

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

----- X

In the matter of the application of :

Index No. 652382/2014

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-Wuerttemberg (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), :

Part 60

Hon. Marcy S. Friedman

**RESPONDENTS' PRE-
TRIAL MEMORANDUM**

Petitioners,

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

----- X

TABLE OF CONTENTS

	<u>Page</u>
AMBAC’S EFFORTS TO OBTAIN RELIEF FROM JPMORGAN	3
AMBAC’S ARGUMENT.....	4
I. STANDARD OF REVIEW	4
II. THE TRUSTEES ARE SELF-INTERESTED WITH RESPECT TO THE PROPOSED SETTLEMENT	5
A. The Trustees Are Self-Interested	5
i. Avoiding Claims By The Institutional Investors	5
ii. Avoiding Liability For Servicer Misconduct.....	6
iii. Avoiding Liability For Fraudulent Assessments of Compliance.....	7
B. The Trustees Cannot Prove Entire Fairness.....	9
III. THE TRUSTEES’ RELIANCE ON PROFESSOR FISCHEL DOES NOT JUSTIFY APPROVAL OF THE PROPOSED SETTLEMENT	11
IV. EVEN IF THE COURT APPROVES THE PROPOSED SETTLEMENT, THE TRUSTEES ARE NOT ENTITLED TO THE RELIEF THEY ARE SEEKING.....	13
W&L’S ARGUMENT	14
A. THE SETTLEMENT AGREEMENT IS INTENDED TO COMPENSTE FOR BREACHES OF REPRESENTATIONS AND WARRANTIES BUT THE DISTRIBUTION METHODOLOFY PREVENTS THAT	14
B. THE DISTRBUTION METHODOLOGY IS INCONSISTENT WITH THE GOVERNING AGREEMENTS.....	15
C. THE TRUSTEE DID NOT CONSIDER WHETHER THE DISTRIBUTION METHODOLOGY MEETS THE PURPOSE OF THE SETTLEMENT AGREEMENT OR COMPLIES WITH THE GOVERNING AGREEMENTS, AND, THEREFORE, THE TRUSTEE’S DECISION TO ACCEPT THE DISTRIBUTION METHODOLOGY IS ENTITLED TO NO DEFERENCE	17

D. THE COURT SHOULD ORDER DISTRIBUTION OF THE ALLOCABLE SHARES FOR THE W&L TRUSTS TO EFFECT THE PURPOSE OF THE SETTLEMENT AGREEMENT AND IN A MANNER THAT COMPLIES WITH THE GOVERNING AGREEMENTS.....18

TABLE OF AUTHORITIES

<u>Cases</u>	<u>Page(s)</u>
<i>Alpert v. 28 Williams St. Corp.</i> , 63 N.Y.2d 557 (1984)	10
<i>Ambac Assur. Corp. v. EMC Mortg. LLC</i> , First Am. Compl, Index No. 651013/2012 (N.Y. Sup. Ct. Aug. 14, 2012)	3
<i>Ambac Assur. Corp. v. EMC Mortg. LLC</i> , 121 A.D.3d 514 (1st Dep’t 2014)	1
<i>Beck v. Mfrs. Hanover Trust Co.</i> , 218 A.D.2d 1 (1st Dep’t 1995)	5
<i>BlackRock Allocation Target Shares v. The Bank of New York Mellon</i> , No. 14-cv-09372 (S.D.N.Y. 2014)	10
<i>BlackRock Core Bond Portfolio v. U.S. Bank Nat’l Ass’n</i> , Am. Compl., No. 14-cv-09401 (S.D.N.Y. July 2, 2015)	5
<i>Chubb & Son, Inc. v. Consoli</i> , 283 A.D.2d 297 (1st Dep’t 2001)	6
<i>Dabney v. Chase Nat’l Bank</i> , 196 F.2d 668 (2d Cir. 1952)	5
<i>Fiore v. Fiore</i> , 46 N.Y.2d 971 (1979)	16
<i>Galena Street Fund, L.P. v. Wells Fargo Bank, Nat’l Ass’n</i> , No. 12-cv-00587 (D. Colo. 2012)	11
<i>Gesoff v. IIC Indus., Inc.</i> , 902 A.2d 1130 (Del. Ch. 2006)	10
<i>Kimeldorf v. First Union Real Estate Equity & Mortg. Invs.</i> , 309 A.D.2d 151 (1st Dep’t 2003)	9
<i>In re The Bank of New York Mellon</i> , 42 Misc.3d 1237(A) (N.Y. Sup. Ct. Jan. 31, 2014)	17
<i>In re The Bank of New York Mellon</i> , 127 A.D.3d 120 (1st Dep’t 2015)	4, 11, 17

