Exhibit 1

2019 WL 1431923
Only the Westlaw citation is currently available.

Court of Appeals of Minnesota.

In the MATTER OF: AMERICAN HOME MORTGAGE ASSETS TRUST 2007-5.

A18-0768
|
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Hennepin County District Court, File No. 27-TR-CV-15-354

Attorneys and Law Firms

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Considered and decided by Hooten, Presiding Judge; Reyes, Judge; and Cochran, Judge.

UNPUBLISHED OPINION

COCHRAN, Judge

***1** Appellant, a beneficiary of an investment trust, challenges orders issued by the district court in a trust-instruction proceeding initiated by respondent, the securities administrator for the trust, to resolve a dispute regarding the calculation of distributions made by the trust. Because we conclude that the district court did not err in interpreting the trust documents, but did err by dismissing appellant's counterclaims, we affirm in part, reverse in part, and remand.

FACTS

This appeal centers on a dispute over the proper interpretation of documents executed in connection with the 2007 creation of a residential mortgage-backed securities trust. Appellant LibreMax Capital, LLC holds certificates issued by the trust that entitle it to distributions based on interest paid on the mortgages held by the trust. Respondent Wells Fargo Bank, N.A., as securities administrator for the trust, is charged with calculating and making monthly distributions.

The trust is governed by a Pooling and Servicing Agreement (PSA), which incorporates a Servicing Agreement. Both the PSA and the Servicing Agreement include choice-of-law clauses providing for the application of New York law.

The PSA established 17 different classes of certificates. Each certificate represents an ownership interest in the trust, and each class of certificates has different rights to distributions from the trust. Only two active classes remain: Class A and Class X-P. [1]

LibreMax bought 100% of the Class X-P certificates on the secondary market, approximately six years after they were issued. As holder of the Class X-P certificates, LibreMax possesses 1% of the voting rights within the trust.

Wells Fargo calculates the amount to be distributed to each class of certificateholders based on the instructions specified in section 4.01, or the waterfall clause, of the PSA and distributes the available funds in accordance with the priority set forth in that section. Under the waterfall clause, Wells Fargo first distributes "Accrued Certificate Interest" to Class A and Class X-P. [2] For Class A, the Accrued Certificate Interest is paid directly to Class A certificateholders. But for Class X-P, the waterfall clause provides that any Accrued Certificate Interest payable is deposited into a shortfall reserve fund and first used to pay any carry-forward amounts due to certain other classes (now effectively only Class A). The remaining interest, if any, is then distributed to Class X-P certificateholders.

For both Class X-P and Class A, the Accrued Certificate Interest is based on the "then-applicable Pass-Through Rate." The "Pass-Through Rate" for each class is

specified in the PSA. For LibreMax's Class X-P certificates, the PSA defines the Pass-Through Rate for the interest-only components as:

> ***2** For any Distribution Date and the X-IO-A Component, the excess, if any, of (i) *the weighted average of the Net Mortgage Rates for the Mortgage Loans* as of the first day of the related Due Period over (ii) the quotient of (a) the product of (I) 12 multiplied by (II) the aggregate amount of interest accrued on the Class A Certificates for the related Accrual Period divided by (b) the Notional Amount of the X-IO-A Component for such Distribution Date.
>
> For any Distribution Date, and the X-IO-B Component, the excess, if any, of (i) *the weighted average of the Net Mortgage Rates for the Mortgage Loans* as of the first day of the related Due Period over (ii) the quotient of (a) the product of (I) 12 multiplied by (II) the aggregate amount of interest accrued on the Class M and Class B Certificates for the related Accrual Period divided by (b) the Notional Amount of the X-IO-B Component for such Distribution Date.

(Emphasis added.) Because the Pass-Through Rate for Class X-P depends on the "weighted average of the Net Mortgage Rates for the Mortgage Loans," it is necessary to determine the weighted average of the Net Mortgage Rates for the Mortgage Loans in order to determine the Accrued Certificate Interest to be distributed to Class X-P.[3]

The "Net Mortgage Rate" for a mortgage is defined in the PSA as the "per annum rate of interest equal to the then-applicable Mortgage Rate on such Mortgage Loan less the Servicing Fee Rate." "Mortgage Rate" is the "annual rate at which interest accrues on such Mortgage Loan, as adjusted from time to time in accordance with the provisions of the Mortgage Note." The "Mortgage Note" is "the note or other evidence of the indebtedness of a Mortgagor under a Mortgage Loan."

