

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK

In the matter of the application of

U.S. BANK NATIONAL ASSOCIATION, THE BANK  
OF NEW YORK MELLON, THE BANK OF NEW  
YORK MELLON TRUST COMPANY, N.A.,  
WILMINGTON TRUST, NATIONAL ASSOCIATION,  
LAW DEBENTURE TRUST COMPANY OF NEW  
YORK, WELLS FARGO BANK, NATIONAL  
ASSOCIATION, HSBC BANK USA, N.A., and  
DEUTSCHE BANK NATIONAL TRUST COMPANY  
(as Trustees under various Pooling and Servicing  
Agreements and Indenture Trustees under various  
Indentures),

Petitioners,

for an order, pursuant to CPLR § 7701, seeking judicial  
instruction.

Index No. 652382/2014

Assigned to: Friedman, J.

**AMBAC'S MEMORANDUM  
OF LAW REGARDING  
DISCOVERY FROM  
JPMORGAN**

Ambac Assurance Corporation and The Segregated Account of Ambac Assurance Corporation (“Ambac”) respectfully submit this memorandum of law in response to the Court’s request for brief submissions concerning the scope of discovery in this proceeding. Ambac has joined in Respondents’ Memorandum of Law Regarding the Scope of Discovery Under Article 77 and respectfully offers this separate submission to address the appropriateness of discovery served by Ambac on Petitioner JPMorgan Chase & Co. and its affiliates (“JPMorgan”).

### **PRELIMINARY STATEMENT**

Ambac has litigated with JPMorgan for six years concerning JPMorgan’s fraudulent RMBS securitization practices. Ambac therefore has the benefit of extensive discovery into JPMorgan’s practices and the quality (or lack thereof) of loans it securitized. With the benefit of that experience, Ambac has made targeted requests to JPMorgan for certain documents and data that are highly probative of highly relevant matters to the Proposed Settlement and are readily discoverable. *See* Ex. 1. These targeted requests seek documents and information that easily falls within the broad “material and necessary” standard for disclosure applicable to Article 77 proceedings in that they (1) contradict the Trustees’ claim that they conducted “an exhaustive evaluation process”, and (2) demonstrate that the value of claims to be released in the Proposed Settlement with respect to the Ambac Insured Trusts dwarfs the consideration to be paid by JPMorgan for those trusts and thus that the Trustees’ decision was unreasonable with respect to those trusts. The targeted material Ambac seeks is also readily discoverable, as much of it has already been produced to and marshalled by Ambac.

### **BACKGROUND**

As detailed in Ambac’s Statement of Grounds for Objection (Doc. # 149) (“Ambac Objection”), Ambac provided financial guaranty insurance with respect to about a dozen mortgage securitization offerings by JPMorgan-affiliate Bear Stearns. Ambac has been litigating with JPMorgan for more than six years concerning four of those securitizations (“Second-Lien Litigation”). In the course of that litigation, Ambac uncovered extensive evidence of a RMBS securitization machine at Bear Stearns that had run amok. Ambac found compelling evidence

that Bear Stearns lied about the quality of loans – telling Ambac and investors that the collateral was of investment quality while internally describing that collateral as a “Sack o’ [expletive]” – and lied about its due-diligence and quality-control processes – telling Ambac and investors that these processes were in place to ensure the quality of the collateral when in fact they were used by JPMorgan to pocket recoveries for itself at the expense of the trusts. Discovery in that case is complete and expert reports will be filed by the end of the year.