<i>In re Croton River Club, Inc.</i> , 52 F.3d 41 (2d Cir. 1995).....	5, 9
<i>In re Gilbert</i> , 350 N.Y.2d 663 (1976).....	16
<i>In re Perry H. Koplik & Sons, Inc.</i> , 476 B.R. 746 (Bankr. S.D.N.Y. 2012), <i>adopted in part</i> , 499 B.R. 276 (S.D.N.Y. 2013), <i>aff'd</i> , 567 F. App'x 43 (2d Cir. 2014).....	9
<i>In re Stillman</i> , 107 Misc.2d 102 (Sur. Ct. 1980).....	17
<i>In re Trusteeship Created by Am. Home Mtg. Inv. Trust 2005-2</i> , No. 14-cv-02494, 2014 WL 3858506, 2014 U.S. Dist. LEXIS 111867 (S.D.N.Y. 2014).....	16
<i>In re U.S. Bank Nat'l Ass'n</i> , Index No. 653902/2014, 2015 WL 9271693 (N.Y. Sup. Ct. Dec. 18, 2015).....	4
<i>Int'l Equity Invs., Inc. v. Opportunity Equity Partners, Ltd.</i> , 407 F. Supp. 2d 483 (S.D.N.Y. 2005), <i>aff'd and remanded</i> , 246 F. App'x 73 (2d Cir. 2007).....	9
<i>Isaacs v. Westchester Wood Works, Inc.</i> , 278 A.D.2d 184 (1st Dep't 2000).....	15
<i>Kaufman v. Cohen</i> , 307 A.D.2d 113 (1st Dep't 2003).....	8
<i>Limmer v. Medallion Grp., Inc.</i> , 75 A.D.2d 299 (1st Dep't 1980).....	9
<i>Melbourne v New York Life Ins. Co.</i> , 271 A.D.2d 296 (1st Dep't 2000).....	6
<i>Nomura Asset Acceptance Corp. Alt. Loan Trust, series 2006-S4 v. Nomura Credit & Cap., Inc.</i> , Index No. 653390/2012, 2014 WL 2890341, 2014 N.Y. Misc. LEXIS 2905, 2014 N.Y. Slip. Op. 31671(U) (N.Y. Sup. Ct. June 26, 2014).....	15
<i>Phoenix Light SF Ltd. v. The Bank of New York Mellon</i> , No. 14-cv-10104 (S.D.N.Y. 2014).....	16
<i>Phoenix Light SF Ltd. v. Wells Fargo Bank, Nat'l Ass'n.</i> , No. 14-cv-10102 (S.D.N.Y. 2014).....	11

<i>Rales v. Blasband</i> , 634 A.2d 927 (Del. 1993)	6
<i>Royal Park Invs. SA/NV v. HSBC Bank USA, Nat’l Ass’n</i> , No. 14-cv-08175, 2015 WL 3466121, 2015 U.S. Dist. LEXIS 70675 (S.D.N.Y. June 1, 2015)	5
<i>Royal Park Invs. SA/NV v. The Bank of New York Mellon</i> , No. 14-cv-06502 (S.D.N.Y. 2014).....	10
<i>Schwartz v. Marien</i> , 37 N.Y.2d 487 (1975)	9
<i>Simon v. Becherer</i> , 7 A.D.3d 66 (1st Dep’t 2004)	5
<i>Sutton v. East River Savings Bank</i> , 55 N.Y.2d 550 (1982)	16
<i>Stanfield Offshore Leveraged Assets, Ltd. v. Metro. Life Ins. Co.</i> , 64 A.D.3d 472 (1st Dep’t 2009)	8
<i>Terrydale Liquidating Trust v. Barness</i> , 611 F. Supp. 1006 (S.D.N.Y. 1984).....	9
<i>Terrydale Liquidating Trust v. Barness</i> , 642 F. Supp. 917 (S.D.N.Y. 1986), <i>aff’d</i> , 846 F.2d 845 (2d Cir. 1988).....	9
<i>The Western and Southern Life Ins. Co. v. The Bank of New York Mellon</i> , No. A1302490 (C.P. Hamilton Cnty. Ohio 2013)	10
<i>Valeant Pharm. Int’l v. Jerney</i> , 921 A.2d 732 (Del. Ch. 2007).....	10
<i>Visual Arts Found., Inc. v. Egnasko</i> , 91 A.D.3d 578 (1st Dep’t 2012)	8
<i>Zheng v. Icahn</i> , Index No. 650499/2010, 2013 WL 363410, 2013 N.Y. Misc. LEXIS 302 (N.Y. Sup. Ct. 2013), <i>aff’d as modified sub nom. R2 Investments, LDC v. Icahn</i> , 117 A.D.3d 632 (1st Dep’t 2014)	10

Other Authorities

17 C.F.R. § 240.13a-18 (2005)	7
-------------------------------------	---

17 C.F.R. § 229.1122 (2014)	7
Frank J. Fabozzi, <i>The Handbook of Fixed Income Securities</i> (8th ed. 2012)	16
Restatement (Third) of Agency § 1.02 (2006).....	6
Restatement (Third) of Trusts § 77 (2007)	12
Restatement (Third) of Trusts § 78 (2007)	5
Restatement (Third) of Trusts § 80 (2007)	4
Restatement (Third) of Trusts § 87 (2007)	17
Restatement (Third) of Trusts § 93 (2007)	4

Ambac has litigated with JPMorgan since 2008 in an attempt to recover more than \$1.5 billion in insurance losses – more than \$500 million in connection with trusts at issue here – resulting from JPMorgan’s fraudulent securitization practices. In the course of this effort, Ambac discovered extensive evidence of fraud on a massive scale, and this evidence formed the basis for other lawsuits and government investigations. The government investigations culminated in JPMorgan’s \$13 billion settlement with the Department of Justice, in which JPMorgan *admitted* that it knowingly dumped defective mortgages into its securitization trusts. In 2013, Ambac’s contract claims against JPMorgan for breaching representations concerning loans in the Ambac-insured trusts at issue here were dismissed for lack of standing. The First Department affirmed, holding that the Trustees have the exclusive power and “full responsibility” to assert those claims on Ambac’s behalf. *Ambac Assur. Corp. v. EMC Mortg. LLC*, 121 A.D.3d 514, 520 (1st Dep’t 2014) (“*Ambac*”). Ambac’s related fraud claims against JPMorgan are pending.

Most of the losses suffered by RMBS investors and insurers could have been avoided had RMBS trustees, who are tasked with enforcing the rights of investors and insurers, done their job. In recent years, investors have commenced a wave of lawsuits against RMBS trustees (including the Trustees here) for failing in their duties to police the conduct of mortgage servicers and enforce investor rights. In particular, Blackrock, PIMCO, and others who negotiated the Proposed Settlement have sued the Trustees with respect to virtually all the RMBS trusts in which they invested, with the notable exception of those trusts for which the Trustees accepted global settlements negotiated by those Institutional Investors. The very same law firms defending the Trustees against the Institutional Investors’ claims are representing the Trustees in this proceeding.