Since the inception of the trust, Wells Fargo has used the actual, then-applicable interest rates on the underlying mortgages to calculate the Net Mortgage Rates used in its calculation of the Pass-Through Rates and Accrued Certificate Interest. In other words, if the servicer lowered the interest rate on a Mortgage Loan through a loan-modification agreement with the borrower to avoid default, Wells Fargo used the modified rate provided by the servicer to compute the Net Mortgage Rate. In its role as securities administrator, Wells Fargo interpreted the phrase "then-applicable Mortgage Rate" in the PSA to mean interest rates as adjusted by the original mortgage note or by a loan-modification agreement (also known as a "servicing modification").

In February 2015, LibreMax contacted Intex Solutions, Inc., a private company that creates cash-flow models for residential mortgage-backed securities trusts. LibreMax questioned Wells Fargo's calculation of the Net Mortgage Rate. Wells Fargo and Intex exchanged email communications, disputing how loan modifications affect the Net Mortgage Rate. In May and June 2015, LibreMax contacted Wells Fargo directly, asking for any updates on the disputed calculations but did not identify itself as a certificateholder. In July 2015, LibreMax contacted Wells Fargo again, identified itself as a Class X-P certificateholder, and asked Wells Fargo to explain the calculations. LibreMax asserted that, under the terms of the Servicing Agreement, servicing modifications should not impact the calculation of interest distributions. Specifically, LibreMax relied on section 4.04 of the Servicing Agreement, which provides:

> ***3** The mortgage rate and Net Mortgage Rate as to any mortgage loan will be deemed not reduced by any servicing modification, so that the calculation of accrued note interest (as defined in the prospectus supplement[4]) payable on the Offered Certificates will not be affected by the servicing modification.

In December 2015, after several emails, and having reached no consensus on how distributions should be calculated, Wells Fargo filed a trust-instruction proceeding (TIP), asking the district court to: (1) approve and ratify Wells Fargo's determination that "under the terms of the PSA, for purposes of calculating the Net Mortgage Rate, the Mortgage Rate includes a change in the annual rate pursuant to a servicing modification;" (2) reform the Servicing Agreement to conform with this determination; and (3) declare that

Wells Fargo is not subject to any liability in making the distributions at issue. LibreMax filed an objection, answer, and counterclaims alleging breach of contract, negligence, gross negligence, servicing failures, failure to provide notice, and accounting. LibreMax also moved for judgment on the pleadings.

The district court held a hearing and dismissed LibreMax's counterclaims, determining that they were not properly brought under the PSA. The district court also denied LibreMax's motion for judgment on the pleadings, determining that there was reasonable doubt as to the administration of the trust.

Following a bench trial, the district court issued an order granting Wells Fargo's petition and construing the PSA consistent with Wells Fargo's position. The district court applied New York contract law to determine that the PSA and Servicing Agreement must be interpreted as a single contract because they "were both components of a larger design to securitize the loans in the [trust] for sale to investors." The district court also concluded that there was an ambiguity when the documents are construed together and looked to extrinsic evidence to interpret the PSA and Servicing Agreement. Based on the testimony heard at trial, industry practice, and the specificity of the PSA's waterfall clause, the district court ruled in Wells Fargo's favor and ordered construction of the PSA to require distributions based on "the actual Mortgage Rates on the underlying Loans as such Mortgage Rates may be adjusted by the Servicer in connection with authorized modifications of the Mortgage Loans." The district court also determined that Wells Fargo was not subject to liability for its actions in making distributions and denied LibreMax's request for damages and attorney fees.

LibreMax appeals.

