COURT OF CHANCERY
OF THE
STATE OF DELAWARE

LEO E. STRINE, JR.
CHANCELLOR

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***RE: Bear Stearns Mortgage Funding Trust 2007-AR2 v. EMC Mortgage LLC,* C.A. No. 6861-CS**

Dear Counsel:

EMC Mortgage LLC ("EMC"), the defendant in this action, has filed two motions challenging the Second Amended Verified Complaint filed by the Trustee of Bear Stearns Mortgage Funding Trust 2007-AR2 (the "Trust"), the plaintiff. In its complaint, the Trustee alleges that EMC, a mortgage servicing company, has breached its contractual obligation, set out in the parties' Pooling and Servicing Agreement,[1] to repurchase from the Trust mortgages that did not comply with representations and warranties made in another agreement, the Mortgage Loan Purchase Agreement (the "Purchase

[1] Second Am. V. Compl. Ex. A § 2.03(b) ("Pooling and Servicing Agreement" (Feb. 1, 2007)) [hereinafter PSA].

Agreement").[2] EMC moves to strike certain allegations from the complaint under Court of Chancery Rule 12(f) on the ground that they are immaterial, impertinent, and scandalous.[3] EMC also moves to dismiss Count IV of the complaint, in which the Trustee seeks indemnification for its legal fees, under Court of Chancery Rule 12(b)(6) on the ground that it does not state a claim on which relief can be granted.[4] For the following reasons, I deny the motion to strike and grant the motion to dismiss.

EMC moves to strike 13 paragraphs from the complaint.[5] These paragraphs include allegations that EMC staff knew about the supposedly poor quality of the loans that EMC was underwriting, and declined to investigate them in detail;[6] that a firm that performed an analysis of 938 loans that had fallen into default determined that 74 of them became delinquent within less than 6 months of being made;[7] that EMC refused to repurchase loans from the Trust, but at the same time pursued claims against the originators of the loans;[8] that EMC's expressed view that missing documents could not give rise to a claim of breach of representations and warranties was not accepted by

[2] PSA Ex. H § 7 ("Form of Mortgage Loan Purchase Agreement" (Feb. 28, 2007)) [hereinafter MLPA].
[3] Del. Ct. Ch. R. 12(f) ("Upon motion made by a party before responding to a pleading . . . the Court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter.").
[4] Del. Ct. Ch. R. 12(b) ("[T]he following defenses may at the option of the pleader be made by motion: . . . .(6) failure to state a claim upon which relief can be granted . . . .").
[5] EMC moves to strike only part of paragraph 57. Defs.' Op. Br. 15 n.9.
[6] Second Am. V. Compl. ¶¶ 17-23.
[7] *Id.* ¶ 57.
[8] *Id.* ¶¶ 63-65.

EMC's own staff;[9] and that EMC personnel have given testimony in other litigation that conflicts with the position taken by EMC in this case.[10] In all of these paragraphs, the Trustee is citing or quoting depositions or discovery used in complaints in other litigation involving EMC.[11]

A party that seeks to strike an averment in a complaint must show that the averment is "not relevant to an issue in the case," or that it is "unduly prejudicial."[12] Motions to strike are granted "sparingly."[13] EMC claims that the averments it is challenging have nothing to do with the loans in dispute in this case. But, the allegations are obviously connected to the Trustee's claim that EMC breached the representations and warranties in the Purchase Agreement, because, among other reasons, they provide a basis for the Trustee's contention that EMC did not adhere to accepted underwriting standards and that EMC's own understanding of relevant commercial terms in the Agreements, as shown by its course of dealing in analogous circumstances, was different from what it now contends.[14] There is "general judicial agreement" that a motion to strike will be denied unless the challenged allegations "have no possible relation" to the

[9] *Id.* ¶ 89.
[10] *Id.* ¶ 100.
[11] *See* Compl., *Syncora Guarantee Inc. v. J.P. Morgan Secs. LLC*, No. 651566/2011 (N.Y. Sup. Ct. June 24, 2011); Compl., *Assured Guar. Corp. v. EMC Mortg. LLC*, No. 650805/2012 (N.Y. Sup. Ct. Mar. 15, 2012); Compl., *AMBAC Assurance Corp. v. EMC Mortg. LLC*, No. 651013/2012 (N.Y. Sup. Ct. Aug. 14, 2012).
[12] *Salem Church (Del.) Assocs. v. New Castle Cnty.*, 2004 WL 1087341, at *1 (Del. Ch. May 6, 2004) (citation omitted).
[13] *Id.* at *2.
[14] *See, e.g.*, Second Am. V. Compl. ¶¶ 17-23 (alleging that EMC had lax underwriting processes); *id.* ¶ 65 (alleging that EMC has made repurchase requests to originators based on the same breach allegations that the Trust has submitted to EMC).

subject matter of the case.[15] The challenged allegations easily survive under this standard.

