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), AEGON USA Investment Management, LLC (intervenor), Bayerische Landesbank (intervenor), BlackRock Financial Management, Inc. (intervenor), Cascade Investment, LLC (intervenor), the Federal Home Loan Bank of Atlanta (intervenor), the Federal Home Loan Mortgage Corporation (Freddie Mac) (intervenor), the Federal National Mortgage Association (Fannie Mae) (intervenor), Goldman Sachs Asset Management L.P. (intervenor), Voya Investment Management LLC (f/k/a ING Investment LLC) (intervenor), Invesco Advisers, Inc. (intervenor), Kore Advisors, L.P. (intervenor), Landesbank Baden-Wurttemberg (intervenor), Metropolitan Life Insurance Company (intervenor), Pacific Investment Management Company LLC (intervenor), Sealink Funding Limited (intervenor), Teachers Insurance and Annuity Association of America (intervenor), The Prudential Insurance Company of America (intervenor), the TCW Group, Inc. (intervenor), Thrivent Financial for Lutherans (intervenor), and Western Asset Management Company (intervenor), Petitioners, for an order, pursuant to CPLR § 7701, seeking judicial instruction.	Index No. 652382/2014 Part 60 Motion Sequence No. 24 Hon. Marcy S. Friedman

THE QVT FUNDS' MEMORANDUM OF LAW
IN SUPPORT OF THEIR MOTION FOR PARTIAL SUMMARY JUDGMENT

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Other Authorities

Intervenor-Respondents QVT Fund V LP, QVT Fund IV LP and Quintessence Fund L.P. (collectively, the "QVT Funds") respectfully submit this memorandum of law together with the Affidavit of Joel Wollman ("Wollman Aff.") and the Affirmation of Michael C. Ledley ("Ledley Aff."), both sworn to on September 4, 2015, and the Joint Statement of Undisputed Facts submitted by the QVT Funds and U.S. Bank National Association ("U.S. Bank"), dated September 4, 2015, in support of the QVT Funds' motion for summary judgment.

PRELIMINARY STATEMENT

The Petitioners assert that "[t]he Governing Agreements grant to the Trustees the right to sue to enforce the Seller's repurchase obligations and the Servicer's servicing obligation. Under longstanding principles of trust law, that power to sue includes the power to compromise claims in settlement." Petition, ¶ 46. Petitioners omit, however, that a Trustee's powers (including the purported implied power to settle claims pre-suit) are limited by the terms of the Governing Agreements. In particular, as the Trustees' experts recognize, the Pooling and Servicing Agreements for most residential mortgage backed securities ("RMBS") trusts expressly grant holders of a requisite percentage of securities issued by the trust – usually 25% – the right to direct the Trustee in the exercise of its delegated powers.

The QVT Funds collectively hold more than 25% of the outstanding securities in JPMAC 2006-WMC1, one of the Accepting Trusts at issue in this proceeding for which U.S. Bank is the Trustee. After careful consideration, the QVT Funds determined that the Proposed Settlement was not in the best of investors in JPMAC 2006-WMC1. In particular, although the total settlement compensation offered by JPMorgan Chase & Co. (together with its affiliates, "JPMorgan") reflects approximately 7.1% of losses projected for the trusts in the aggregate (itself an unreasonably low figure), the settlement payment to investors in JPMAC 2006-WMC1

is subject to a massive, unjustifiable 90% discount (the "Haircut," as further defined below) and reflects only ***0.8%*** of the more than $393 million in lifetime losses to the trust. In return for this nominal recovery, the Proposed Settlement would release JPMorgan of all future liability and leave investors in JPMAC 2006-WMC1 without a remedy for the remaining $390 million in losses.

The QVT Funds, through their investment manager QVT Financial LP ("QVT"), made repeated attempts to obtain some explanation from U.S. Bank for this massive Haircut but U.S. Bank refused (or was unable) to provide any information. Nor do the Trustees' expert reports provide a reason for the Haircut or any evidence that U.S. Bank or its experts even considered the reasonableness or fairness of the discount to investors in JPMAC 2006-WMC1. There simply is no reasonable justification for the massive discount, which renders the settlement payment to JPMAC 2006-WMC1 utterly inadequate (particularly in comparison to the settlement proceeds to be paid to other trusts).

Moreover, on June 23, 2014, QVT exercised the QVT Funds' power under the Pooling and Servicing Agreement for JPMAC 2006-WMC1 (the "PSA") (annexed as Exhibit 1 to the Wollman Affidavit), as holders of 25% or more of the securities issued by the Trust, to direct U.S. Bank to reject the proposed settlement. In subsequent communications with U.S. Bank, QVT offered to provide a "reasonable indemnity" to U.S. Bank for its costs and potential liabilities incurred in complying with QVT's direction as provided by the PSA. QVT's offer to indemnify U.S. Bank for potential liability it may incur in connection with following QVT's direction to reject the settlement remains open. [redacted]

[redacted] QVT refused to give in to U.S. Bank's extortionate demands. In return, U.S. Bank ignored QVT's direction, declined to engage in further negotiations, and purported to accept the settlement on behalf of the investors in JPMAC 2006-WMC1, in violation of its obligations under the PSA and outside the scope of its delegated powers.

U.S. Bank's purported acceptance of the Proposed Settlement on behalf of JPMAC 2006-WMC1 exceeded its powers under the PSA. Even in the absence of QVT's direction, U.S. Bank's decision to accept the Proposed Settlement was objectively unreasonable and U.S. Bank's failure to consider whether the Haircut was fair to investors in JPMAC 2006-WMC1 constitutes an abuse of discretion. For these reasons, the QVT Funds are entitled to partial summary judgment rejecting the Proposed Settlement with respect to JPMAC 2006-WMC1.