The evidence of Bear Stearns’ fraudulent RMBS securitization machine uncovered by Ambac, which also pertains to the transactions insured by Ambac at issue in this proceeding – lay the foundation for the multi-billion dollar settlements by JPMorgan with government entities and private plaintiffs. In early 2012, Ambac sued JPMorgan for fraud and breach of contract to recover the losses it suffered on these trusts that are included in the Proposed Settlement (“First-Lien Litigation”). In its publicly filed complaint in the First-Lien Litigation, Ambac cites evidence demonstrating the existence of widespread breaches of representations and warranties, including the results of forensic re-underwriting of loan files. *See* Ambac Objection, Ex.2. Discovery is ongoing in that litigation and Ambac has obtained or is in the process of obtaining targeted evidence that is highly probative of whether or not the Trustees’ acceptance of the settlement for these deals is reasonable, including (1) loan files for a random sample of the securitized loans; (2) data and reports concerning Bear Stearns’ due diligence on and quality control of the mortgage loans; (3) data concerning any “bulk settlements” that Bear Stearns entered into with mortgage loan sellers concerning defective securitized loans without repurchasing the loans from the securitization trusts.

## **ARGUMENT**

### **A. The Discovery Ambac Seeks is Highly Probative**

An Article 77 proceeding is governed by Article 31, CPLR § 408, under which “there shall be full disclosure of all matter material and necessary in the prosecution or defense of an action, regardless of the burden of proof.” CPLR § 3101(a); *see also Diamond State Ins. Co. v. Utica First Ins. Co.*, 37 A.D.3d 160, 161 (1st Dep’t 2007); Respondents’ Memorandum of Law

at 1-2. The discovery Ambac seeks from JPMorgan is directly goes directly to whether the decision to accept the Proposed Settlement with respect to the Ambac Insured Trusts was reasonably prudent.

The Institutional Investors seek to thwart meaningful discovery with respect to this extraordinary proceeding – seeking judicial blessing of a Proposed Settlement relating to over 300 trusts, for the payment of *over \$4 billion* and the resolution of exposure of *\$65 billion* – based on the remarkable proposition that “[t]he proper scope of review does not include an evaluation of the merits of the underlying claim or the adequacy of the settlement consideration” and instead is solely about “process.” Institutional Investors’ Memorandum of Law on the Scope of Discovery (Doc. # 192) at 6.<sup>1</sup> Ambac therefore anticipates that Petitioners will oppose any discovery from JPMorgan. However, even if the Petitioners’ circumscribed view of the scope of review here were correct (and it is not), their position on the appropriate scope of discovery would not follow. Clearly, to evaluate the reasonableness of the Trustees’ process, one must consider not only what the Trustees chose to look at, but also what they chose not to look at, particularly where the Trustees claim to have conducted an “exhaustive evaluation process.” Trustees’ Omnibus Response to Objections (Doc. # 194) at 2. A trustee must make an investigation that is “appropriate to the particular action.” Restatement (Third) of Trusts, § 77 cmt. b (“What constitutes due diligence, satisfying the duty of prudence, is inevitably affected by the nature of the transaction or activity. . . .”). A transaction that contemplates the release of approximately \$65 billion of claims demands a correspondingly high level of diligence. In none of the authorities cited by Petitioners for the proposition that a trustee may rely on expert advice did the trustee knowingly disregard other relevant information that was available to it. On the contrary, blackletter law states that a trustee’s reliance on expert advice is not a complete defense. *Id.* (“Reliance on advice of counsel, however, is not a complete defense to an alleged breach of trust, because that would reward a trustee who shopped for legal advice that would

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<sup>1</sup> Tellingly, even the Trustees do not appear to agree with this position; the Trustees recognize that at issue is the overall good faith and reasonableness of their decision.

support the trustee's desired course of conduct or who otherwise acted unreasonably in procuring or following legal advice.”).

As discussed below, there is a vast universe of evidence in JPMorgan’s possession identified by Ambac (and other litigants, including government agencies) that was available to the Trustees but which the Trustees made no effort to obtain or consider. Ambac’s targeted requests seek only a narrow subset of that universe.