EMC claims that these allegations are immaterial and impertinent because the Trustee has pled that it could prevail without making these allegations, on the ground that it is necessary to evaluate the loans individually for breaches of the representations and warranties and a "strict liability" standard for such breaches should attach.[16] But, even if the Trustee can prevail without proving the challenged allegations, that does not make them immaterial and impertinent under Rule 12(f). Rather, EMC must show that the allegations have "no bearing" on the subject matter of the litigation, which it has failed to do.[17] Furthermore, EMC is mistaken that the Trustee may not use any material obtained or discovered in other lawsuits in its complaint. A plaintiff may use material from third-party sources in its complaint, provided that it is combined with material that the plaintiff has investigated personally.[18] And, the Trustee has not simply recycled allegations made in other complaints, but has used specific materials cited in these complaints.[19] These

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[15] 5C Charles Alan Wright et al., *Federal Practice and Procedure: Federal Rules of Civil Procedure* § 1382 (3d ed. updated 2012).
[16] *See* Second Am. V. Compl. ¶ 29.
[17] *Nicastro v. Rudegair*, 2007 WL 4054757, at *1 (Del. Ch. Nov. 13, 2007).
[18] *See, e.g., In re Connetics Corp. Secs. Litig.*, 542 F. Supp. 2d 996, 1005 (N.D. Cal. 2008) (noting that an attorney "an attorney may rely in part on other sources . . . as part of his or her investigation into the facts"); *In re Cylink Secs. Litig.*, 178 F. Supp. 2d 1077, 1080 (N.D. Cal. 2001) (holding that a complaint that combined the plaintiff's own allegations with allegations from an SEC complaint met the pleading requirements for scienter).
[19] *See, e.g., Bethel v. Baldwin Cnty. Bd. of Educ.*, 371 F. App'x 57, 61 (11th Cir. 2010) (upholding district court's decision to strike amended complaint that was "compilation of six complaints"); *RSM Prod. Corp. v. Fridman*, 643 F. Supp. 2d 382, 403 (S.D.N.Y. 2009) (striking exhibits that were complaints filed in other actions, and striking paragraphs "based solely" on

materials largely consist of statements by EMC personnel in depositions or discovered documents that concern EMC's supposedly lax underwriting practices and purported reluctance to repurchase loans, and the Trustee has connected these materials with material from its own investigations into the same subjects.[20]

Nor are the Trustee's allegations "unduly prejudicial" to EMC.[21] The fact that EMC may have to respond to discovery requests based on these averments does not make the averments "prejudicial" in the sense contemplated by Rule 12(f)—that is, "scandalous." For a court to strike allegations on the ground that they are scandalous, they must be "cruelly derogatory."[22] It is not enough that they may put the moving party in an unflattering light, as here.[23] Therefore, I deny the motion to strike.

By contrast, I grant EMC's motion to dismiss Count IV of the complaint. In Count IV, the Trustee seeks indemnification by EMC for claims against it arising out of the Pooling and Servicing Agreement and the Purchase Agreement. In support of its

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these complaints); *see also King Cnty. v. Merrill Lynch & Co.*, 2012 WL 2389998, at *2 (W.D. Wash. June 25, 2012) (stating that allegations are not immaterial simply because they "mirror" allegations from other complaints).

[20] *Compare, e.g.*, Second Am. V. Compl. ¶¶ 17-23 (alleging lax underwriting practices, based on other complaints), *with id.* ¶¶ 66-83 (alleging details of loans made to seemingly uncreditworthy borrowers, based on investigation carried out for the Trustee); *compare also, e.g., id.* ¶¶ 84-88 (alleging that EMC improperly refused to repurchase loans, based on investigation carried out for the Trustee), *with id.* ¶ 89 (alleging that EMC staff knew that EMC had a duty to repurchase loans, based on another complaint).

[21] *Salem Church (Del.) Assocs. v. New Castle Cnty.*, 2004 WL 1087341, at *1 (Del. Ch. May 6, 2004) (citation omitted).

[22] *Cobell v. Norton*, 224 F.R.D. 1, 5 (D.D.C. 2004) (citation omitted).

[23] *See, e.g., Gateway Bottling, Inc. v. Dad's Rootbeer Co.*, 53 F.R.D. 585, 588 (W.D. Pa. 1971) (denying motion to strike allegations that "may be unpleasant for plaintiff to have on the record").

claim, the Trustee points to the indemnification provisions in the Agreements. Section 13 of the Purchase Agreement provides that EMC "shall indemnify and hold harmless the Purchaser from and against any loss, claim, damage, or liability or action in respect thereof" insofar as such a loss or action arises out of "any representation or warranty assigned or made by [EMC]."[24] And, under § 7.03 of the Pooling and Servicing Agreement, EMC "agrees to indemnify the Indemnified Persons [*viz.*, the Trustee]" against any loss "related to [EMC's] failure to perform its duties in compliance with this Agreement."[25]

These Agreements are governed by New York law.[26] A court applying New York law will only interpret an indemnification provision so as to shift attorneys' fees between the parties if it is "unmistakably clear" that the indemnification provision is intended to waive the general rule that parties are responsible for their own costs.[27] Therefore, a party seeking indemnification for first-party claims must be able to point to specific language that is applicable to such claims.[28] Here, there is no such specific language. Rather, the indemnification provisions contain language that indicates that they apply only to third-party claims. The Purchase Agreement provides that EMC will reimburse