DECISION

LibreMax argues on appeal that the district court erred by (1) denying LibreMax's motion for judgment on the pleadings, (2) interpreting the PSA and Servicing Agreement in Wells Fargo's favor, and (3) dismissing LibreMax's counterclaims. We address these issues in turn below. [5]

I. The denial of LibreMax's motion for judgment on the pleadings is not within the scope of this appeal.

*4 LibreMax moved for judgment on the pleadings, arguing that Wells Fargo did not adequately set forth a claim for reformation of the Servicing Agreement. The district court denied LibreMax's motion and held a bench trial. After the trial, the district court concluded that Wells Fargo had properly interpreted the trust documents and determined that it "need not address Wells Fargo's alternative argument requesting reformation of the Servicing Agreement." LibreMax now seeks review of the district court's denial of the motion for judgment on the pleadings.

This court "has the authority to review orders that 'affect' the judgment being appealed." *Bahr v. Boise Cascade Corp.*, 766 N.W.2d 910, 918 (Minn. 2009) (citing Minn. R. Civ. App. P. 103.04). Minnesota courts have repeatedly held that "the denial of a motion for summary judgment is not within an appellate court's scope of review after a trial has been held and the parties have been given a full and fair opportunity to litigate their claims" because summary-judgment orders no longer affect the judgment being appealed. *Sorchaga v. Ride Auto LLC*, 893 N.W.2d 360, 367-68 (Minn. App. 2017) (quotation omitted); *see Bahr*, 766 N.W.2d at 918. The same logic applies to preclude an appellate court's review of a denial of judgment on the pleadings after a trial has been held. Because the parties have been given a full opportunity to litigate the proper interpretation of the PSA and Servicing Agreement at trial, the district court's order denying LibreMax's motion for judgment on the pleadings is not reviewable by this court. *See*, *e.g.*, *Bennett v. Pippin*, 74 F.3d 578, 585 (5th Cir. 1996) (explaining that issues arising from denial of motion to dismiss are mooted by trial because "[a]ny pleading defect may be cured by a motion under Fed. R. Civ. P. 15(b), and the sufficiency of the plaintiff's evidence may be tested by an appeal on that issue"); *Bahr*, 766 N.W.2d at 918 (finding persuasive similar analysis of federal courts addressing postjudgment reviewability of denial of summary judgment).

II. The district court did not err in interpreting the PSA and Servicing Agreement.

The district court determined that the PSA and Servicing Agreement, read together, [6] were ambiguous, and resolved that ambiguity in favor of Wells Fargo based on the evidence presented at trial. LibreMax argues that

the trust documents unambiguously require the exclusion of servicing-modification interest-rate adjustments from the calculation of distributions.

While Minnesota law governs the procedural aspects of this court's review, interpretation of the PSA and Servicing Agreement is governed by New York law under the choice-of-law provisions included in the trust documents. *See Davis v. Furlong*, 328 N.W.2d 150, 153 (Minn. 1983) (noting that Minnesota follows "the almost universal rule that matters of procedure and remedies [are] governed by the law of the forum state"); *Miliken & Co. v. Eagle Packaging Co.*, 295 N.W.2d 377, 380 n.1 (Minn. 1980) (stating that Minnesota courts are "committed to the rule that parties may agree that the law of another state shall govern their agreement and will interpret and apply the law of another state where such an agreement is made" (quotation omitted)).

Whether a contract is ambiguous is a matter of law. *Greenfield v. Philles Records, Inc.*, 780 N.E.2d 166, 170 (N.Y. 2002); *see also Denelsbeck v. Wells Fargo & Co.*, 666 N.W.2d 339, 346-47 (Minn. 2003). When a contract is ambiguous, extrinsic evidence may be considered to aid in interpretation. *Greenfield*, 780 N.E.2d at 170. A district court's determinations regarding the interpretation of an ambiguous contract will not be reversed unless clearly erroneous. *Alpha Real Estate Co. of Rochester v. Delta Dental Plan of Minn.*, 671 N.W.2d 213, 221 (Minn. App. 2003), *review denied* (Minn. Jan. 20, 2004).

A. There is an ambiguity between the PSA and the Servicing Agreement regarding the interest rate to be used in calculating distributions.

