

## Credit Suisse Ruling Arms Banks In Battle Over MBS Policies

By Bibeka Shrestha

*Law360, New York (October 16, 2012, 9:58 PM ET)* -- In barring Assured Guaranty Municipal Corp. from recovering rescissory damages in its mortgage-backed securities suit against Credit Suisse AG on Thursday, a New York judge handed lenders a powerful tool in their high-stakes fight to block financial guaranty insurers from rescinding similar policies, experts say.

One of several insurance giants to resist covering MBS losses, Assured accused Credit Suisse units DLJ Mortgage Capital Inc. and Credit Suisse Securities (USA) LLC of representing the loans underlying \$1.8 billion in residential mortgage-backed securities as being of higher quality than they actually were. This helped them inflate their credit ratings and lure Assured into insuring the MBS, Assured contends.

In her latest order, Judge Shirley Werner Kornreich struck down Assured's claims for rescissory damages, indemnification, attorneys' and accountants' fees, and consequential damages. Attorneys are paying particular attention to Judge Kornreich's decision to rule out rescissory damages for Assured because the insurer had continued pulling in premiums even after discovering Credit Suisse's alleged misrepresentations.

"It's a warning sign for any insurer [that's] going to want to cover its losses or go after the sponsor or the underwriter for any of this garbage that's out there that they got duped into insuring," Victoria Kummer, a partner at Dickstein Shapiro LLP, said on Tuesday. "As soon as there's a problem, stop accepting the premiums."

David Halbreich, a Reed Smith LLP partner who represents policyholders, said other insurers facing massive losses tied to MBS are also trying rescind their policies or rake in rescissory damages — the financial equivalent when rescission itself is impossible. Halbreich said Judge Kornreich had rightly called out Assured for continuing to accept premiums while trying to rescind coverage.

"I don't think the law would support the insurers' conduct," Halbreich said. "The court cited a pretty robust body of law in support of its decision. I think they should stand up and take notice."

Andrew Lorin, a Drinker Biddle & Reath LLP partner who leads the firm's financial guaranty insurance team, said the decision does eliminate some of the arrows in financial guaranty insurers' quiver.

"It has certainly reduced the settlement value for the financial guaranty insurer in this particular case, and maybe other cases as well," Lorin said. "You can be certain that defendants in these cases will be waving this decision in the faces of their opposing counsel."

Rhonda Orin, an Anderson Kill & Olick PC partner who counsels policyholders, said she expects to see more decisions on rescission in MBS suits like the one Judge Kornreich just handed down.

"Rescission is a very disfavored principle in insurance law," Orin said. "Attempts to rescind have come up in other contexts, and they usually crash and burn."

Daniel Healy, another policyholder attorney at Anderson Kill, pointed out that financial guaranty insurers like Assured often let a lender or another company involved in mortgage purchases do all the underwriting.

"There was a lot of looking away," Orin said. "And if the insurance companies looked away and didn't do any checking, they can't get a free ride."

But Lorin said the ruling isn't all bad news for insurers. The New York judge preserved Assured's breach of contract claims under pooling and service agreements, meaning the insurer will get to delve into discovery.

"That is going to be considered a win for the financial guaranty insurers," Lorin said. "[Assured's] basic claims for breach of contract and damages survive, and now they get to delve into Credit Suisse's documents to find what nasty surprises might lurk there."

Assured's suit centers around thousands of residential mortgage loans the DLJ unit assembled into six securitizations, which Credit Suisse sold to investors between 2006 and 2007. To make the securities more attractive, the defendants sought an insurer to guarantee payments to investors in the event of insufficient payments on the underlying mortgage loans, according to the suit.

In order to get Assured to insure the securities, DLJ issued a set of representations and warranties that vouched for the loans' quality, the suit said. Under the terms of their agreement, Assured would only assume the risk for mortgage loans that met those qualifications, and DLJ would repurchase, substitute or cure any loans that breached those qualifications, according to the insurer.

The residential mortgage-backed securities market collapsed in late 2007. As defaults and delinquencies in the underlying loans piled up, Assured says it examined the loans and discovered DLJ had overstated their quality.

Attorneys for Assured and Credit Suisse were not immediately available for comment Tuesday.

Assured is represented by Philippe Selendy, Adam Abensohn, Nicholas Joseph and Sean Baldwin of Quinn Emanuel Urquhart & Sullivan LLP.

The Credit Suisse affiliates are represented by Barry Levin, Lori Lynn Phillips, Darren Teshima, John Ansbro, Richard Jacobsen and Daniel Robertson of Orrick Herrington & Sutcliffe LLP.

The case is Assured Guaranty Municipal Corp. et al. v. DLJ Mortgage Capital Inc. et al., case number 652837/2011, in the Supreme Court of the State of New York, County of New York.

--Additional reporting by Keith Goldberg. Editing by Kat Laskowski and Katherine Rautenberg.