STATEMENT OF UNDISPUTED FACTS

A. The QVT Funds' Holdings

QVT is a hedge fund manager founded in 2003. Joint Statement of Undisputed Facts ("Facts"), ¶ 4. QVT manages a number of funds, including the QVT Funds, with approximately $3.3 billion in assets under management as of January 1, 2015. *Id.*; Wollman Aff., ¶ 3. On information and belief, the QVT Funds, collectively, are the largest single investor in JPMAC 2006-WMC1.

The JPMAC 2006-WMC1 trust issued two types of certificates – the "Group 1 Certificates" and the "Group 2 Certificates" – which are backed by separate groups of securitized mortgage loans (the "Group 1 Loans" and "Group 2 Loans," respectively). Facts, ¶ 1. [redacted]

[redacted] Facts, ¶ 7.

B. JPMorgan's Obligations Under The PSA

JPMorgan was the sponsor of JPMAC 2006-WMC1, and a JPMorgan affiliate serves as Depositor, Seller, and Servicer in the deal. Facts, ¶ 10. All of the mortgage loans backing JPMAC 2006-WMC1 were originated by WMC Mortgage Corporation ("WMC"). *Id.* WMC sold the loans to JPMorgan Acquisition Corp. ("JPMAC") pursuant to a Mortgage Loan Purchase Agreement subject to numerous representations and warranties concerning the credit quality of the loans. *Id.* JPMAC assigned all of its interests in the loans – including its rights under WMC's various representations and warranties – to the JPMorgan Depositor affiliate, which in turn assigned those interests in the loans to the Trust pursuant to the terms of the PSA. *Id.*

Pursuant to Section 2.03(a)(i) of the PSA, upon discovery "of the breach by the Originator of any representation, warranty or covenant under the Mortgage Loan Purchase Agreement or the Assignment and Assumption Agreement in respect of any Mortgage Loan that materially adversely affects the value of such Mortgage Loan or the interest therein of the Certificateholders," WMC is required to repurchase the loan (or substitute a non-breaching loan). Facts, ¶ 12.

JPMorgan also directly represented that many of the WMC representations and warranties, including representations concerning compliance with underwriting guidelines, the absence of fraud in origination of the loans, the use of proper appraisal practices, and delivery of

the complete mortgage file, were accurate. *Id.* ¶ 13; *see also* PSA § 2.06. JPMorgan is primarily liable for repurchasing loans that breached these representations.[1]

Moreover, JPMorgan, as Seller, agreed to act as ultimate guarantor for WMC's repurchase obligations: "In the event that the Originator shall fail to cure the applicable breach or repurchase a Mortgage Loan in accordance with the preceding sentence, the [Seller] shall do so." *Id.*; Facts, ¶ 14. Critically, there is no requirement under the PSA for the Trustee or other party enforcing a representation and warranty to seek relief first from WMC before making a claim against JPMorgan as guarantor. PSA § 2.06.[2] Indeed, the Trustees' experts agree that "[t]he Trustee need not make a demand on an Originator to cure before claiming against the [guarantor entity]." Facts, ¶ 50; Ledley Aff., Ex. 2 (Expert Report of Alan Schwartz, dated November 13, 2013 ("Schwartz Rep.")) at 6; Ledley Aff., Ex. 3 (Expert Report of Daniel R. Fischel, dated July 17, 2014 ("Fischel Rep.")) at 81 fn.209 (quoting Schwartz Rep.).[3]

C. The Proposed Settlement and the Haircut

On November 19, 2013, the United States Department of Justice announced that it entered a $13 billion settlement with JPMorgan with respect to securities issued by hundreds of

[1] *See Bank of N.Y. Mellon, as Securities Administrator for J.P. Morgan Acquisition Trust 2006-WMC4 v. WMC Mortgage LLC, et al.*, Index No. 654464/2012, 41 Misc. 3d 1230(A), 981 N.Y.S.2d 633 (Sup. Ct. N.Y. Cty. Nov. 21, 2013) (holding that "JPMMAC is effectively warranting the truth of the specific facts behind the loan" and "JPMMAC issued a warranty tantamount to WMC's"). Although in *JPMAC 2006-WMC4*, the JPMorgan "Seller" affiliate provided the representations and warranties rather than the JPMorgan "Depositor" affiliate (which is the case in the PSA for JPMAC 2006-WMC1), that difference does not change the fact that a JPMorgan affiliate is primarily responsible for breaches of representations and warranties regarding the underwriting of the loans.

[2] In contrast, the PSAs for certain other Accepting Trusts include express language requiring the enforcing party to first assert repurchase claims against originators before seeking recourse against JPMorgan. Schwartz Rep. at 4 (quoting the PSA for JPMAC 2005-FLD1). There is no such language in the PSA for JPMAC 2006-WMC1.

[3] Professor Schwartz further acknowledges that, "[u]nder basic guarantee law, the beneficiary can sue the guarantor when the primary obligor does not perform; the beneficiary need not make a formal demand on that obligor." Schwartz Rep. at 4 (*citing Chemical Bank v. Bruce G. Metzger*, 93 N.Y.2d 296, 302-03 (1999)). Whether the guarantor is the "Seller" or the "Depositor" is irrelevant as they are both JPMorgan affiliates.