***5** We must first determine if there is an ambiguity between the language of the PSA and Servicing Agreement, which must be read together. *See This is Me, Inc. v. Taylor*, 157 F.3d 139, 143 (2d Cir. 1998) ("Under New York law, all writings forming part of a single transaction are to be read together."). "A contract is unambiguous if the language it uses has a definite and precise meaning, unattended by danger of misconception in the purport of the agreement itself, and concerning which there is no reasonable basis for a difference of opinion." *Greenfield*, 780 N.E.2d at 170-71 (quotation omitted). If a contract is "reasonably susceptible" to only one meaning, then the contract is not ambiguous. *Id.* But, "when the contract, read as a whole, fails to disclose its purpose and the parties' intent, or when specific language is susceptible of two reasonable interpretations," the contract is ambiguous. *Ellington v. EMI Music, Inc.*, 21 N.E.3d 1000, 1003 (N.Y. 2014) (quotation and citations omitted).

The PSA's waterfall clause states that Class A and Class X-P certificateholders receive Accrued Certificate Interest, which is based on the "then-applicable Mortgage Rate[s]" of the underlying loans. Wells Fargo maintains that the "then-applicable" language refers to the actual interest rate and encompasses any servicing modifications made to the interest rates paid on the underlying loans that would affect the calculation of the Net Mortgage Rate. LibreMax counters that the "then-applicable" rate refers only to the interest rate as adjusted pursuant to the terms of the adjustable-rate-mortgage notes included in the trust, but not pursuant to any servicing modifications that affect the interest rate paid. LibreMax further points to section 4.04 of the Servicing Agreement which states that "[t]he mortgage rate and Net Mortgage Rate as to any mortgage loan will be deemed not reduced by any servicing modification, so that the calculation of accrued note interest ... payable on the Offered Certificates will not be affected by the servicing modification."

In support of its theory that the "then-applicable" rate refers only to the interest rate as adjusted pursuant to the terms of the adjustable-rate-mortgage notes and not servicing modifications, LibreMax points to the definition of Mortgage Rate. Mortgage Rate is defined in the PSA as "the annual rate at which interest accrues on such Mortgage Loan, as adjusted from time to time *in accordance with the provisions of the Mortgage Note*." (Emphasis added.) Thus, according to LibreMax, changes to the interest rate due to the adjustable-rate provisions of the mortgage notes are included but changes in the interest rate due to servicing modifications are not included. LibreMax points out that servicing modifications are made by executing a loan-modification agreement, which is a contract separate from the mortgage note, and argues on that basis that any servicing modification does not affect the calculation of the then-applicable Mortgage Rate. But LibreMax's interpretation fails to account for the definition of Mortgage Note. The PSA defines Mortgage Note more broadly than just the note itself. The term Mortgage Note is defined as "[t]he note or other evidence of the indebtedness of a Mortgagor

under a Mortgage Loan." And, when read with the term Mortgage Rate, the two terms together provide that the mortgage rate to be used is "the annual rate at which interest accrues on such Mortgage Loan, as adjusted from time to time in accordance with the provisions of '[t]he note *or* other evidence of the indebtedness of a Mortgagor under a Mortgage Loan.' " (Emphasis added.)

The phrase "other evidence of the indebtedness of a Mortgagor under a Mortgage Loan" is broad enough to include a loan-modification agreement. The term "indebtedness" is defined as the "condition of owing money." *Black's Law Dictionary* 885 (10th ed. 2014). The record reflects that the loan-modification agreement used by the servicer lists the principal amount of money still owed by the Mortgagor on the Mortgage Loan, the annual interest rate, and any annual changes to the interest rate. Thus, a loan-modification agreement is "other evidence of the indebtedness of a Mortgagor under a Mortgage Loan" within the meaning of the definition of Mortgage Note. And the terms Mortgage Rate and Mortgage Note are properly read together to provide that adjustments to the interest rates due to loan-modification agreements are to be included in the "then-applicable Mortgage Rate[s]" used to calculate the Accrued Certificate Interest.

***6** In sum, the PSA informs Wells Fargo to consider adjustments in the interest rate due to loan-modification agreements, also known as servicing modifications, when calculating interest, but the Servicing Agreement instructs Wells Fargo to not include those same servicing modifications. There is not a harmonious solution to interpreting the waterfall clause of the PSA and section 4.04 of the Servicing Agreement. Instead, the language of the two provisions conflicts, creating an ambiguity and allowing the consideration of extrinsic evidence when interpreting the PSA and Servicing Agreement.

