

AG MIT CMO, LLC v. RBC (Barbados) Trading Corp.: Initial Post-COVID-19 Litigation Challenges to Closeouts of Repurchase Agreements

On March 25, 2020, two mortgage real estate investment trust (“MREIT”) subsidiaries of the Angelo Gordon Mortgage Investment Trust filed a lawsuit against Royal Bank of Canada (“RBC”) seeking a temporary restraining order and preliminary injunction to prohibit an auction of securities subject to two repurchase agreements, as well as damages. The motion for a TRO was denied as moot because the filing was not completed until after the auction was scheduled to begin. Nonetheless, the complaint is noteworthy in that it previews theories and potential claims that may be pursued by others in connection with closeouts of repurchase agreements and other financial contracts amidst the recent market volatility resulting from the COVID-19 crisis.

The Repurchase Agreements

A repurchase agreement is a transaction in which a seller (here, each of the MREITs) sells securities to a buyer (here, RBC) and agrees to repurchase those securities after a specified period of time for a pre-determined price along with periodic interest payments. While structured as a sale and purchase, the transactions also share certain features with short-term borrowings. The agreements here also required the sellers to satisfy margin calls by the buyer if the market value of the securities fell below their initial sale price to the buyer,¹ with market value calculated under the agreements through a “generally recognized source agreed to by the parties.”² If the seller does not meet its margin call obligation, the buyer may declare a default and terminate the agreement. In that event, the agreements provide the buyer with different options for valuing the securities and calculating any termination amount, including by selling the securities.³

¹ Complaint at Exhibits A and B, Section 4(a), *AG MIT CMO, LLC v. RBC (Barbados) Trading Corp.*, No. 1:20-cv-02547 (S.D.N.Y. 2020), ECF No. 1.

² *Id.* at Section 2(j).

³ *Id.* at Section 11.



The Allegations

In their complaint, the MREITs (together, “AG”) alleged that RBC declared a default under the repurchase agreements based on AG’s failure to satisfy RBC’s recent margin calls and that AG had learned that RBC intended to conduct an auction of the securities subject to the agreements beginning at 11 A.M. on March 25. AG sought a TRO, a preliminary injunction, and damages based on its contention that (1) RBC impermissibly calculated the market value of the securities under the agreements for purposes of its margin calls and that those margin calls and RBC’s subsequent declaration of default were therefore void; and (2) there is currently no recognized market as a result of the COVID-19 crisis in which RBC could auction the securities and any auction would not be commercially reasonable.⁴

Background Allegations

The complaint includes extensive allegations regarding the COVID-19 crisis and its adverse impact on the market for the mortgage-backed securities, which are the subject of the repurchase agreements. For example, AG alleged that, irrespective of the legitimacy of RBC’s calculations, margin call obligations, triggered by the decline of the securities’ value and liquidity shortages caused by the worldwide economic slowdown in response to the crisis, are pushing MREITs “to the brink of collapse.”⁵

The complaint also included extensive allegations regarding federal and state economic stabilization efforts, such as (1) the Federal Reserve’s commitment to purchase \$200 billion in agency mortgage backed securities and the creation of a Primary Dealer Credit Facility that would allow RBC to pledge MBS to the Federal Reserve at favorable terms;⁶ and (2) New York Governor Andrew Cuomo’s Executive Order 202.9,

which deemed it an unsafe and unsound practice to fail to grant forbearance to a person or business experiencing financial hardship due to the crisis.⁷ Although AG contended that RBC’s actions in connection with its margin calls and subsequent termination were contrary to public policy and would cause irreparable harm to the mortgage markets and the U.S. economy as a whole,⁸ AG did not assert any causes of action based on government and regulatory action, as those efforts to date have not created any new private rights of action. Furthermore, there are, at a minimum, significant questions as to whether Executive Order 202.9 even applies in these circumstances.⁹

AG’s Claims

AG’s actual claims sound in breach of contract, anticipatory breach, and breach of the implied covenant of good faith and fair dealing:

- First, AG asserted that RBC breached the Agreements by unilaterally failing to calculate the market value of the securities based on a source “agreed to by the parties” as required under the agreements. AG alleged that RBC’s market valuation was instead “based on an artificially (and temporarily) depressed market that is not a reliable or reasonable means of calculating the true value of the underlying securities.”¹⁰
- Second, AG asserted that RBC’s intent to auction the securities was an anticipatory breach (i) because AG had not actually defaulted given that RBC’s margin calls were improperly calculated and void, and (ii) because there is no “recognized market” in light of the COVID-19 crisis in which to auction the securities. Alternatively, AG contended that holding an auction while the value of the securities are

⁴ See *id.* at ¶¶ 3, 51-60.

⁵ *Id.* at ¶¶ 1, 22-23.

⁶ *Id.* at ¶¶ 27-29.

⁷ *Id.* at ¶¶ 31-32.

⁸ See *id.* at ¶ 2.

⁹ For an in-depth analysis of Executive Order 202.9, see Alert Memorandum, Cleary Gottlieb, DFS Regulation

Clarifies Scope of Governor Cuomo’s Forbearance Order (Mar. 25, 2020) available at <https://www.clearygottlieb.com/news-and-insights/publication-listing/dfs-regulation-clarifies-scope-of-governor-cuomos-forbearance-order>.

¹⁰ Compl. at ¶¶ 46-50.

depressed would not be commercially reasonable, as is required under the agreements.¹¹

- Finally, AG asserted that RBC breached the implied covenant of good faith and fair dealing by refusing, despite the crisis, to agree to forbearance, meaning its margin calls “do not have the contractually-intended effect, but instead deprive Plaintiffs of the still-expected fruits of their contracts in favor of windfall profits for Defendants.”¹²

transactions, as parties frequently modify the provisions in master repurchase agreements governing the calculation of the market value of the subject securities, as well as those governing the sale of such securities following an event of default.

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The Outcome

Judge Schofield of the Southern District of New York denied the application for the TRO and preliminary injunction as moot, as by the time AG’s materials could have been reviewed it was likely that the MBS would have already been sold or the auction completed (the auction was scheduled to begin at 11 A.M. but the application was not filed until 11:10 A.M., and AG’s memorandum did not arrive at the courthouse in hard copy or chambers’ inbox until two or more hours later).¹³ The parties have since met and conferred and are working towards a consensual resolution before a follow-up conference currently scheduled for April 2. No further auctions of securities subject to these repurchase agreements are currently scheduled.¹⁴

While the TRO application was rendered moot by timing, the complaint serves as a prelude to what will likely be further litigation related to closeouts of repurchase agreements and other financial contracts where counterparties are likely to challenge valuations in connection with such closeouts and provides at least one potential set of theories and claims on which parties may rely in disputing the validity of valuations based on market prices during the COVID-19 crisis. Market participants should review their contractual documentation carefully in assessing whether these theories may be applicable to their repurchase

¹¹ See *id.* ¶¶ 51-60.

¹² See *id.* ¶¶ 61-64.

¹³ See Order, *AG MIT CMO, LLC v. RBC (Barbados) Trading Corp.*, No. 1:20-cv-02547 (S.D.N.Y. 2020), ECF No. 9.

¹⁴ See Letter from Jonathan E. Pickhardt, *AG MIT CMO, LLC v. RBC (Barbados) Trading Corp.*, No. 1:20-cv-02547 (S.D.N.Y. 2020), ECF No. 15.

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