RMBS trusts (including JPMAC 2006-WMC1).[4] As summarized in the Department of Justice's settlement announcement, "JPMorgan acknowledged it made serious misrepresentations to the public – including the investing public – about numerous RMBS transactions," and JPMorgan admitted that "JPMorgan employees knew that the loans in question did not comply with those [underwriting] guidelines and were not otherwise appropriate for securitization, but they allowed the loans to be securitized – and those securities to be sold – without disclosing this information to investors." *Id.* JPMorgan also admitted that it "waived" in loans for securitization that its due diligence vendors identified as non-compliant because, among other reasons, they were "missing documentation." *Id.* The Department of Justice settlement followed years of voluminous private litigation and government investigations regarding JPMorgan's fraudulent securitization practices.

In the days preceding the Department of Justice announcement, the Institutional Investors also announced that they had negotiated a settlement offer from JPMorgan to pay $4.5 billion to U.S. Bank and the other Trustees to settle claims of 330 securitization trusts (the "Trusts") against JPMorgan for breach of representation and warranty and improper loan servicing claims. Facts, ¶ 21; *see also* Ledley Aff., Ex. 5 ("Petition"), ¶¶ 1-2 and Ex. B (the "Proposed Settlement Agreement"). The Trusts have suffered many billions of dollars in losses and, over the lifetimes of the trusts, are expected to suffer approximately $64 billion. Facts, ¶ 22; *see also* Supp. Fischel Rep., Ex. A at 15. Thus, the Proposed Settlement reimburses investors, on average, approximately 7.1% of their losses. Fischel Report at ¶ 95. In return, JPMorgan would obtain a release for all claims relating to

[4] The Department of Justice's press release announcing the DOJ Settlement, together with the agreement memorializing the DOJ Settlement, the Statement of Facts admitted by JPMorgan, and the list of covered trusts, are available at http://www.justice.gov/opa/pr/2013/November/13-ag-1237.html.

> (i) representations or warranties made by any JPMorgan entity, (ii) any alleged obligation to give notice of alleged breaches of representations or warranties, (iii) any alleged obligation of any JPMorgan entity to enforce claims for breaches of representations or warranties against the originator of a Mortgage Loan . . ., (iv) the documentation of the Mortgage Loans held by the Settlement Trusts including with respect to allegedly defective, incomplete, or non-existent documentation, as well as issues arising out of or relating to recordation, title, assignment, or any other matter relating to legal enforceability of a mortgage or mortgage note. . . , and (v) the servicing of the Mortgage Loans held by the Settlement Trusts (including but not limited to any claim relating to the timing of collection efforts or foreclosure efforts, any foreclosure delays on Mortgage Loans that as of the Effective Date are already in the process of foreclosure, loss mitigation, transfers to subservicers, advances, servicing advances, or claims that servicing includes an obligation to take any action or provide any notice towards, or with respect to, the possible repurchase of Mortgage Loans by the applicable Servicer, Seller, or any other Person).

Proposed Settlement Agreement § 3.02; Facts, ¶ 22.

Under the Proposed Settlement Agreement, the $4.5 billion payment is not shared equally. Section 3.05 of the Proposed Settlement Agreement provides that the settlement payment will be allocated pro rata among the various trusts based on the amount of losses suffered by each trust, with one exception. Proposed Settlement Agreement, § 3.05; Facts, ¶ 23. Section 3.05 further provides that losses "associated" with loans originated by certain "Selected Third-Party Originators" are discounted by 90% in the allocation calculation. *Id.* Professor Fischel refers to this discount as the "Haircut." *See* Fischel Report at ¶ 87. As a result of the Haircut, Trusts backed by loans purchased from Selected Third-Party Originators will receive a smaller allocation of the settlement payment as a percentage of the Trust's losses than other Trusts without loans from Selected Third-Party Originators, regardless of which Trust has a greater percentage of loans that breached representations and warranties or suffered more from improper servicing.

WMC is one of the defined "Selected Third-Party Originators." Facts, ¶ 24. WMC is a defunct subsidiary of General Electronic Corporation that went out of business in October 2007.

See, e.g., Investigation: How lending industry ignored risks, *CBS MoneyWatch* (Jan. 9, 2012), *available at* http://www.cbsnews.com/8301-505123_162-57353837/investigation-how-lending-industryignored-risks/; Facts, ¶ 25. WMC's loan origination operation was rife with fraud, and WMC was second only to New Century Financial among the worst loan originators in terms of percentage of mortgage loans that defaulted. *Id.* Professor Fischel, on behalf of the Trustees, acknowledges that there is no evidence that WMC has the ability to pay any amounts in connection with its repurchase liabilities and it is uncertain whether there is any recourse against General Electric, WMC's parent, in the event WMC is unable to pay. Fischel Rep. at 87 fn. 232; *see also id.*, Ex. S at 3; Facts, ¶ 25.

Despite copious publicly available information about rampant fraud associated with WMC loans, the Proposed Settlement Agreement imposes a 90% discount on losses suffered by JPMAC 2006-WMC1, leaving JPMAC 2006-WMC1 with an estimated recovery of less than $3 million – a mere ***0.8%*** of the approximately $393,718,648 million in projected losses. Ledley Aff., Ex. 4 (Supplemental Expert Report of Daniel R. Fischel, dated July 26, 2014 ("Supp. Fischel Rep.")), Ex. A at 15; Facts, ¶ 26.