B. The district court's interpretation of the PSA and Servicing Agreement is supported by the record.

Under New York law, if two provisions are in conflict with each other, a court should enforce "the clause relatively more principal to the contract." *Israel v. Chabra*, 906 N.E.2d 374, 380 n.3 (N.Y. 2009) (quotation omitted). Following trial, the district court determined that the Servicing Agreement did not contain a more specific provision regarding distributions than the PSA and instead, the waterfall provision was clear. LibreMax contends that the district court erred, arguing that the more specific and principal clause is section 4.04 of the Servicing Agreement. LibreMax maintains that the "PSA's waterfall provision speaks of the general duties of the Securities Administrator in calculating distribution payments, but does not address what happens in the event of a servicing modification." Based on our review of the trust documents and the evidence presented at trial, we disagree.

Importantly, the PSA is the document that creates the trust, and we have no trouble concluding that the waterfall clause of the PSA is more principal than section 4.04 of the Servicing Agreement. The waterfall clause expressly governs the calculation of distributions from the trust, while section 4.04 of the Servicing Agreement has to do with advances, or what actions the Servicer may take when payments are not made on the underlying mortgage loans. The context of the waterfall clause versus section 4.04 of the Servicing Agreement supports the district court's determination that the waterfall clause is the more principal provision. [7]

The evidence presented at trial further supports the district court's determination. The type of extrinsic evidence that a court may look to while interpreting an ambiguous contract includes industry custom or practice, drafting history, and course of performance. *See Christiania Gen. Ins. Corp. of N.Y. v. Great Am. Ins. Co.*, 979 F.2d 268, 274 (2d Cir. 1992) (including industry custom or practice); *MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, 950 F. Supp. 2d. 568, 613-14 (S.D.N.Y. 2013) (including drafting history); *Jobim v. Songs of Universal, Inc.*, 732 F. Supp. 2d 407, 416 (S.D.N.Y. 2010) (including course of performance as extrinsic evidence).

A Wells Fargo business-negotiations consultant testified that the PSA is the "primary governing document" and prescribed Wells Fargo's "roles and responsibilities including items such as waterfall payments ... and reporting to investors." An employee at Wells Fargo who analyzes payment calculation also testified that "the PSA is the legal governing document for the transaction that defines the waterfall and the payment of priorities" to certificateholders. Wells Fargo also introduced evidence of various other residential mortgage-backed securities transactions. In those transactions, the language of the applicable PSAs specifically and expressly excluded loan

modifications from its distributions.[8] In contrast, the PSA here indicates no intent to exclude loan modifications from distributions. This evidence shows that when servicing modifications are intended to be excluded, specific language is included in the PSA itself. That was not done here.

***7** Based on the structure of the PSA and Servicing Agreement, the testimony of multiple witnesses, and industry practice, the district court did not err in interpreting the PSA and Servicing Agreement in Wells Fargo's favor.

III. The district court erred in dismissing LibreMax's counterclaims.

The district court dismissed LibreMax's counterclaims under Minn. R. Civ. P. 12.02(e), based on its interpretation of the PSA's no-action clause. This court reviews de novo the district court's grant of a motion to dismiss under Minn. R. Civ. P. 12.02(e). *Sipe v. STS Mfg., Inc.*, 834 N.W.2d 683, 686 (Minn. 2013). While Minnesota law governs the procedural aspect of this court's review, interpretation of the PSA's no-action clause is governed by New York law pursuant to the PSA's choice-of-law provision. *See Miliken & Co.*, 295 N.W.2d at 380 n.1.

The no-action clause in section 10.03 of the PSA provides in relevant part that "[n]o Certificateholder shall have any right by virtue of any provision of this Agreement to institute any suit, action or proceeding in equity or at law upon or under or with respect to this Agreement" except where certain conditions are met. The no-action clause further specifies that a certificateholder may institute a proceeding only if the holder provides notice to the trustee, possesses at least 51% of the voting rights, and offers to indemnify the trustee.

LibreMax brought counterclaims for breach of contract, negligence, gross negligence, servicing failures, failure to provide notice, and accounting. The district court determined that the filing of counterclaims by LibreMax constituted "institution of a suit, action or proceeding" under section 10.03 of the PSA. The district court also determined that LibreMax failed to meet the requirements for instituting a proceeding in accordance with the no-action clause in section 10.03 because LibreMax possessed only 1% of voting rights. Therefore, the district court dismissed LibreMax's counterclaims.

