable state of mind in the latter category of cases, that is enough to prevent it from relying on an exculpatory clause, regardless of whether the breach gives rise to remedies in contract, tort, or both. In contrast, when the parties are clearly in the contract realm, and where the allegations only concern breaches of express contractual representations, a defendant's state of mind is irrelevant. *See Metro. Life*, 84 N.Y.2d at 435. That is why, in such circumstances, limiting remedies for an intentional breach of contract, in the absence of an "inten[t] to inflict harm on plaintiff . . . through the means of breaching the contract," does not offend public policy. *Id.* at 438-39.

The findings in the SEC Order do not change the analysis. The alleged misstatement of delinquency data for 3% of the loans, which the Trustee alleges breached a representation and warranty concerning the loans' delinquency status, is still an alleged "fail[ure] to deliver goods as promised," which "clearly [sounds in] contract." *Sommer*, 79 N.Y.2d at 550. That does not mean, as Deutsche Bank suggests, that Morgan Stanley is arguing that these alleged breaches "were no big deal," Resp. 31, but it does mean that these alleged breaches do not trigger the narrow public policy exception to the enforcement of contracts. Deutsche Bank argues that the statements in the offering documents amounted to "fraud," Resp. 36-37, but even if that were true, the duty that those misstatements allegedly breached was owed to *certificateholders*, not the Trustee. Deutsche Bank has alleged no breach of any independent duty owed to *it*, and therefore cannot rely on the gross negligence exception. *See* Br. 36-37.

At bottom, the allegations in this case are not meaningfully different from the pervasive breach allegations in *Nomura II* and *Ambac*, despite the Trustee's attempt to repackage them under a different legal argument. *See* Br. 28-30. Plaintiff in *Nomura II* alleged breach rates as high as 83%, while plaintiff in *Ambac* alleged breach rates as high as 100%.[7] Despite the Trustee's protestations to the contrary, affirming the Appellate Division's Decision here would hollow out the holdings in *Nomura II* and *Ambac*. Indeed, in light of the Appellate Division's Decision, numerous RMBS plaintiffs have already sought, or intend to seek, leave to add "gross negligence" allegations, hoping that changing the label on their allegations is now the key to circumventing the sole remedy provision.[8] Despite this change of labels, this Court should not reach a different result than it reached in *Nomura II* and *Ambac*.

## IV. PUNITIVE DAMAGES ARE NOT AVAILABLE IN THIS TRUSTEE BREACH-OF-CONTRACT ACTION

The Appellate Division erred in reinstating the Trustee's claim for punitive damages. As Deutsche Bank concedes, "the pleading elements required to state a claim for punitive damages" include alleging a tort that is

[7] *See* Compl. ¶ 47, *Nomura Home Equity Loan, Inc. v Nomura Credit & Capital, Inc.*, No. 650337/13 (Sup. Ct. N.Y. Cty. Jan. 30, 2013) (NYSCEF No. 1); Second Am. Compl. ¶ 12, *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, Index No. 651612/10 (Sup. Ct. N.Y. Cty. May 28, 2013) (NYSCEF No. 107).

[8] *See, e.g.*, Ltr. from Pls' Liaison Counsel to J. Friedman, No. 777000/15 (Sup. Ct. N.Y. Cty. Sept. 27, 2019) (NYSCEF No. 689).

"*directed to plaintiff*." *N.Y. Univ. v. Continental Ins. Co.*, 87 N.Y.2d 308, 316 (1995) (emphasis added); *see* Resp. 40. The Trustee has not and cannot plead this element, and cannot rely on mistaken claims of waiver to overcome this fatal shortcoming.

For the reasons described in Point III, *supra*, and in Morgan Stanley's opening brief, Br. 31-40, both the gross negligence and the punitive damages claims fail because the Trustee has not alleged that Morgan Stanley breached any duty, outside of the contract, that was owed to the Trustee. The argument that Morgan Stanley made similar representations about delinquent loans in both its contract with the Trustee and in the offering documents provided to certificateholders, Resp. 42-44, is beside the point. Morgan Stanley's representation to the Trustee was only contained in the contract and, if false, only gives rise to a breach of contract. Unlike certificateholders, the Trustee has not and could not allege that Morgan Stanley breached any non-contractual duty owed to it.

It is for this reason that, in the scores of RMBS trustee lawsuits against sponsors filed in the wake of the 2008 financial crisis—including this one—the trustees consistently did *not*, because they could not, file claims for fraud; they only brought contract claims.[9] Similarly, for this same reason, the trustees did *not* assert demands for punitive damages.[10] The trustees and their lawyers in these scores of cases did not forego such demands out of consideration for the defendants they sued—they did so because, in the absence of a tort duty, there is no basis under the law to demand punitive damages. Notably, while Deutsche Bank argues that "[c]ourts in other RMBS cases alleging fraud have 'repeatedly declined to strike the punitive damages claims,'" Resp. 46 (citations omitted), it cites only cases brought by RMBS investors or insurers who brought claims based on fraudulent inducement. *Id*. at 46 & n.16. No RMBS trustee, including Deutsche Bank here, has tried to allege a claim for fraud, because the only duties at issue were contractual.