In a notice dated December 11, 2013, U.S. Bank and the other Trustees announced that they had received and were considering the Proposed Settlement. Ledley Aff., Ex. 7; Facts, ¶ 27. Neither the Trustees' notice nor the Proposed Settlement Agreement, itself, offered an explanation for the Haircut. *Id.*

D. QVT Directs U.S. Bank To Reject The Proposed Settlement For JPMAC 2006-WMC1

By letter dated January 10, 2014, QVT sent a letter to U.S. Bank concerning the Proposed Settlement. *See* Wollman Aff., Ex. 3; Facts, ¶ 28. [redacted] *Id.* QVT

informed U.S. Bank of its view that the aggregate payment offered in the Proposed Settlement was too low for similar reasons to those detailed by Professor Fischel, the Trustees' own expert. *Id.*, ¶ 29.[5] *See* Fishel Report ¶ 95. QVT expressed its concern that the Haircut unfairly penalized investors in JPMAC 2006-WMC1 because JPMorgan was liable for virtually all of the Trust's damages but was being released for all but a tiny fraction of those damages without any reasonable basis to conclude the damages could be recovered from WMC (or any other source). Among other things, QVT pointed out the following:

- JPMorgan was responsible under the terms of the PSA for repurchasing defective loans in the event WMC failed to do so. *See* PSA §2.03(a)(i).
- JPMorgan directly represented that many of the WMC representations, including representations concerning compliance with underwriting guidelines, the absence of fraud, the use of proper appraisal practices, and delivery of the complete mortgage file, were accurate. *See* PSA § 2.06.
- WMC was undercapitalized and may not be able to pay claims for breaches of its representations and warranties.[6]
- Claims against WMC may be untimely under the First Department's decision in *ACE Securities Corp. v. DB Structured Products, Inc.*, 977 N.Y.S.2d 229 (1st Dep't 2013).

See generally Wollman Aff., Ex. 3 at 2-4. For these reasons, QVT stated "it would be premature to absolve JPMorgan from its obligations before first pursuing claims against WMC Mortgage and GE Capital." *Id.* at 4. The January 10 letter concluded by instructing U.S. Bank not to accept the Proposed Settlement for JPMAC 2006-WMC1 "in its current form" and invited US. Bank to provide its "thoughts on the matter." *Id.* at 4.

U.S. Bank did not respond to QVT's January 10 letter. Wollman Aff. ¶ 7; Facts, ¶ 33.

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[5] QVT pointed out that the Proposed Settlement offered lower value, on a percentage of loss basis, than the $8.5 billion settlement entered into by Bank of New York Mellon ("BNY"), as trustee to 530 Countrywide-sponsored trusts, with Bank of America (Countrywide's parent) despite the fact that JPMorgan (unlike Countrywide) was not subject to bankruptcy risk that (as determined by BNY) limited the amount that could be recovered in litigating repurchase and servicing misconduct cases against Countrywide. Wollman Aff., Ex. 3.

[6] Professor Fischel agrees that it is "uncertain" whether WMC would be able to pay or whether the Trust could seek recourse from WMC's parent, General Electric. Fischel Rep., ¶ 137 n. 232.

By letter dated April 11, 2014, QVT reiterated its concerns, repeated its instruction to U.S. Bank not to accept the Proposed Settlement for JPMAC 2006-WMC1, and noted it was "eager to discuss [its] concerns with you in more detail." *Id.* at Ex. 4; Facts, ¶ 33. U.S. Bank responded by letter dated April 25, 2014 and stated that "the Trustee has not made any determination on behalf of any trust regarding the advisability of entering into the Proposed Settlement Agreement" but provided no explanation for the Haircut or substantive response to the issues QVT raised. *Id.* at Ex. 5; Facts, ¶ 35. However, on April 29, 2014, U.S. Bank and the other Trustees issued a notice inviting Certificateholders that wished to provide a direction to the Trustees with respect to the Proposed Settlement to contact the Trustees and obtain a proposed form of Direction and Indemnity Letter. *Id.* at Ex. 6; Facts, ¶ 37. QVT sent an email to U.S. Bank requesting the form Direction and Indemnity Letter on May 5, 2014. *Id.* at ¶ 11; Facts, ¶ 38.

On June 23, 2014, QVT sent another letter in response to the April 29 notice. Wollman Aff., Ex. 7; Facts, ¶ 40. QVT (i) once again reiterated its serious concerns regarding the unreasonableness of the Haircut as applied to JPMAC 2006-WMC1 (which U.S. Bank never addressed), (ii) informed U.S. Bank that QVT had acquired additional certificates issued by JPMAC 2006-WMC1 such that its holdings in the Trust exceeded 25%, and (iii) explicitly directed U.S. Bank to reject the Proposed Settlement for JPMAC 2006-WMC1. *Id.* at Ex. 7. QVT simultaneously provided documentation of its holdings in JPMAC 2006-WMC1. *Id.* at ¶ 5, Ex. 2; Facts, ¶ 41. In subsequent communications, both orally and in writing, QVT indicated the QVT Funds would provide U.S. Bank with a "reasonable indemnity" against liabilities and costs that it may incur in connection with its direction, as provided in the PSA, if U.S. Bank's expert recommended acceptance of the Proposed Settlement for JPMAC 2006-WMC1. *See* PSA §§

8.02(a)(iii), (v); Wollman Aff., ¶ 13, Ex. 9; Facts, ¶ 44. Counsel for U.S. Bank and the other Trustees have represented that they have received no express directions from any investor to accept the Proposed Settlement. Ledley Aff., ¶ 11; *see also* Facts, ¶ 65.

Although QVT first asked U.S. Bank for its proposed form Direction and Indemnity Letter on May 5, 2014 (and made repeated follow-up requests), U.S. Bank did not provide any proposed form until July 10, 2014. Wollman Aff., ¶ 15, Ex. 8; Facts, ¶ 43. [redacted]

Wollman Aff., Ex. 9; Facts, ¶ 44. During a call on July 16, 2014, U.S. Bank indicated that it expected to make the expert reports available shortly and said it would discuss next steps with QVT after QVT had the opportunity to review the expert reports. Wollman Aff., ¶ 17; Facts, ¶ 45. QVT inquired about the expert reports two days later, and U.S. Bank agreed to notify QVT by email when the reports were available. *Id.*; Facts, ¶ 46.