LibreMax argues that bringing a counterclaim does not amount to instituting a suit, action, or proceeding, and thus section 10.03 does not apply to the filing of counterclaims. LibreMax cites to *Local Union No. 38, Sheet Metal Workers' Int'l Ass'n, AFL-CIO v. Pelella* for the proposition that:

> A party institutes an action when he commences a judicial proceeding....
>
> An action is therefore instituted when a plaintiff files a complaint as that constitutes the first step invoking the judicial process. In sharp contrast, a defendant asserts a counterclaim in response to a plaintiff's institution of an action. A counterclaim, by definition, is a claim for relief asserted against an *opposing party after* an *original* claim has been made.
>
> In other words, a defendant does not "institute" an action when he asserts a counterclaim.

350 F.3d 73, 82 (2d Cir. 2003) (quotation and citations omitted). New York state courts have adopted this interpretation. *See GLC Securityholder LLC v. Goldman, Sachs & Co.*, 905 N.Y.S.2d 27, 28 (N.Y. App. Div. 2010) ("While defendants would be barred by the indenture's 'no action' clause from commencing an action to recover payments due on the notes, they are not barred from asserting counterclaims for such relief.").

***8** Wells Fargo cites to a Second Circuit case that barred counterclaims as an "action or proceeding against the debtor ... notwithstanding the fact that the plaintiff initiated the lawsuit." *Koolik v. Markowitz*, 40 F.3d 567, 568 (2d Cir. 1994) (quotation omitted). But that case involved the interpretation of the automatic-stay provision of the federal bankruptcy code, which includes broader language than the no-action clause at issue here. *See id.* Wells Fargo additionally argues that the no-action clause prohibits LibreMax from instituting any *proceeding*, and "proceeding" is a comprehensive term that may include counterclaims. But as LibreMax correctly points out, the real issue is whether asserting counterclaims *institutes* a proceeding. Applying New York law, we conclude that LibreMax did not "institute" a proceeding, but instead responded to Wells Fargo. *See Pelella*, 350 F.2d at 82; *GLC Securityholder*, 905 N.Y.S.2d at 28. Because LibreMax did not institute a proceeding,

the no-action clause in section 10.03 does not bar its counterclaims.

The district court erred in dismissing LibreMax's counterclaims. Because the district court did not consider the merits of LibreMax's counterclaims, we reverse the dismissal of the counterclaims, and remand for further proceedings not inconsistent with this opinion.

All Citations

Not Reported in N.W. Rptr., 2019 WL 1431923

Footnotes

1 Class X-P is divided into two components: principal-only and interest-only. It is the interest-only component that is at issue in this proceeding. The interest-only component is further subdivided into two components: X-IO-A and X-IO-B.

2 The waterfall clause also provides that Class R has first priority to Accrued Certificate Interest along with Class A and Class X-P but Class R is no longer an active class.

3 The PSA defines the Pass-Through Rate for Class A differently than for Class X-P but the Pass-Through Rate for Class A, like Class X-P, also depends on "the weighted average of the Net Mortgage Rates on the Mortgages Loans."

4 The Prospectus Supplement is a legal document that must be filed with the Securities and Exchange Commission for potential investors to rely upon when making investment decisions.

5 LibreMax also argues that, assuming the district court erred in interpreting the trust documents, it also erred by determining that Wells Fargo is not subject to liability to the trust's beneficiaries and that LibreMax is not entitled to damages including attorney fees incurred. Because we conclude that the district court did not err in interpreting the trust documents, we do not reach these issues.

6 The district court read the PSA and Servicing Agreement together as a single contract.

7 Although we agree with the district court that the conflict can be resolved by enforcing the waterfall clause as the more principal clause, we also note that, "in the case of total repugnancy between two contract clauses, the first of such clauses shall be received and the subsequent one rejected." *Honigsbaum's, Inc. v. Stuyvesant Plaza, Inc.*, 577 N.Y.S.2d 165, 166 (N.Y. App. Div. 1991).

8 Those PSAs also provided that any risk due to a loan modification was to be borne by the recipient of excess interest.