The Trustees now seek the Court’s approval of their decision to accept a pennies-on-the-dollar settlement for any and all of their claims – whether arising in contract, tort, or otherwise –

related to JPMorgan's loan securitization and servicing misconduct in connection with the trusts at issue. The Trustees' principal justification for this extraordinary decision is their reliance on the recommendations of Professor Daniel Fischel, an academic with no expertise in RMBS securitizations. The linchpin of Fischel's analysis is his assumption, contradicting the plain language of the Governing Agreements and the First Department ruling in *Ambac*, that the Trustees have *no responsibility* to assert contract claims on behalf of Ambac and investors in the trusts unless the Trustees are directed to do so by investors who indemnify the Trustees and agree to fund all litigation expenses. The Trustees did not seek any *independent* legal advice concerning their responsibilities under the Governing Documents (and Fischel declined to offer any such opinion). Instead, the Trustees chose to rely on their litigation counsel – the same firms defending the Trustees against claims by investors, including the Institutional Investors – concerning the Trustees' failure to meet those obligations.

The Court should find that the Trustees abused their discretion and therefore reject the Proposed Settlement with respect to the Ambac-insured trusts, because the Trustees are self-interested as to approval of the Proposed Settlement, and because the Trustees have unreasonably relied on the opinions of an entirely unqualified expert and the advice of plainly conflicted counsel. That said, to the extent the Court finds that the Trustees did not abuse their discretion in accepting the Proposed Settlement, the Court should make no additional findings that could preclude Ambac or investors from asserting claims for Trustee misconduct that may only be adjudicated, after full discovery, in a plenary action with the attendant right to a jury.

AMBAC'S EFFORTS TO OBTAIN RELIEF FROM JPMORGAN

Ambac provided financial guaranty insurance with respect to eight RMBS trusts that are subject to the Proposed Settlement (the “Ambac Insured Trusts”).¹ In 2011 and 2012, Ambac undertook a forensic review of the loans backing the Ambac Insured Trusts and uncovered evidence of pervasive breaches of representations and warranties by JPMorgan. For example, Ambac eventually obtained files for a sample of 100 loans in six of the eight Ambac Insured Trusts, and a re-underwriting review of those files indicated a breach rate of 61% to 90%. Ambac
Objection at 8 and Appendix A. Ambac notified the Trustees and requested their assistance in compelling JPMorgan to cure these breaches. The Trustees, in turn, sent notices to JPMorgan demanding that it repurchase the breaching loans in accordance with the Governing Agreements. RX120-123, 125-127, 130. JPMorgan refused. Accordingly, in 2012 Ambac sued JPMorgan for fraud and breach of contract to recover the losses it suffered on these trusts. RX260 (First Amended Complaint filed in *Ambac Assur. Corp. et al. v. EMC Mortg. LLC et al.*, Index No. 651013/2012 (N.Y. Sup. Ct. Aug. 14, 2012)). On October 16, 2014, the First Department affirmed the dismissal of Ambac’s contract claims on the basis that the Trustees had the sole responsibility for enforcing breaches of JPMorgan’s representations and warranties. RX271.

On December 18, 2013, during the Trustees’ evaluation of the Proposed Settlement, Ambac informed the Trustees that Ambac has an “urgent and direct interest” in any settlement purporting to release JPMorgan from liability with respect to the Ambac Insured Trusts and

¹ Petitioner Wells Fargo serves as trustee and Petitioner Law Debenture serves as “separate trustee” for five Ambac Insured Trusts: BSMF 2006-AR2, BSMF 2006-AR4, GPMF 2005-AR5, GPMF 2006-AR2, GPMF 2006-AR3. Petitioner BNY Mellon serves as trustee for two others: SAMI 2006-AR7 and SAMI 2006-AR8. Petitioner Wilmington Trust serves as trustee for BALTA 2006-4, certain tranches of which are included in BALTA 2006-R1, also an Ambac Insured Trust.

further informing the Trustees of Ambac’s ongoing litigation of fraud claims against JPMorgan. RX15, 164. The Trustees nonetheless refused to provide information requested by Ambac regarding the Proposed Settlement. Accordingly, Ambac directed the Trustees to “reject the settlement offer . . . as it pertains to any certificate issued by the [Ambac Insured Trusts].” RX55, 257. Ignoring Ambac’s interests and instructions, the Trustees purported to accept the Proposed Settlement on behalf of the Ambac Insured Trusts.

AMBAC’S ARGUMENT

I. STANDARD OF REVIEW

“The ultimate issue for determination [in an Article 77 proceeding] is whether the trustee’s discretionary power was exercised reasonably and in good faith.” *In re The Bank of New York Mellon*, 127 A.D.3d 120, 125 (1st Dep’t 2015). This means a court’s task “is limited to ensuring that the trustee has not acted in bad faith such that his conduct constituted an abuse of discretion.” *Id.* In applying this abuse of discretion standard on appeal of the Countrywide Article 77 proceeding, the First Department considered whether the actions of the trustee (Bank of New York) were (i) within its authority; (ii) not tainted with self-interest; and (iii) reflected reasonable reliance on plausible, qualified, and independent advice of counsel. *Id.* at 126. Reliance on expert advice – if in good faith – may support a trustee’s exercise of discretion if the expert was “selected . . . prudently and in good faith,” and offered “plausible advice on a matter within the adviser’s competence.” *In re U.S. Bank Nat’l Ass’n*, Index No. 653902/2014, 2015 WL 9271693, at *8 (N.Y. Sup. Ct. Dec. 18, 2015) (“*U.S. Bank*”) (*quoting* Restatement (Third) of Trusts § 93 cmt. c (2007)). Even when it receives legal or expert advice, a trustee still “must exercise independent, prudent, and impartial fiduciary judgment on the matters involved.” *Id.* (*quoting* Restatement (Third) of Trusts § 80 cmt. b (2007)). If a trustee uses advisers lacking impartiality its decision making is infected with impartiality as well. Moreover, the deference

normally afforded in an Article 77 simply does not apply once there is a showing of self-interest. *Cf. In re Croton River Club, Inc.*, 52 F.3d 41, 44 (2d Cir. 1995) (“It is black-letter, settled law that when a [fiduciary] has an interest in a decision, the business judgment rule does not apply.”).