Toward the end of July – and shortly before the August 1, 2014 deadline for acceptance or rejection of the Proposed Settlement – the Trustees finally made available on their joint website (without notifying QVT) the reports of the experts they retained to evaluate the Proposed Settlement. Wollman Aff., ¶ 18; Facts, ¶ 48. Although U.S. Bank agreed to email QVT when its website had been updated, it did not do so when the expert reports were posted. Facts, ¶¶ 46, 48. QVT discovered the expert reports on or about July 29, 2014. *Id.* The expert reports made available by the Trustees failed to explain the reason for the Haircut or demonstrate any analysis of the fairness of the Haircut to investors in JPMAC 2006-WMC1. *Id.*; Facts, ¶ 49. In fact, the expert reports demonstrate that the Haircut is unreasonable and unwarranted, at least as respects JPMAC 2006-WMC1. Professor Fischel was forced to speculate that it was "possible" that the Haircut was an attempt to take into account a potential requirement in PSAs for certain trusts that repurchase claims must be asserted first against Originators. Fischel Rep., ¶ 38 n.52; Facts, ¶ 49. Fischel's speculation is inapplicable to JPMAC 2006-WMC1, the PSA for which contains no

requirement that repurchase remedies be pursued first against WMC and no such requirement could apply in any event to claims against JPMorgan for the breach of its own express representations and warranties. Moreover, Professor Fischel's speculation is incompatible with Professor Schwartz's opinion that "[t]he Trustee need not make a demand on an Originator before claiming against the Seller [*i.e.*, JPMorgan]." Schwartz Rep., ¶ 18.

Promptly upon discovery of the expert reports, QVT sent a further letter to U.S. Bank expressing its concerns to U.S. Bank that, among other things, the expert reports "are conspicuously silent in justifying the punitive treatment of third party originated loans" and noting that "[i]t [was] puzzling . . . why a feature unique to this settlement that results in a dramatic reduction in settlement proceeds to certain trusts receives such little focus in the expert review." Wollman Aff., Ex. 10; Facts, ¶ 60. QVT concluded that "[w]e reiterate our direction to reject this settlement and direct U.S. Bank to obtain a fair deal for JPMAC 2006-WMC1 with respect to the other trusts in the JPM RMBS Agreement." *Id.*

QVT expected to continue discussions with U.S. Bank concerning indemnity terms after it responded to the expert reports, as U.S. Bank had suggested. Wollman Aff., ¶ 20. Instead, U.S. Bank confirmed receipt of QVT's July 29 letter but waiting until 11:07 p.m. on July 31 to respond substantively. At that time, U.S. Bank's outside counsel sent a letter to QVT refusing to follow the QVT Funds' direction purportedly because the QVT Funds did not provide an indemnity, even though QVT had indicated the QVT Funds' willingness to do so but was thwarted by U.S. Bank's unreasonable demands and refusal to negotiate. *Id.* at ¶ 20, Ex. 11; Facts, ¶ 63. U.S. Bank then proceeded to accept the Proposed Settlement on behalf of JPMAC 2006-WMC1 the following day, August 1, 2014, without further discussion. Wollman Aff., Ex. 12; Facts, ¶ 64. Notably, the Trustees also announced on August 1 that they had reached

agreement with JPMorgan to extend to October 1, 2014 the deadline to respond to the Proposed Settlement with respect to certain *other* Trusts and Loan Groups. Wollman Aff., Ex. 12; Facts, ¶ 66. There appears to be no reason why U.S. Bank could not have secured the same extension for JPMAC 2006-WMC1 to provide more time to negotiate indemnity terms as the parties had discussed, but instead U.S. Bank chose to run out the clock and disregard the QVT Funds' direction.

In subsequent correspondence U.S. Bank again refused to explain the reason for the Haircut or demonstrate that it conducted any evaluation of reasonableness and fairness of the Haircut to investors in JPMAC 2006-WMC1. Wollman Aff., ¶¶ 22-23 and Exs. 11, 13. U.S. Bank merely stated that it "disagreed" with QVT's "assertions," without explaining the reasons for the disagreement or answering QVT's straightforward questions, and directed QVT to the Trustees' expert reports (which provide no explanation of the Haircut). *Id.* at Exs. 11, 13. It is apparent from the expert reports and U.S. Bank's inability to provide substantive responses to QVT's questions that U.S. Bank never conducted even a cursory investigation of the reason for the Haircut by, for example, asking JPMorgan or the Institutional Investors why it was included in the Proposed Settlement Agreement.

ARGUMENT

I. Summary Judgment Standard

This Article 77 proceeding is governed by Article 4 of the Civil Practice Law and Rules ("CPLR") with respect to special proceedings, except as may be provided in Article 77. *See* CPLR §§ 401, *et seq.*; *see generally* Siegel, NEW YORK PRACTICE, § 550. Pursuant to Section 409 of the CPLR, "[t]he court shall make a summary determination upon the pleadings, papers and admissions to the extent that no triable issues of fact are raised." CPLR § 409(b). A

respondent in a special proceeding "may move for summary judgment pursuant to CPLR § 409 (b)" although the Court may also grant summary relief in the absence of a formal motion. *In the Matter of the Council of the City of New York v. Bloomberg*, 6 N.Y.3d 380, 400 (2006). "The standards of summary judgment applied to actions should also be applied by the court to proceedings governed by CPLR 409." *In the Matter of the Port of New York Authority v. 62 Cortlandt St. Realty Co.*, 18 N.Y.2d 250, 255 (1966).