[24] MLPA § 13(a). The Purchaser is the intermediary from which the Trust obtained the loans, Structured Asset Mortgage Investment II Inc. ("SAMI"). Under § 2.03(a) of the Pooling and Servicing Agreement, SAMI assigned its rights to the Trustee.
[25] PSA § 7.03(a).
[26] *Id.* § 11.06; MLPA § 21.
[27] *Hooper Assocs., Ltd. v. AGS Computers, Inc.*, 548 N.E.2d 903, 905 (N.Y. 1989); *see also Gotham P'rs, L.P. v. High River Ltd. P'ship*, 906 N.Y.S.2d 205, 207 (1st Dep't 2010) (discussing the "exacting" *Hooper* standard).
[28] *See, e.g.*, *TAG 380, LLC v. ComMet 380, Inc.*, 890 N.E.2d 195, 201 (N.Y. 2008) (citing *Hooper*, 548 N.E.2d at 904).

the Trustee and other indemnified parties their legal expenses incurred in "investigating or defending" a loss or claim—not in filing or prosecuting a claim, as is the case here.[29] And, the Pooling and Servicing Agreement requires that the indemnified party give notice of a breach to the indemnifying party "promptly."[30] This notice provision can only be read to apply to third-party indemnification claims, because a notice requirement "has no logical application" to a first-party claim.[31]

The indemnification provisions in the Agreements cannot be read to cover first-party claims between EMC and the Trustee for another critical reason. These provisions must be read in conjunction with other provisions of the Agreements, which limit the Trustee's rights against EMC.[32] Section 2.03 of the Pooling and Servicing Agreement provides that the "sole remedy" that the Certificateholders and the Trustee shall have against EMC for any breach of the representations and warranties in the Purchase Agreement shall be EMC's obligation to repurchase, or substitute, loans as to which the representations and warranties have been breached.[33] And, §§ 7 and 15 of the Purchase Agreement provide that the Trustee's and Certificateholders' "sole and exclusive" remedy of any breach of the Purchase Agreement shall be EMC's obligation to cure the

[29] MLPA § 13(a).
[30] PSA § 7.03(a).
[31] *Hooper*, 548 N.E.2d at 905.
[32] *See Beal Sav. Bank v. Sommer*, 865 N.E.2d 1210, 1213-14 (N.Y. 2007) ("[A] contract should be 'read as a whole, and every part will be interpreted with reference to the whole . . . .'") (citation omitted).
[33] PSA § 2.03(a), (b).

breach, repurchase the loan, or substitute a new loan.[34] Because these provisions specify the extent of the Trustee's remedies, the indemnification provisions must be read as covering only third-party claims.[35]

Contrary to the Trustee's argument, reading the indemnification provisions as covering third-party claims only does not violate standard principles of contractual construction by rendering part of the provisions redundant or meaningless.[36] The Trustee points to a clause in § 13 of the Purchase Agreement, which provides that the indemnity "is in addition to any liability, which [EMC] otherwise may have to the Purchaser or any other such indemnified party."[37] But the Trustee is wrong to claim that this clause would be "surplusage" if the indemnification provision only covers third-party claims.[38] The clause is no more "surplus" if the indemnification provision is interpreted to cover only third-party claims than it is if the provision is interpreted to cover first-party claims. And, the Trustee is also mistaken in arguing that, because it is the only party that can bring a claim against EMC, the indemnification provisions must cover first-party claims. Even if it were correct that only the Trustee could sue EMC, the Trustee is also capable

[34] MLPA §§ 7, 15.
[35] *Accord Assured Guar. Mun. Corp. v. Flagstar Bank*, 2011 WL 5335566, at *4-6 (S.D.N.Y. 2011) (finding, in similar circumstances, that the "sole remedy" available to the buyer of mortgage loans was to require the seller to repurchase or substitute them, and that broadly worded indemnification provisions could not add to these "exclusive" remedies).
[36] *See, e.g., God's Battalion of Prayer Pentecostal Church, Inc. v. Miele Assocs., LLP*, 845 N.E.2d 1265, 1267 (N.Y. 2006) ("A contract 'should be read to give effect to all its provisions.'") (citation omitted).
[37] MLPA § 13(a).
[38] Pl's. Br. in Opp. 19.

of being sued itself—by Certificateholders or borrowers, for example.[39] The indemnification provisions would cover these claims and provide protection to the Trustee, and therefore the Trustee's argument that the provisions must cover first-party claims or be of no utility fails.

In conclusion, I DENY the motion to strike allegations from the Second Amended Complaint, and I GRANT the motion to dismiss Count IV of the Second Amended Complaint. IT IS SO ORDERED.

Very truly yours,

/s/ Leo E. Strine, Jr.

Chancellor

[39] Indeed, as counsel for the Trustee candidly admitted in oral argument, corporations that assume roles as trustees for securities issuances are unlikely to accept that responsibility without receiving a promise that they will be indemnified for their costs if they are dragged into litigation over the securities. Tr. of Oral Arg. 19:23-20:2 (Jan. 11, 2013).