II. THE TRUSTEES ARE SELF-INTERESTED WITH RESPECT TO THE PROPOSED SETTLEMENT

At all times, the Trustees owed Ambac and investors a duty of loyalty, which requires a trustee to avoid conflicts of interest and to discharge its obligations “with absolute singleness of purpose.” *Dabney v. Chase Nat’l Bank*, 196 F.2d 668, 669-71 (2d Cir. 1952) (L. Hand, J.); *see also Beck v. Mfrs. Hanover Trust Co.*, 218 A.D.2d 1, 11 (1st Dep’t 1995) (trustee has “obligation to give his beneficiary his undivided loyalty, free from any conflicting personal interest”); Restatement (Third) of Trusts § 78 cmt. a (2007).

A. The Trustees Are Self-Interested

The Trustees here have a self-interest in approval of the Proposed Settlement in at least three ways:

(i) Avoiding Claims By The Institutional Investors. Several of the Institutional Investors, including Blackrock and PIMCO, have sued the Trustees in five actions involving over 1,000 different RMBS trusts.² Courts that have considered motions to dismiss in these actions have sustained the Institutional Investors’ claims in material part. *See Royal Park Invs. SA/NV v. HSBC Bank USA, Nat’l Ass’n*, No. 14-cv-08175, 2015 WL 3466121, 2015 U.S. Dist. LEXIS 70675 (S.D.N.Y. June 1, 2015). Notably, the Institutional Investors have *not* sued the Trustees with respect to RMBS trusts that were subject to global settlements negotiated by the Institutional Investors and accepted by the Trustees. In fact, the Institutional Investors explicitly

² *See, e.g., Am. Compl., BlackRock Core Bond Portfolio v. U.S. Bank Nat’l Ass’n*, No. 14-cv-09401 (S.D.N.Y. July 2, 2015).

threatened to hold the Trustees accountable with respect to the trusts at issue here during the Trustees' consideration of the Proposed Settlement. As these circumstances demonstrate, the Trustees have a clear-cut motive to avoid further Institutional Investor lawsuits by accepting the Proposed Settlement, regardless of whether the settlement is in the best interest of *all* investors. This obvious self-interest undermines the Trustees' independence. *See Simon v. Becherer*, 7 A.D.3d 66, 72 (1st Dep't 2004) ("a [fiduciary] cannot be expected to exercise his or her independent business judgment without being influenced by the adverse personal consequences resulting from the decision" and "a substantial likelihood" of being sued undermines a fiduciary's independence) (citing *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993)).³

(ii) *Avoiding Liability For Servicer Misconduct*. A principal is liable for the acts of an agent within the scope of its agency. *See, e.g., Chubb & Son, Inc. v. Consoli*, 283 A.D.2d 297, 299 (1st Dep't 2001). The Pooling and Servicing Agreements ("PSAs") for each of the Ambac Insured Trusts state that the Servicer or Master Servicer is the agent of the Trustee when "tak[ing] action in the name of the Trustee." *E.g.*, RX14.6 (BSMF 2006-AR2 PSA) § 3.05.⁴ Among other things, a servicer acts in the name of the Trustee when foreclosing on loans, and various investors, including the Institutional Investors, have alleged that JPMorgan breached its prudent-servicing obligations by engaging in widely reported improper and fraudulent foreclosure practices. RX109; *see also* Reifsnyder ¶ 46. Because the Trustees are potentially liable as a principal for claims against JPMorgan for this and other misconduct, the Trustees have

³ Section 4.06 of the Settlement Agreement is further evidence of the Trustees' bad faith and self-interest. Through this provision, the Trustees have extracted an unwarranted settlement credit or judgment reduction that they otherwise would not have under New York law.

⁴ Although the PSAs also recite that Servicer is not the Trustee's agent for other purposes, "[w]hether a relationship is characterized as agency in an agreement between parties or in the context of industry or popular usage is not controlling," Restatement (Third) of Agency § 1.02 (2006), and whether a party is an agent or an independent contractor is generally an issue of fact. *Melbourne v New York Life Ins. Co.*, 271 A.D.2d 296, 297 (1st Dep't 2000).

a clear conflict with respect to approving the resolution of those claims through the Proposed Settlement.

(iii) Avoiding Liability For Fraudulent Assessments of Compliance. The PSAs require the Depositor to transfer to the Trustee or the Custodian (on the Trustee's behalf) a "Mortgage File" for each loan containing certain essential documents. RX14.6 § 2.01. The Trustee (or Custodian) is required to provide periodic certifications, concluding with a "Final Certification" 180 days after the closing of the securitization, that it is in possession of all required documents in the Mortgage File other than specified missing items. *Id.* § 2.02.⁵ The Final Certifications are provided to all parties to the PSAs (but not to Ambac or investors). On an industry-wide basis, securitizing banks like JPMorgan systematically failed to obtain and transfer the necessary collateral documents to RMBS trusts, resulting in the "robo-signing" scandal in which loan documents were falsely signed and forged on a routine basis. Indeed, the Final Certifications for the Ambac Insured Trusts show that the trusts did not receive complete Mortgage Files for large numbers of loans. RX1, 84-86, 88, 279-80.