A party is entitled to summary judgment pursuant to CPLR 3212 when there are no material issues of fact to be tried. CPLR § 3212; *2386 Creston Ave. Realty, LLC v. M-P-M Mgt. Corp*., 58 A.D.3d 158, 162 (1st Dep't 2008). Summary judgment is designed to expedite the resolution of all civil cases by the elimination from the docket all claims which can be resolved by the Court as a matter of law. *Andre v. Pomeroy*, 35 N.Y.2d 361, 364 (1974). The proponent of a summary judgment motion must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to eliminate any material issues of fact from the case. *Winegrad v. New York University Medical Center*, 64 N.Y.2d 851, 853 (1985). Once the movant has made such a showing, the burden shifts to the opponent to demonstrate that a material issue of fact exists through the admission of admissible evidence. *See Grasso v. Angerami*, 79 N.Y.2d 813, 814-15 (1991). In order to defeat a motion for summary judgment, a factual issue sufficient to warrant a trial must be real, genuine and substantial, and not feigned or created purely to defeat the motion. *See Adolphe v. Ramirez*, 173 A.D.2d 583, 584 (2d Dep't 1991). Thus, "[w]here there is no genuine issue to be resolved at trial, the case should be summarily decided." *Andre*, 35 N.Y.2d at 364.

II. U.S. Bank Has No Power To Accept The Proposed Settlement With Respect To JPMAC 2006-WMC1 In Violation Of The QVT Funds' Express Direction

"It is settled that the duties and powers of a trustee are defined by the terms of the trust agreement. . . ." *In re IBJ Schroder Bank & Trust Co.*, 271 A.D.2d 322, 706 N.Y.S.2d 114 (1st Dep't 2000); *see also* Restatement (Third) of Trusts § 85. Indeed, when a trustee fails to comply with the trust agreement, "[a] breach of trust may be found even though the trustee acted reasonably and in good faith, perhaps even in reliance on advice of counsel." Restatement (Third) of Trusts § 93 cmt. c; *see also* Restatement (Second) of Trusts § 201 cmt. b ("The extent of [a trustee's] duties and powers is determined by the trust instrument and the rules of law which are applicable, and not by his own interpretation of the instrument or his own belief as to the rules of law.").

The Trustees contend in the Petition that a power to accept the Proposed Settlement is implied by "the Trustees' right to sue to enforce the Seller's repurchase obligations and the Servicer's servicing obligations." Petition ¶¶ 46-48. However, the Trustees' powers under the applicable PSAs, including the power to assert claims on behalf of investors (and purported power to settle claims), are limited and circumscribed by the rights of investors to direct the Trustees in the exercise of such powers. "[I]f the terms of a trust reserve to the settlor or confer upon another a power to direct or otherwise control certain conduct of the trustee, the trustee has a duty to act in accordance with the requirements of the trust provision reserving or conferring the power and to comply with any exercise of that power, unless the attempted exercise is contrary to the terms of the trust or power or the trustee knows or has reason to believe that the attempted exercise violates a fiduciary duty that the power holder owes to the beneficiaries." *See* Restatement (Third) of Trusts § 75; *see also In re Estate of Rubin*, 143 Misc. 2d 303, 306-07, 540 N.Y.S.2d 944, 947 (Sur. Ct., Nassau Cty.) (discussing exception to trustee duty to carry out

instructions of advisor where trustee has reason to suspect advisor is violating a fiduciary duty)); *Network Holdings, Inc. v. FDIC*, 2012 U.S. Dist. LEXIS 111944 (N.D. Ill. 2012) ("Because [beneficiary] held the power of direction, the Trustee was required to comply with his written instructions.").

The PSA for JPMAC 2006-WMC1 provides that Certificateholders have the power to direct the Trustee to conduct an investigation into potential claims and with respect to the time, method and place of conducting any remedy pursuant to the PSA. PSA §§ 8.01, 8.02. For example, the PSA provides that

> The Trustee shall not be under any obligation to exercise any of the trusts or powers vested in it by this Agreement or to institute, conduct or defend any litigation hereunder or in relation hereto at the request, order or direction of any of the Certificateholders, pursuant to the provisions of this Agreement, unless such Certificateholders shall have offered to the Trustee reasonable security or indemnity satisfactory to it against the costs, expenses and liabilities which may be incurred therein or thereby.

PSA § 8.02(iii).[7] Although phrased in the reverse, the logical significance of this provision is that if a Certificateholder *does* direct the Trustee in the exercise of its powers *and* offers to provide "reasonable" indemnity in connection with the direction, the Trustee *is* obligated to comply with the Certificateholders' direction. *Id.*; *see also* Restatement (Third) of Trusts § 75; *see also* Fischel Rep., ¶ 19. Under New York law, the use of the word "unless" in a written agreement constitutes "unmistakable language of condition," and once the condition is satisfied, the counterparty is obligated to perform. *See MHR Capital Partners LP v. Presstek, Inc.*, 12 N.Y.3d 640, 645 (2009); *Oppenheimer & Co. v. Oppenheim, Appel, Dixon & Co.*, 86 N.Y.2d 685, 690 (1995); *M & B Equities, LLC. v. Parkway Gardens Owners, Inc.*, 286 A.D.2d 755, 756,

[7] The PSA also provides that the "Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, consent, order, approval, bond or other paper or document, unless requested in writing to do so by the Holders of Certificates entitled to at least 25% of the Voting Rights," PSA § 8.02(a)(v), which means that the Trustee *is* required to conduct an investigation if directed by Certificateholders with the requisite 25% holdings.