[9] *See, e.g.*, Complaints, Index Nos. 600352/09; 652388/11; 653541/11; 652257/16; 651282/12; 651827/12; 652344/12, 652644/12; 652614/12; 652619/12; 652985/12; 653429/12; 156016/12 653267/12; 653394/12; 653390/12; 652763/12; 653783/12; 653787/12; 654403/12; 654464/12; 650291/13; 650312/13; 650337/13; 650339/13; 650369/13; 650579/12; 650692/13; 650693/13; 650949/13; 651124/13; 651174/13; 651338/13; 153945/13; 651627/13; 651789/13; 651936/13; 651954/13; 651957/13; 651959/13; 652001/13; 652686/13; 652699/13; 653048/13; 653707/13; 653831/13; 654157/12; 651370/14; 651371/14; 651373/14; 651388/14; 651854/14; 652087/14; 652088/14; 652727/14; 652842/14; 654147/12; 653140/15 (Sup. Ct. N.Y. Cty.). Morgan Stanley is not aware of any RMBS trustee putback case filed in New York that purported to bring a fraud claim.

[10] *See generally* Complaints, *supra* note 9. Other than this case and one other complaint filed by the same plaintiff's counsel in 2017, *see* Second Am. Compl., Index No. 651563/13 (Sup. Ct. N.Y. Cty. Oct. 13, 2017) (NYSCEF No. 157), Morgan Stanley is not aware of any RMBS trustee putback case filed in New York that sought punitive damages.

It is therefore unsurprising that the Trustee's primary defense of the Appellate Division's Decision to reinstate the punitive damages demand is that Morgan Stanley purportedly "waived" this argument, and that the Trustee could have amended its complaint if it had been raised. Resp. 40-42 & n.12. This argument is wrong as a matter of fact and law. Morgan Stanley has argued at every level that the punitive damages claim fails for the same reason that the gross negligence claim does: because the complaint fails to allege any independent tortious conduct.[11] The Trustee does not contest that Morgan Stanley preserved its argument that the gross negligence claim fails because the complaint does not allege a breach of any extracontractual duty owed to the Trustee. At both the IAS Court and Appellate Division, Morgan Stanley explicitly incorporated this argument in arguing that plaintiff's punitive damages claim should be dismissed. *See supra* n.11. It cannot be that Morgan Stanley preserved this argument with respect to the gross negligence claim, yet somehow waived it with respect to the punitive damages claim. Indeed, the Appellate Division recognized that Morgan Stanley had contested this issue on punitive damages by separately addressing it in its Decision. (A525-27.)

[11] Morgan Stanley's Mem. of Law in Supp. of its Mot. to Dismiss dated March 9, 2015 at 6-7; Morgan Stanley's Reply in Supp. of its Mot. to Dismiss dated May 13, 2015 at 4-5; Morgan Stanley's Br. in Opp. to Pl's Appeal dated August 10, 2016 at 19-26.

Even if this were an entirely new legal argument—and it is not—Deutsche Bank's position on "waiver" would be unavailing. "[T]he general rule concerning questions raised neither at the trial nor at previous stages of appeal is far less restrictive than some case language would indicate," and unless the "new contentions could have been obviated or cured by factual showings or legal countersteps, . . . [they] may be raised on appeal for the first time." *Telaro v. Telaro*, 25 N.Y.2d 433, 439 (1969); Resp. 42 n.12. The absence of any extracontractual duty owed to the trustee is not something that Deutsche Bank could have changed through "factual showings or legal countersteps." While Deutsche Bank suggests that it could have "amend[ed] the Complaint" to remedy this flaw, Resp. 42 n.12, it offers nothing to suggest how it could have done so. Contrary to Deutsche Bank's suggestions, *see* Resp. 37, 42-44, it could not have alleged a fraud claim because the alleged misrepresentations are only contained in the parties' contract. *See First Bank of Ams. v. Motor Car Funding Inc.*, 257 A.D.2d 287, 291 (1st Dep't 1999).[12]

Finally, even if the Trustee had alleged the breach of an independent, extracontractual duty owed to it, the law provides that such breach must be particularly "egregious" even relative to other torts. *See* Br. 40. The allegations

[12] Even if there had been a "waiver," and even if the Court concluded that Deutsche Bank should have the opportunity to amend its complaint, that would not be a basis to affirm the reinstatement of the demand for punitive damages, but rather to permit Deutsche Bank to try to amend its complaint.

based on the SEC Order relating to 3% of the loans in the Trust need not be treated lightly in order to conclude that they fall well short of the extremely high standard set forth in *Walker v. Sheldon*, 10 N.Y.2d 401 (1961) and its progeny. And the Trustee's attempt to compare the alleged $21 million loss on those loans—2% of the $1.051 billion original principal balance of the Trust (*see* A49 ¶ 2)—to the $1,380 loss in *Walker* is completely misguided. *See* Resp. 45-46. In *Walker*, this Court concluded that the relatively low amount of damages would be insufficient to encourage the allegedly serial victims of defendant's scheme to enforce their remedies, and only "occasional award[s] of compensatory damages . . . would have little deterrent effect." *Walker*, 10 N.Y.2d at 404-06. By contrast, the substantial penalties touted in the Trustee's brief, *see* Resp. 45-46, make clear that there is no risk that the conduct alleged in the SEC Order would be "undeterred" unless the Trustee is allowed to recover punitive damages in addition to the complete remedy already provided by the contract. The Trustee cannot claim that it is the victim of any non-contractual breach, much less one that would justify punitive damages under New York law.