Apart from Final Certifications by the Trustees, the Servicer or Master Servicer is obligated under the terms of every PSA and Item 1122 of Regulation AB to file with the SEC, and provide to the other parties to the PSA, annual "Assessments of Compliance" with certain required "Servicing Criteria." RX14.6 § 3.17; *see also* 17 C.F.R. § 240.13a-18 (2005). The Servicing Criteria require, among other things, that "[c]ollateral or security on pool assets is maintained as required by the transaction agreements or related pool asset documents," and "[p]ool assets and related documents are safeguarded as required by the transaction agreements." 17 CFR § 229.1122(d)(4)(i)-(ii) (2014). The Custodian, acting as the Trustee's agent, is also

⁵ The Custodian is the Trustee's agent. RX14.6 at Ex. G (Custodial Agreement) §§ 2.1, 3.1.

required to make the same certification in its Assessments of Compliance. However, because the Ambac Insured Trusts did not receive complete Mortgage Files for all loans as evidenced by the Final Certifications, the Assessments of Compliance by JPMorgan as Servicer for six of the Ambac Insured Trusts were knowingly false. Each false assessment was a breach of Section 3.17 of the PSAs, a violation of the securities laws, a fraud on investors, not an Event of Default, for which the Trustee is required to “immediately terminate” the Servicer. RX14.6 § 3.17.

The Trustees are jointly liable as aiders and abettors of this JPMorgan servicing fraud. *See Visual Arts Found., Inc. v. Egnasko*, 91 A.D.3d 578, 579 (1st Dep’t 2012) (joint and several liability for aiding and abetting under New York law). Under New York law, a claim of aiding and abetting fraud requires “(1) the existence of an underlying fraud; (2) knowledge of the fraud on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in achievement of the fraud.” *Stanfield Offshore Leveraged Assets, Ltd. v. Metro. Life Ins. Co.*, 64 A.D.3d 472, 476 (1st Dep’t 2009) (citations omitted). “Substantial assistance exists where (1) a defendant affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed, and (2) the actions of the aider/abettor proximately caused the harm on which the primary liability is predicated.” *Id.* (citations omitted).

Here, the Trustees received Final Certification for numerous trusts, including the Ambac Insured Trusts, indicating large numbers of missing documents, and therefore had knowledge that the Assessments of Compliance were false. Because the Trustees were obligated to take action under the PSAs to (among other things) terminate the Servicer or Master Servicer, their inaction constitutes “substantial assistance.” *Id.*; *see also Kaufman v. Cohen*, 307 A.D.2d 113, 126 (1st Dep’t 2003). Moreover, the Custodian, as the Trustee’s agent, provided direct assistance by submitting its own false Assessments of Compliance.

B. The Trustees Cannot Prove Entire Fairness

Under New York law, when a fiduciary is conflicted or has a self-interest in a proposed transaction, its decisions are not entitled to deference and it must instead show that the transaction is entirely fair to its beneficiaries. *See, e.g., Schwartz v. Marien*, 37 N.Y.2d 487, 491 (1975); *Limmer v. Medallion Grp., Inc.*, 75 A.D.2d 299, 303 (1st Dep’t 1980); *In re Croton River Club, Inc.*, 52 F.3d at 44 (applying New York law); *Terrydale Liquidating Trust v. Barness*, 642 F. Supp. 917, 919 (S.D.N.Y. 1986), *aff’d*, 846 F.2d 845 (2d Cir. 1988).⁶ “The New York and Delaware courts have elaborated on the concept of fairness. . . . The law is substantially the same in New York, which indeed relies upon the relevant Delaware precedent.” *Int’l Equity Invs., Inc. v. Opportunity Equity Partners, Ltd.*, 407 F. Supp. 2d 483, 501-02 (S.D.N.Y. 2005).⁷ The entire fairness standard encompasses a two-pronged inquiry as to fair process and fair price: (i) “whether the [fiduciary] made the necessary investigation and undertook due deliberation with respect to [its] decision” and (ii) “whether the decision is defensible on the merits.” *Id.*

There are a number of steps that even an interested fiduciary may take to ensure a fair process, but the Trustees failed to take any of them. For example:

Appointment of an independent party to evaluate the Proposed Settlement. Boards of directors must appoint an independent negotiating committee or special committee of the board

⁶ Standards applicable to corporate directors apply equally to trustees of business trusts, as New York courts look to corporate law as to matters relating to the exercise of fiduciary duties. *See, e.g., Kimeldorf v. First Union Real Estate Equity & Mortg. Invs.*, 309 A.D.2d 151, 160 (1st Dep’t 2003) (applying business judgment rule to Ohio REIT through application of New York law); *Terrydale Liquidating Trust v. Barness*, 611 F. Supp. 1006, 1017 (S.D.N.Y. 1984) (noting the “practical similarity between the standards governing trustees and corporate directors”).

⁷ *See also In re Perry H. Koplik & Sons, Inc.*, 476 B.R. 746, 803 n.307 (Bankr. S.D.N.Y. 2012), *adopted in part*, 499 B.R. 276 (S.D.N.Y. 2013), *aff’d*, 567 F. App’x 43 (2d Cir. 2014) (“Though New York law [on entire fairness] may not be as well as developed as the Delaware law, it is to the same effect.”).

to evaluate a proposed transaction in which some members have an interest. *Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557, 570 (1984). The analogous action here would have been for the Trustees to appoint a special trustee or co-trustee to evaluate the Proposed Settlement.⁸ However, no Trustee sought to appoint an independent special trustee to evaluate servicing claims released by the Proposed Settlement, including those claims for which Trustees were potentially liable.