730 N.Y.S.2d 728 (2d Dep't 2001). Recognizing that following the direction of one Certificateholder could later subject the Trustee to potential claims by other Certificateholders, the PSA also expressly exculpates the Trustee from liability for complying in good faith with its obligation to follow the Certificateholders' direction with respect to, among other things, "the time, method and place of conducting any remedy pursuant to this Agreement." PSA § 8.01(iii).

[redacted] Wollman Aff., Ex. 2. QVT, on behalf of the QVT Funds, indisputably provided an express direction to U.S. Bank to reject the Proposed Settlement with respect to JPMAC 2006-WMC1. *Id.*, Exs. 3, 7, 10. Following the QVT Funds' direction would not violate any other provision of the PSA, conflict with any contrary direction from another investor, or cause U.S. Bank to breach its fiduciary duties. Nor is there a reasonable dispute that QVT indicated that the QVT Funds would provide a "reasonable indemnity" to U.S. Bank in connection with that direction. *See, supra*, at 11-12.

U.S. Bank's intransigence in demanding unreasonable indemnity terms, failing to notify QVT when its expert reports were posted so the parties could resume discussions as it promised to do, and subsequently refusing to negotiate a "reasonable indemnity" (and failing even to engage until the clock had run out) prevented the parties from agreeing to final, written indemnity terms. However, a trustee such as U.S. Bank cannot rely on the non-satisfaction of a condition when its own bad faith conduct prevented the condition from being satisfied. *In re Bankers Trust Co.*, 450 F.3d 121, 127 (2d Cir. 2006) (holding that indenture trustee's failure to inspect collateral may not excuse its failure to comply with duty to give notice of defaults that would have been discovered had the indenture trustee inspected the collateral); *see generally*

RSB Bedford Assoc., LLC v Ricky's Williamsburg, Inc., 91 A.D.3d 16, 23, 933 N.Y.S.2d 3, 12 (1st Dep't 2011) ("A party cannot prevent the fulfillment of a contractual condition and then argue failure of that condition as a defense to a claim that it breached the contract."); *Okla. Police Pension & Ret. Sys. v. United States Bank Nat'l Ass'n*, 291 F.R.D. 47, 70-71 (S.D.N.Y. 2013); 3A Corbin, Contracts § 767, at 540 (1960) ("One who unjustly prevents the performance or the happening of a condition of his own promissory duty thereby eliminates it as such a condition. He will not be permitted to take advantage of his own wrong, and to escape from liability for not rendering his promised performance by preventing the happening of the condition on which it was promised."); Restatement (Second) of Contracts § 225 cmt. b (condition "may be excused by prevention or hindrance of its occurrence through a breach of the duty of good faith and fair dealing").

Lest there be any question as to bona fides of the QVT Funds' previous offer to provide U.S. Bank with a "reasonable indemnity," the QVT Funds reiterate their offer of such an indemnity. If the Court grants the QVT Funds their requested relief, the QVT Funds will pay for all reasonable expenses, including the reasonable costs to litigate claims against JPMorgan (to the extent not otherwise reimbursable from the Trust), and potential liability U.S. Bank may incur in connection with complying with the QVT Funds' direction, and the QVT Funds are prepared to execute an agreement to that effect. Wollman Aff., ¶ 26.

Accordingly, the Court must reject the Proposed Settlement with respect to JPMAC 2006-WMC1 because U.S. Bank lacks the power to accept the Proposed Settlement in the face of the QVT Funds' express direction to the contrary and offer of a reasonable indemnity.

III. Even If U.S. Bank Had Discretion To Accept The Settlement For JPMAC 2006-WMC1, It Abused That Discretion

Even if U.S. Bank had the power – and therefore the discretion – to accept the Proposed Settlement for JPMAC 2006-WMC1, it was required to exercise that discretion with "reasonable prudence." *In re Bank of N.Y. Mellon*, 42 Misc. 3d 1237(A), *9, 986 N.Y.S.2d 864 (Sup. Ct., N.Y. Cty. 2014) (*citing* Restatement (Second) of Trusts § 192); *see also* Restatement (Third) of Trusts § 86 cmt. f ("a trustee [may not exercise its] power to abandon or disclaim property that is or otherwise would be held in the trust . . . unless it is to serve the interest of the beneficiaries and is consistent with the purposes of the trust, as well as with the trustee's other fiduciary duties."). In order to properly exercise its discretion, a trustee must conduct an investigation of the proposed action 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. . . ."). Here, U.S. Bank seeks to release $393,718,648 in potential claims for a payment of only $3 million (*i.e.*, 0.8% of the potential damages) due to the Haircut. Given the size and significance of the dollar amounts at issue, and the stark disparity in the treatment of JPMAC 2006-WMC1 (and the small number of other Haircut trusts) compared to the rest of the Trusts, U.S. Bank was required to take *some action* to determine whether the Haircut was reasonable for JPMAC 2006-WMC1. It did nothing. Indeed, no one in this proceeding – not the Trustees, not the Institutional Investors, and not JPMorgan – has even attempted to justify the Haircut.