## V. THE PSA DOES NOT MEET THE *HOOPER* STANDARD FOR SHIFTING ATTORNEY'S FEES

New York law requires contracting parties to demonstrate an "unmistakably clear" intent if they wish to alter the American Rule that parties bear their own attorney's fees. Br. 40-41. The Trustee argues that this standard is met here, but when the sophisticated parties to the PSA intended to refer to attorney's fees, they did so *explicitly*—seventeen times in the agreement. It is illogical to suggest that they also intended the definition of Repurchase Price to include attorney's fees when, rather than saying so, they relied solely on the phrase "costs and expenses"—a phrase which has a well-established meaning under New York law that *excludes* attorney's fees. To say the least, this does not reflect the "clear and unmistakable intent" to *include* attorney's fees required by *Hooper Associates, Ltd. v. AGS Computers, Inc.*, 74 N.Y.2d 487 (1989).

The Trustee's focus on the word "enforce" is misplaced because the PSA's repurchase protocol includes a detailed *pre-suit* remedial mechanism, and therefore "enforcement" does not necessarily imply litigation. Br. 47. But even if it did, the contract refers only to "costs and expenses"—terms that, even when used in the context of litigation, do not include attorney's fees. *See* Br. 43; *see also LeVine v. Catskill Regl. Off-Track Betting Corp.*, 57 A.D.3d 624, 626-27 (2d Dep't 2008) ("litigation-related costs and expenses" do not include attorney's fees). The PSA itself confirms this view. For example, Section 3.02(c) refers to "costs, expenses *or attorneys fees*" incurred in the "*enforcement*" of subservicing agreements. (A185 § 3.02(c) (emphasis added).) If the parties intended "costs" and "expenses" to include attorney's fees when used in the context of "enforcement," their inclusion of "attorneys fees" in Section 3.02(c) would be superfluous—a result that should be avoided. *See* Br. 45-46.

The far more logical conclusion is that the parties understood that "costs" and "expenses" exclude attorney's fees, and therefore they explicitly referenced attorney's fees when they wanted to ensure they were included. *See* Br. 43. By not including the same explicit reference in the definition of Repurchase Price, the parties demonstrated an intent *not* to include attorney's fees in that section. Indeed, under the doctrine of *expressio unius est exclusio alterius*, the parties' explicit use of "attorney's fees" in other sections of the PSA compels the conclusion that the omission of attorney's fees from the definition of Repurchase Price was intentional. Br. 44-45.[13]

The Trustee tries to explain away the explicit references to attorney's fees in other sections by suggesting that those references were necessary "because the scope of those provisions would otherwise be ambiguous." Resp. 53-54. This is no distinction at all. If simply referring to "costs" and "expenses" in these other sections of the PSA would leave it ambiguous as to whether the parties intended to include attorney's fees, then the parties' reference to "costs"

[13] The Trustee cites authority limiting this doctrine when applied to statutes drafted piecemeal over the course of multiple legislative sessions, or to otherwise unambiguous contractual language. Resp. 52-53. Neither situation exists here.

and “expenses” in the definition of Repurchase Price cannot demonstrate a “clear and unmistakable intent” to include them.

Attempting to deflect attention from the actual language of the PSA, the Trustee argues that some courts have found that other contracts shift attorney’s fees without referring to them explicitly. Resp. 49-50. But Morgan Stanley has never argued that the *only* way parties can shift fees is by explicitly mentioning them. It is the context of this particular contract—specifically, the mere use of “costs” and “expenses” in the definition of Repurchase Price, combined with the explicit reference to attorney’s fees in other sections—that makes the failure to explicitly refer to attorney’s fees critical here.

Finally, the Trustee suggests that it would have been irrational to exclude attorney’s fees from the Repurchase Price because those fees are larger than the “costs” and “expenses” that are referenced. But the fact that a reading of the PSA is costly to the Trustee does not render that reading irrational. Indeed, the law *assumes* that parties intend to bear their own attorney’s fees, which are often significant. Parties negotiating at arm’s length can alter that rule, but if that is their intent, it must be unmistakably clear. Here, the language used by the parties indicates that they did not intend to alter the default American Rule, but at a minimum, it is not unmistakably clear that they did.

## CONCLUSION

For the foregoing reasons, the Appellate Division's Decision should be reversed.

Dated: New York, New York
October 31, 2019

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