Obtain advice from independent counsel. Reasonable reliance on counsel, while not sufficient to establish entire fairness, is a pertinent factor in evaluating a fiduciary's actions. *See Zheng v. Icahn*, Index No. 650499/2010, 2013 WL 363410, 2013 N.Y. Misc. LEXIS 302 (N.Y. Sup. Ct. 2013), *aff'd as modified sub nom. R2 Investments, LDC v. Icahn*, 117 A.D.3d 632 (1st Dep't 2014); *Valeant Pharm. Int'l v. Jerney*, 921 A.2d 732, 751 (Del. Ch. 2007). However, counsel must be *independent*. *See, e.g., Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1151 (Del. Ch. 2006). Here, although the Trustees retained Professor Alan Schwartz and Justice Anthony Carpinello as independent legal advisors on certain discrete issues, the Trustees were mainly advised by their regular counsel, who are not independent. For example, Bank of New York retained the Mayer Brown firm, which regularly represents Bank of New York, including as defense counsel for the bank in numerous actions brought by RMBS investors.⁹ Wells Fargo retained the Faegre Baker firm, which regularly represents Wells Fargo, including in the defense

⁸ In fact, Wells Fargo initiated a proceeding in Minnesota for the appointment of Law Debenture to act as special trustee to evaluate breach of representation and warranty claims, because Wells Fargo is a major originator of mortgage loans subject to breach of representation claims in its own right. *Sohlberg Aff.* ¶ 13; *Musarra Aff.* ¶ 1 n.1; RX316.

⁹ *See, e.g., BlackRock Allocation Target Shares v. The Bank of New York Mellon*, No. 14-cv-09372 (S.D.N.Y. 2014); *The Western and Southern Life Ins. Co. v. The Bank of New York Mellon*, No. A1302490 (C.P. Hamilton Cnty. Ohio 2013); *Phoenix Light SF Ltd. v. The Bank of New York Mellon*, No. 14-cv-10104 (S.D.N.Y. 2014); *Royal Park Invs. SA/NV v. The Bank of New York Mellon*, No. 14-cv-06502 (S.D.N.Y. 2014).

of claims by RMBS investors, *see, e.g., Galena Street Fund, L.P. v. Wells Fargo Bank, Nat'l Ass'n*, No. 12-cv-00587 (D. Colo. 2012), and Wells Fargo is regularly defended by other counsel within the Trustee counsel group. *See, e.g., Phoenix Light SF Ltd. v. Wells Fargo Bank, Nat'l Ass'n*, No. 14-cv-10102 (S.D.N.Y. 2014). These firms plainly are unable to provide *independent* advice with respect to the Proposed Settlement. Nevertheless, as their privilege logs reflect, the Trustees relied on their go-to counsel as to, among other things, the evaluation of the Proposed Settlement, the retention and assignments of experts, the Trustees' duties, and the release of claims against JPMorgan. [See ECF No. 551].

III. THE TRUSTEES' RELIANCE ON PROFESSOR FISCHEL DOES NOT JUSTIFY APPROVAL OF THE PROPOSED SETTLEMENT

The principal basis for the Trustees' decision to accept the Proposed Settlement was the recommendation of Professor Fischel. Sohlberg Aff. ¶ 46; Lundberg Aff. ¶ 16. The Trustees' reliance on Fischel's advice could help to justify the Trustees' decision only if the advice were "plausible" and within Fischel's expertise. *In re The Bank of New York Mellon*, 127 A.D.3d at 126; *U.S. Bank* at *3. But Fischel's opinions are neither plausible nor within his expertise.

Before becoming a full-time witness for hire, Fischel was a law professor and Dean of the University of Chicago Law School. His academic focus was the economic analysis of law. He has no academic or professional expertise in mortgage loan securitization, loan underwriting, or loan servicing. Other than his name, Fischel brings little to the table. The Court should not approve the Proposed Settlement on his say-so.

Aside from Fischel's lack of expertise in RMBS, his advice is not plausible. Fischel opined that the Trustees should accept the Proposed Settlement for a given trust (or loan group) unless certain criteria were met. *See* Sohlberg Aff. ¶ 48. The linchpin of his analysis was an assumption that the Trustees have no obligation to assert claims against JPMorgan with respect

to a trust unless and until they are directed to do so by an investor or investor group holding at least 25% of the securities issued by the trust. Fischel therefore advised that the Trustees should reject the settlement as to a particular trust only if they were confident that a 25% group of investors would provide direction and indemnity, and agree to fund a litigation against JPMorgan. *Id.* However, Fischel admitted that he lacks expertise in interpreting PSAs and disclaimed any legal opinion on the scope of the Trustees' duties. The Trustees have offered no evidence that they obtained any independent advice as to their duties and powers, which is necessary to demonstrate good faith. Restatement (Third) of Trusts § 77 cmt. b(2) (2007). There is simply a failure of proof on this fundamental issue.

The evidence will show that the Trustees referred questions about their duties to their litigation counsel. As discussed above, these attorneys are deeply conflicted due to their longstanding representation of the Trustees and advocacy of the Trustees' interests in suits brought by RMBS investors. They are in no position to provide any advice that might prejudice the defense of the Trustees in cases their own firms are defending, and for this reason the Trustees could not have relied on their advice as to approval of the Proposed Settlement in good faith. *See In re Bank of New York*, 127 A.D.3d at 126. Moreover, the Trustees blocked all discovery into their litigation counsel's advice, and should not be permitted to fill the hole in their case at trial by offering evidence as to any advice they previously refused to disclose.

Finally, Fischel's assertion that the Trustees have no obligation to litigate absent direction and indemnity is wrong. The First Department, in evaluating the PSA for the Ambac Insured Trusts at issue here, held not only that the Trustees had the exclusive *power* to bring repurchase claims against JPMorgan, but they also had the "full responsibility for enforcing those claims on behalf of the certificateholders and, expressly, on behalf of the certificate insurer—namely, Ambac." *Ambac*, 121 A.D.3d at 519. Indeed, the PSAs state that the Trustee "shall enforce"

repurchase claims for loans lacking necessary mortgage documentation, *e.g.*, RX14.6 § 2.02(a)-(b), and should enforce repurchase claims for representation and warranty breaches if the Depositor does not do so. *Id.* at § 2.03(a).

