

GE Unit Loses Bid to Sink Megabucks Mortgage Suits

By Jan Wolfe
April 1, 2014

A federal judge in Connecticut refused Monday to dismiss claims that WMC Mortgage Corp., a subsidiary of General Electric Co.'s financial services arm, misled investors about billions of dollars' worth of mortgage-backed securities. A newcomer to MBS litigation, the judge recited various arguments the banks have raised in recent years and then rejected them one-by-one in unusually colorful fashion. He even quoted New York Times columnist Paul Krugman—never a good sign if you're a financial institution—though it was his citations to a trio of Manhattan federal judges handling similar cases that ultimately sank the defense.

The claims were brought by two MBS trustees, Deutsche Bank National Trust Company and Law Debenture Trust Company of New York, which are represented by Steven Molo of MoloLamken and Harvey Wolkoff of Ropes & Gray, respectively. Jenner & Block is defending WMC.

WMC is best known for originating subprime mortgages. But it also pooled them into securities, which were sold to investors through trusts. Deutsche Bank and Law Debenture served as trustees for MBS trusts.

After the securities plummeted in value, Molo brought three lawsuits against WMC on behalf of Deutsche Bank. The three cases were all filed in 2012 in Connecticut, where GE is headquartered. Typically, MBS trustees file suit at the request of hedge funds and other large institutional investors. Molo declined to tell us which investors are driving his cases.

All told, Molo's cases involve three MBS trusts with a combined face value of more than \$4 billion. His client alleges that WMC misrepresented the soundness of the underlying mortgages, and is therefore obliged under the relevant agreements to repurchase them. Molo said the trustee is seeking somewhere in the ballpark of \$2 billion in damages on behalf of investors.

Molo's cases were assigned to Senior U.S. District Judge Charles Haight Jr., who used to sit in Manhattan but relocated to New Haven when he took senior status. For briefing purposes, he combined Molo's cases with a related suit that Ropes & Gray's Wolkoff brought on behalf of Law Debenture. That case involves



James Ward

Steve Molo

a fourth MBS trust with a face value of a bit less than \$1 billion.

For its defense, WMC retained legal heavyweight Paul Smith of Jenner & Block. In a motion to dismiss, he argued that the plaintiffs didn't put WMC on notice that most of the mortgages were defaulting, so it never had a chance to buy them back.

That's a defense argument that's come up again and again in parallel cases. So it was interesting to see Haight's incredulous reaction. "One conjures up a mental picture of platoons of experienced, highly motivated WMC employees, each one ready, able and eager at the drop of a seemingly troubled mortgage loan file to examine the file, evaluate any discernible potential deficiencies, and by the laying on of healing hands, cure any deficiencies that could be remedied," he wrote. "It is a reassuring, even a comforting, vision. But its relationship to reality may plausibly be questioned."

The reality of the situation, Haight concluded, was that the trusts reviewed a sample of the underlying home loans in 2012 and concluded that many of them didn't conform with the underwriting standards WMC vowed it would use. To this day, WMC hasn't repurchased a single one of those home loans, the judge noted. "These rather stark circumstances give rise to the legitimate suspicion—for this early stage of the case I put it no higher—that the grief WMC professes in its brief over a lost opportunity to evaluate and cure [loans] is not genuinely felt," he wrote.

To support his conclusions, Haight relied heavily on three U.S. district judges in the Southern District of New York who have refused to toss similar claims: Jed Rakoff, Alison Nathan and Robert Sweet.

Molo praised Haight for adopting a "legally grounded but commonsense" approach. "If you take a step back, what he's doing is saying he's not buying the hypertechnical arguments that defendants have made in these cases," Molo said.

Jenner's Smith didn't immediately return a call seeking comment.