Moreover, this Court’s review of the Proposed Settlement is not limited to an evaluation of the Trustees’ process. Even under an abuse-of-discretion standard, the Court must determine whether the decision reached by the Trustees was objectively reasonable.<sup>2</sup> Restatement (Third) of Trusts, § 87 cmt. c (trustee abuses its discretion by “act[ing] unreasonably--that is, beyond the bounds of a reasonable judgment”). Judicial intervention for abuse of discretion is therefore “called for” where “the trustee’s decision is one that would not be accepted as reasonable by persons of prudence.” *Id.* In this case, the Court cannot assess whether the Trustees exercised “reasonable judgment” without some review of the merits and value of the claims to be released in comparison with the compensation to be paid. The targeted information Ambac seeks from JPMorgan is directly relevant to that review.

#### **B. The Discovery Ambac Seeks is Readily Obtainable**

A significant amount of the evidence of Bear Stearns’ fraudulent practices uncovered in the Second-Lien Litigation was made public or identified in court filings. The Trustees knew or should have known about this information, which is directly probative of the claims to be released in the Proposed Settlement, and therefore could and should have requested this evidence from JPMorgan (or obtained it from Ambac with JPMorgan’s consent) in order to properly evaluate the Proposed Settlement. In any event, such information has already been produced by

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<sup>2</sup> Petitioners have cited a number of authorities providing generally that the reasonableness of a trustee’s conduct should be determined by facts available to the trustee at the time rather than through hindsight. *See, e.g.*, The Institutional Investors’ Memorandum of Law on the Scope of Discovery at 1, n. 3, 9. None of these authorities would permit a trustee to ignore information to enter into a transaction that was substantively unreasonable based on the information available at the time. To the contrary, a review of these cases demonstrates the courts uniformly evaluate the substantive reasonableness of the trustee’s decision. *Id.*; *see also id.*, n. 10 (citing cases).

JPMorgan and carefully analyzed and marshalled by Ambac. As such, this highly relevant and targeted discovery can be produced in this proceeding quickly and at minimal cost.

Similarly, other discovery that Ambac seeks from JPMorgan in this proceeding has been, or is in the process of being, produced in Ambac's other litigation against JPMorgan concerning *several securitizations that are covered by the Proposed Settlement*. Again, it is hard to imagine any credible argument that evidence related to loans underlying trusts covered by this Proposed Settlement are not relevant. This highly relevant and targeted discovery also can be produced in this proceeding quickly and at minimal cost.

Finally, Ambac also seeks discovery of materials that JPMorgan has already produced to the United States Department of Justice ("DOJ") and the Securities and Exchange Commission ("SEC"), with respect to investigations of JPMorgan's mortgage-securitization misconduct – investigations that resulted in a \$296.9 million settlement with the SEC in November 2012 and a \$13 billion settlement with the DOJ in which JPMorgan also admitted that it knowingly securitized loans that violated representations and warranties concerning the underwriting quality of the loans.<sup>3</sup> It is difficult to fathom how such materials were ignored by the Trustees in their evaluation of the Proposed Settlement. Once again, these materials can be produced in this proceeding quickly and at minimal cost.

## CONCLUSION

For the foregoing reasons, Ambac respectfully submits that the discovery it and the other Objectors seek from JPMorgan is reasonable and appropriate and should be provided.

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<sup>3</sup> Ambac also seeks the draft complaint the DOJ provided JPMorgan prior to the DOJ settlement, which presumably marshals and organizes the evidence of JPMorgan's misconduct that the DOJ obtained during its investigation and would have greatly informed the Trustees' evaluation had they bothered to seek it. *See JPMorgan Settles Pittsburgh Bank Suit Probing U.S. Deal*, Bloomberg News (Jan. 4, 2014) available at <http://www.bloomberg.com/news/2014-01-03/jpmorgan-to-settle-pittsburgh-bank-lawsuit-over-mortgage-debt.html>. One court has already ordered JPMorgan to produce the draft DOJ complaint, although it appears the case settled before JPMorgan complied with the order. *Id.*

Dated: New York, New York  
December 9, 2014

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