IV. EVEN IF THE COURT APPROVES THE PROPOSED SETTLEMENT, THE TRUSTEES ARE NOT ENTITLED TO THE RELIEF THEY ARE SEEKING

The Court appropriately directed the Trustee's to narrow the scope of their requested relief. The Trustees complied only *in part* in their Proposed Final Order and Judgment [ECF No. 553] *compare* Am. Petition [ECF No. 57] ¶ 77. The Trustees narrowed their requested findings, but they did not similarly narrow the scope of the bar on claims against the Trustee. As currently drafted, the bar on claims in Paragraph 6 of the Proposed Final Order and Judgment is substantively the same as the finding already rejected by the Court that the Trustees have complied with all 330 Governing Agreements. If claims against a Trustee for breach of a Governing Agreement were barred, then removing the finding that the Trustees complied "with all applicable duties under the Governing Agreements" would become a pointless alteration.

In addition, Paragraph 6 should be removed because a bar on claims is unnecessary and inappropriate. Under the First Department's *Countrywide* decision, the Trustees may be entitled to a finding that they did not abuse their discretion or act in bad faith, but no more. Any such finding will be afforded appropriate weight and collateral effect in any future proceeding against a Trustee under the law and specific facts applicable in that case. Moreover, the bar on all claims against Trustees would preclude claims based on a higher standard of proof than the "abuse of discretion" standard at issue in this proceeding, such as claims for recklessness or fraud. Since there is no case or controversy involving those standards before the Court, entering the bar would amount to an unwarranted advisory opinion.

W&L's ARGUMENT

With respect to two trusts, Chase 2007-A3 and Chase 2007-S6 (the “W&L Trusts”),¹⁰ W&L Investments, LLC (“W&L”) objects to the distribution methodology set forth in Section 3.06 of the Settlement Agreement (the “Distribution Methodology”) for three independent reasons: (1) the methodology fails to meet the purpose of the Settlement Agreement, (2) the methodology is inconsistent with the Governing Agreements for W&L Trusts, and (3) neither the Trustee for the W&L Trusts, the Bank of New York Mellon (“BNY Mellon” or the “Trustee”), nor any of their experts considered whether the methodology meets the purpose of the Settlement Agreement or complies with the Governing Agreements.

A. The Settlement Agreement is intended to compensate for breaches of representations and warranties but the Distribution Methodology prevents that.

The Settlement Agreement resolves claims for improper servicing and breaches of representations and warranties. *See* Ex. 3 § 3.02; Ex. 1 ¶ 41. The consideration for the breach claims is \$4.5 billion allocated among the Accepting Trusts. Deposition of BNY Mellon Corporate Representative (“BNYM Dep.”) at 14:10-17; Ex. 3 § 3.05.¹¹ The cash payment to each trust is referred to as an “Allocable Share.” Ex. 3 § 3.05. W&L objects to the manner in which the Allocable Shares are distributed among the Classes of Certificates issued by the W&L Trusts.

To effect the purpose of the Settlement Agreement—that is, to compensate for breaches of representations and warranties as contrasted with some other form of loss not covered by the Settlement Agreement—the Allocable Shares must be paid to the junior Certificates. “[D]efaults on loans with material breaches which led to defaults generally occur early in the life of such loans” and, therefore, “all or a significant portion of the losses on the Settlement Loans in the

¹⁰ W&L’s holdings are set forth in Ex. 357.

¹¹ The consideration for the servicing claims is a set of servicing improvements.

[W&L Trusts] were borne by the [junior] certificates purchased by W&L.” RX328 (Expert Report of Matthew Lewis (“Lewis Report”)) ¶¶ 18-21. However, the Distribution Methodology creates the opposite effect by distributing the Allocable Shares to the senior Certificates. *See* Ex. 3 § 3.06; BNYM Dep. at 70:11-71:16. The junior Certificates owned by W&L suffered the harm this Settlement seeks to remedy and, therefore, the settlement compensation should be paid to those Certificates.

B. The Distribution Methodology is inconsistent with the Governing Agreements.

The Settlement Agreement treats each Accepting Trust’s Allocable Share as a “Subsequent Recovery” under the Governing Agreements. Ex. 3 § 3.06. Subsequent Recoveries are moneys received after liquidation of collateral, and are paid to the Accepting Trusts as unscheduled principal. Ex. 14 (Chase 2007-A3) at 65; *id.* (Chase 2007-S6) at 31. But under the Governing Agreements, the *sole remedy* for breaches of representations and warranties is under Sections 2.02 and 3.01. *Id.* (Chase 2007-A3) at 71, 90; *id.* (Chase 2007-S6) at 37, 48. Payment for breaches of representations and warranties other than as set forth in Sections 2.02 or 3.01 is therefore inconsistent with the Governing Agreements. *E.g., Nomura Asset Acceptance Corp. Alt. Loan Trust, series 2006-S4 v. Nomura Credit & Cap., Inc.*, Index No. 653390/2012, 2014 WL 2890341, at *6-8, 2014 N.Y. Misc. LEXIS 2905, 2014 N.Y. Slip Op. 31671(U) (N.Y. Sup. Ct. June 26, 2014) (Friedman, J.).

Payments under those sections are defined as Repurchase Proceeds, not Subsequent Recoveries. Ex. 14 (Chase 2007-A3) at 62; *id.* (Chase 2007-S6) at 28. A different interpretation would render the “Repurchase Proceeds” provision a nullity, and violate the rule that a specific contract provision must prevail over a general one. *Isaacs v. Westchester Wood Works, Inc.*, 278 A.D.2d 184, 185 (1st Dep’t 2000).

Repurchase Proceeds, in turn, must be paid as loan prepayments. *See* RX303 at S-28;

RX304 at S-16. Such payments are to be applied at the time the breaching loan is removed from the Trust. *E.g.*, RX303 at S-81 (“[T]he repurchase price will be passed through to the related Certificateholders as a prepayment of principal in the month following the month of such repurchase.”) *see also* BNYM Dep. at 35:16-36:1, 41:9-16.

