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RMBS Seller's Bankruptcy Axes Class Suit Against Citibank

By **Dunstan Prial**

Law360 (March 22, 2018, 6:57 PM EDT) -- A New York federal judge on Tuesday dismissed a proposed class action alleging Citibank NA failed to properly oversee investments in certain residential mortgage-backed securities, saying the bankruptcy of the companies that sold and serviced the securities had blocked the bank from taking steps that might have helped investors.

U.S. District Judge Jesse M. Furman approved the bank's bid to exit the suit, rejecting arguments by a group of institutional investors that Citibank breached its duties as the trustee of a statutory trust containing residential mortgage-backed securities by failing to act after learning of problems with the securities.

"The court concludes that plaintiffs' claims fail as a matter of law because they cannot prove that Citibank could have taken action to avoid the harms that ultimately befell them," the judge wrote.

The judge said that the 2007 bankruptcy of the trust's seller and servicer — American Home Mortgage Acceptance Inc. and American Home Mortgage Servicing Inc. — had effectively tied Citigroup's hands because by the time the bank found out about the trust's problems in 2009 the bankruptcy proceedings prevented them from doing anything that would benefit the trust's investors.

"Specifically, because of the automatic bankruptcy stay, Citibank was precluded from taking any actions outside of the bankruptcy to recover against the bankrupt entities," the judge wrote. In addition, he said the bankruptcy proceedings prevented Citibank from pursuing any enforcement measures "that would have avoided the losses that plaintiffs claim to have suffered" when the bank discovered problems with the trust in 2009.

"It follows that plaintiffs cannot establish breach, causation, or damages — all necessary elements for their claims," the judge wrote.

The investors had claimed Citi internal communications and other documentary and circumstantial evidence showed that the bank knew or should have known of problems in the RMBS trust it oversaw, yet failed to take contractually obligatory steps to protect the trust's investors. The investors say this caused them to suffer more than $68 million in diminished cash flows.

But the ruling, in the Southern District of New York, said that by the time Citibank learned about the problems in 2009, as alleged in the investors' suit, the entities with which Citibank might have pursued claims had already declared bankruptcy and the deadline under the rules of those bankruptcy proceedings for such claims had passed.

“Against that backdrop, plaintiffs fail to present any non-speculative reason to believe that Citibank could have and should have taken any different actions than it did, let alone that such actions would have prevented any harms to plaintiffs,” Judge Furman wrote.

The judge added that the plaintiffs, which included several PIMCO funds, were between a “rock and a hard place.” By claiming in their suit that Citibank did not learn of the alleged problems until 2009, the investors had avoided statute-of-limitations issues, the judge said. But using the 2009 date ran them “headlong into a bankruptcy problem,” he added.

Citi had moved for summary judgment in April, arguing that the investors had relied on “circumstantial and generalized allegations” that fell short of providing the kind of loan- and trust-specific evidence necessary to back up their claims regarding the problems that Citi allegedly knew about.

The institutional investors originally sued Citibank in 2014, alleging that the bank had ignored widespread problems in 27 private-label RMBS trusts that it administered as trustee. Those trusts were securitized between 2004 and 2007, during the run-up to the housing crisis, and were originally backed by more than $17.4 billion in home loans. According to the investors, Citi had ample opportunity to figure out that there were pervasive loan defects in the trust. In addition to the documentation deficiencies flagged in mortgage file reports, the trust’s poor performance should have been a clue that something was amiss, the investors said .

Since that initial complaint, Citibank has successfully whittled down some of the claims against it, while other investors have dropped out of the suit. The remaining investors were seeking class action certification by pressing forward with allegations related to Citibank’s handling of one trust in particular, AHM 2004-3.

A Citibank spokesman said, "We are pleased with the decision." Counsel for the investors did not respond to requests for comment.

The investors are represented by Jeroen Van Kwawegen, David R. Kaplan, Brett M. Middleton, Timothy A. DeLange, Benjamin Galdston, Niki L. Mendoza, Robert Steven Trisotto, David R. Stickney and Lucas E. Gilmore of Bernstein Litowitz Berger & Grossmann LLP.

Citibank is represented by Matthew D. Ingber, Christopher J. Houpt, Allison Joan Zolot, Michael E. Rayfield, Bronwyn F. Pollock, Jarman D. Russell and Lisa Robyn Blank of Mayer Brown LLP and Michael Martinez of Kramer Levin Naftalis & Frankel LLP.

The case is Fixed Income Shares et al. v. Citibank NA, case number 1:14-cv-09373, in the U.S. District Court for the Southern District of New York.

-- Additional reporting by Jon Hill. Editing by Peter Rozovsky.