It is apparent that U.S. Bank failed to conduct any investigation as to the purpose of the Haircut or to perform even a cursory analysis of the reasonableness or fairness of the Haircut as applied to JPMAC 2006-WMC1. U.S. Bank never even bothered to ask JPMorgan or the Institutional Investors about the reasons or basis for the Haircut. U.S. Bank was unable to

provide any explanation in response to the numerous inquiries from QVT. *See supra* at 12-13. The Trustees' expert reports also indicate that the experts were never provided any explanation of the reason for the Haircut as applied to JPMAC 2006-WMC1, and those reports actually demonstrate the clear unreasonableness of the Haircut (at least as applied to JPMAC 2006-WMC1). *See id.*

Counsel for the Institutional Investors, who negotiated the Proposed Settlement Agreement, represented to the Court during the hearing on December 16, 2014 that the Haircut "was applied only as to obligors that were solvent." Ledley Aff., Ex. 8 (12/16/14 Hr'g Tr.) at 25. There is no evidence for such a claim. U.S. Bank never conducted any investigation as to whether WMC – a defunct, shell corporation – is, in fact, solvent. Professor Fischel stated in his report that he was not provided any information about WMC's ability to pay claims and/or whether U.S. Bank, as Trustee, had recourse against General Electric, WMC's parent, in the event WMC was not solvent. Fischel Rep. at 87 fn. 232. Professor Fischel was left to conclude that it was "uncertain" whether any recovery could be obtained from WMC or General Electric. *Id.*; *see also* Facts, ¶ 25. In any event, there is no basis to shift the burden of collecting from WMC from JPMorgan to investors in JPMAC 2006-WMC1, particularly because it is undisputed that "[t]he Trustee need not make a demand on an Originator before claiming against the Seller [*i.e.*, JPMorgan]." Schwartz Rep., ¶ 18; Facts, ¶ 50. JPMorgan remains *directly* liable for the breach of its own representations, regardless of any rights investors in JPMAC 2006-WMC1 have against WMC. Professor Fischel also acknowledged that claims against WMC may be time barred, which would leave investors in JPMAC 2006-WMC1 with no recourse with respect to 90% of its losses. *Id.*

Professor Fischel's report contains no discussion of JPMAC 2006-WMC1. However, Professor Fischel did address the Haircut with respect to a different Accepting Trust (JPMAC 2006-WF1) that was subject, in part, to the Haircut. With respect to that Accepting Trust, Professor Fischel concluded that "[i]f the claims against Third Party Originators are time barred, and this allows the Trust to assert repurchase claims against JPM, it would make the Proposed Settlement less attractive." *Id.* ¶ 128. As a result, Professor Fischel *only* recommended acceptance of the Proposed Settlement "because the Holdings of Supporting Certificateholders exceed 50% and those of Opposing Certificateholders are less than 5%." *Id.* However, there is no comparable disparity between opposing and supporting Certificateholders (*i.e.*, the Institutional Investors) with respect to JPMAC 2006-WM1. [redacted] Facts, ¶¶ 8-9. Professor Fischel was only provided holdings information for Supporting Investors as of October 31, 2013, Fischel Rep., ¶ 52, but even based on the (indisputably stale) information that U.S. Bank made available to Professor Fischel, the QVT Funds' holdings exceeded the Supporting Investors' holdings for the Group 2 Certificates ([redacted]), *see* Fischel Supp. Rep., Ex. B at 12, and were comparable to the Supporting Certificateholders' holdings with respect to the Trust overall ([redacted]), *see* Fischel Rep., Ex. P at 5.[8] Accordingly, based on Professor Fischel's own reasoning with respect to JPMAC 2006-WF1, U.S. Bank should have rejected the Proposed Settlement for JPMAC 2006-WMC1.

[8] As of October 31, 2013, the Institutional Investors owned [redacted] of the Group 2 Certificates and [redacted] of the overall securities. Supp. Fischel Rep., Ex. B at 12; Fischel Rep., Ex. P at 5.

The apparent reason for the disconnect between Professor Fischel's reasoning concerning JPMAC 2006-WF1 and his conclusion for JPMAC 2006-WMC1 is that Professor Fischel did not take into consideration the QVT Funds' holdings in his reports. *See* Fischel Rep., Ex. P at 5 (stating that total percentage holdings of Certificateholders in JPMAC 2006-WMC1 opposing the Proposed Settlement was 1.79% although the QVT Funds, by themselves, hold [redacted] of the Trust); Fischel Supp. Rep., Ex. B at 12 (stating that total percentage holdings of Opposing Certificateholders in Group 2 Certificates was 1.95% although the QVT Funds, by themselves, hold [redacted] of the Group 2 Certificates); Facts, ¶ 70-71.[9] QVT informed U.S. Bank of the discrepancy on August 4, 2014. Wollman Aff. Ex. 14. Professor Fischel therefore was working with information that *U.S. Bank knew to be incomplete and inaccurate* and yet U.S. Bank made no effort to correct Professor Fischel and relied on his analysis anyway. Facts, ¶¶ 70-72. Clearly, it is not reasonable for a Trustee knowingly to rely on a misinformed expert. Under any conceivable standard, that constitutes an abuse of discretion.

CONCLUSION

For all of these reasons, the QVT Funds respectfully request that the Court grant their Motion for Partial Summary Judgment and reject the Proposed Settlement with respect to JPMAC 2006-WMC1.

[9] When one combines the QVT Funds' holdings with the holdings of other Opposing Certificateholders that Professor Fischel did consider, (1) Opposing Certificateholders' total holdings for the Group 2 Certificates are [redacted] compared to only [redacted] held by the Institutional Investors, *compare* Fischel Suppl. Rep., Ex. B at 12 *with* Wollman Aff., ¶ 5, and (2) Opposing Certificateholders' total holdings for the entire Trust are [redacted] compared to [redacted] for the Institutional Investors. *Compare* Fischel Rep., Ex. P at 5 *with* Wollman Aff., ¶ 5. Notably, U.S. Bank could have rejected the Proposed Settlement (or obtained an extension in order to negotiate indemnity terms with the QVT Funds, as it did with other Trusts and Loan Groups) with respect to the Group 2 Certificates and accepted with respect to Group 1; it simply ignored the QVT Funds instead.

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