Application of Repurchase Proceeds as prepayments will have a different effect on the Certificates than application of Subsequent Recoveries after approval of the Settlement Agreement. *See* BNYM Dep. at 35:10-15; *see also* Frank J. Fabozzi, *The Handbook of Fixed Income Securities* (8th ed. 2012) (“Fabozzi”) at 523 (“The timing and amount of cash flows received by pass-through MBS are greatly affected by the prepayment behavior of the underlying mortgages within the MBS pool.”).

Therefore, failure to apply Repurchase Proceeds as required by the Governing Agreements would upset the reasonable expectations of the Certificateholders, in contravention of New York law. *See, e.g., Sutton v. East River Savings Bank*, 55 N.Y.2d 550, 555 (1982) (“[T]he aim [of contract construction] is a practical interpretation of the expressions of the parties to the end that there be a realization of [their] reasonable expectations.”); *see also In re Trusteeship Created by Am. Home Mortg. Inv. Trust 2005-2*, No. 14-cv-02494, 2014 WL 3858506, at *20-23, 2014 U.S. Dist. LEXIS 111867 (S.D.N.Y. 2014) (reading RMBS transaction documents together to reach the intent of the parties and reasonable expectations of investors).

The Court should not rewrite those agreements by approving the Distribution Methodology for the W&L Trusts. *See Fiore v. Fiore*, 46 N.Y.2d 971, 973 (1979); *In re Gilbert*, 350 N.Y.2d 663, 667 (1976); *see also* Ex. 3 § 7.05 (“The Parties agree that this Settlement Agreement...is not intended to, and shall not be argued or deemed to constitute, an amendment to any term of any Governing Agreement.”).

C. The Trustee did not consider whether the Distribution Methodology meets the purpose of the Settlement Agreement or complies with the Governing Agreements, and, therefore, the Trustee’s decision to accept the Distribution Methodology is entitled to no deference.

The Trustee for the W&L Trusts did not consider whether the Distribution Methodology meets the purpose of the Settlement Agreement or complies with the Governing Agreements, and no expert was hired to consider that issue. *See* BNYM Dep. at 65:4-66:6 (no analysis of applying Allocable Shares as Repurchase Proceeds instead of as Subsequent Recoveries); *see also id.* at 59:9-20 (no analysis of what W&L Trust losses caused by breaches of representations and warranties); *id.* at 59:23-60:1 (no analysis of cause of losses of Classes of Certificates in W&L Trusts); *id.* at 62:22-64:4 (Trustee accepted methodology as negotiated by Institutional Investors and JPMorgan). As a result, the Trustee’s acceptance of the methodology is entitled to no deference. *See* Restatement (Third) of Trusts § 87 cmt. b-c (2007); *In re Stillman*, 107 Misc.2d 102, 110-11 (Sur. Ct. 1980). This would be the case even if the Trustee’s failure is innocent. *In re Stillman*, 107 Misc.2d at 110-11.

In this regard, *BNYM* is instructive. There, the court approved an RMBS settlement agreement except with respect to the release of repurchase claims arising from loan modifications. *In re The Bank of New York Mellon*, 42 Misc.3d 1237(A), 986 N.Y.S.2d 864, at *28-29 (N.Y. Sup. Ct. Jan. 31, 2014). Concluding that the Trustee did not “investigate [the loan modification claims’] potential worth or strength,” the court declined to defer to the Trustee’s decisionmaking and rejected the settlement to that extent. *Id.* The Appellate Division reversed, holding that the evidence demonstrated that the Trustee’s evaluative process included “thoroughly reviewing the relevant governing agreements” and was “reasoned and reasonable.” *In re The Bank of New York Mellon*, 127 A.D.3d 120, 126, 128 (1st Dep’t Mar. 5, 2015).

Here, by contrast, the Trustee did not “thoroughly review[] the relevant governing agreements” with respect to the Distribution Methodology and, in fact, accepted the incorrect distribution provision. The Trustee also undertook no evaluation of whether it should distribute the limited funds to the Certificates that actually suffered losses from the breach claims being released. Incorrect distribution would not only constitute an improper amendment to the Governing Agreements and undermine the reasonable expectations of investors, but could jeopardize the W&L Trusts’ REMIC status. The Trustee’s decision to accept the Distribution Methodology, therefore, was not “reasoned” or “reasonable.”

D. The Court should Order distribution of the Allocable Shares for the W&L Trusts to effect the purpose of the Settlement Agreement and in a manner that complies with the Governing Agreements.

W&L’s Certificates in Chase 2007-A3 lost more than \$18 million (Ex. 245), but W&L will receive none of Trust’s \$4.2 million Allocable Share (Ex. 20 at Ex. Q-1). W&L’s Certificates in Chase 2007-S6 absorbed over \$30 million in losses (Ex. 243), but W&L will receive none of the Trust’s \$7.1 million Allocable Share (Ex. 20 at Ex. Q-1). Yet, according to the only witness in the case on this issue, “the Settlement Agreement assumes very few or of no Settlement Loans defaulted after the initial years of each transaction,” and, therefore “a significant portion of losses...in the [W&L Trusts] were borne by the certificates purchased by W&L.” (*Id.* at ¶¶ 19, 21). In order to compensate the Certificates that actually suffered losses as a result of the conduct being settled, the Court should order the distribution of the W&L Trusts’ Allocable Shares to W&L Certificates. Allowing the Trustee to do otherwise would subvert the purpose of the Settlement Agreement and contravene the Governing Agreements.

Dated: New York, New York
January 18, 2016

WOLLMUTH MAHER & DEUTSCH LLP

By: /s/ David H. Wollmuth

David H. Wollmuth
Michael C. Ledley
Jeffrey Coviello
Niraj J. Parekh
Danielle A. D'Aquila
Devika Persaud

500 Fifth Avenue
New York, New York 10110
Tel: (212) 382-3300

*Attorneys for Ambac Assurance Company and
The Segregated Account of Ambac Assurance
Corporation*