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

In the matter of the application of

THE BANK OF NEW YORK MELLON (as Trustee under various Pooling and Servicing Agreements and Indenture Trustee under various Indentures), *et al.*

Petitioners,

for an order, pursuant to C.P.L.R. § 7701, seeking judicial instructions and approval of a proposed settlement.

Index No. 651786/2011

Assigned to: Kapnick, J.

CONSOLIDATED RESPONSE TO STATEMENTS IN SUPPORT OF THE PROPOSED SETTLEMENT

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Pursuant to the February 26, 2013 Amended Scheduling Order, the undersigned respectfully submit this consolidated brief in response to The Bank of New York Mellon's Brief in Support of the Settlement (Doc. No. 750) and to the Institutional Investors' Statement in Support of the Settlement (Doc. No. 740).

INTRODUCTION

This settlement should not be approved. It is a pennies on the dollar giveaway of valuable claims to Bank of America. Contrary to what the Bank of New York Mellon and the Inside Institutional Investors seem to believe, this case is not about whether settlements are good as a matter of general public policy. Rather, it is about whether *this* particular settlement should be judicially approved, and as stated above, it should not.

The proposed settlement was negotiated by a minority of certificateholders in the Covered Trusts whose counsel stands to recover $85 million in legal fees, despite the fact that no lawsuit was ever filed and no discovery was ever taken. The deal was accepted by a conflicted Trustee who did not represent its beneficiaries, did not investigate the claims, did not seek to maximize recoveries, and relied on facially flawed and inadequate advisor reports to rubber stamp an inadequate settlement amount. Even BNYM's own trust law expert acknowledges that the Trustee is a fiduciary with respect to all of its conduct and decisions related to the proposed settlement. This Court can, and the objecting investors say should, withhold judicial approval and direct the Trustee to finally act like the fiduciary that it is by returning to the negotiating table on behalf of *all* certificateholders in *all* 530 trusts to conduct an open, fair process with the aim of maximizing recoveries for its beneficiaries, instead of an aim toward protecting itself, appeasing Bank of America, and caving into the demands of a minority of certificateholders.

The Inside Institutional Investors once again resort to irrelevant attacks on the objecting investors and red herring arguments, calling the investors "a vocal minority." The fact of the matter is the settlement must be evaluated *on the merits*. The Court's task is to determine whether the settlement is fair. Attacking the objecting investors who have, in fact, suffered massive losses on their investments in the Covered Trusts does nothing but distract from the important task the Court faces in determining whether Bank of America should be allowed to walk away from the single largest liability it faces by writing a check for a small fraction of the Covered Trusts' total losses.

What has become clear over the course of this proceeding is that BNYM was supposed to, but did not, protect the beneficiaries of the 530 Covered Trusts. BNYM was supposed to, but did not, seek to maximize the recoveries that could be obtained from Bank of America and Countrywide. BNYM was supposed to, but did not, avoid self-dealing in the settlement process. This Court cannot and should not approve a settlement that is not fair and reasonable, or which is the result of a conflicted and flawed process, regardless of who supports or opposes the settlement.

In their papers, the settlement proponents articulate an unjustifiably narrow standard and scope of judicial review. They essentially advocate that this Court overlook the glaring inadequacies in the settlement amount, gloss over the facts demonstrating the Trustee breached its fiduciary duties, ignore recent developments in the law, and effectively rubber stamp the proposed settlement. Indeed, under their view, the Court would wholly ignore the terms of the settlement and would thus serve no purpose at all but to rubber stamp the Trustee's conduct. BNYM and the Inside Institutional Investors' plea for a constrained and surface-level judicial review demonstrates their knowledge that neither the Trustee's conduct nor the merits of the settlement withstand judicial scrutiny.

The record establishes that the settlement amount is woefully inadequate. The Trustee failed in its fiduciary duties to the certificateholders. The settlement process was conflicted, unreliable, and largely driven by Bank of America. Indeed, Bank of America bought and paid for the settlement in every way—the Inside Institutional Investors' lawyers, the Trustee's lawyers, and even the Trustee's purportedly independent experts. Bank of America has paid each and every dollar for this settlement, because it takes care of Bank of America's single largest outstanding liability. Given the facts, the Court should not approve the proposed settlement as it currently stands.

ARGUMENT

I. The Settlement Proponents' Articulation of the Standard and Scope of the Court's Review is Incorrect

From the moment the case returned to this Court, the settlement proponents have attempted to limit and restrict the scope of this Court's review of the settlement and the process leading to it.[1] The trend continues in the settlement proponents' latest briefs, where they once again press for a standard intended to limit the scope of this Court's review. The settlement proponents' position is unsupported by the findings they seek, by the law, or by common sense.

A. The Broad Findings BNYM Seeks Merit A Broad Standard of Review

Wholly ignoring the broad findings it has asked this Court to make and which it clearly has the burden to prove, BNYM argues that this Court's examination of the settlement and the process leading to it is limited to a review of whether the Trustee "acted in bad faith, or had a

[1] *See* Doc. Nos. 205, 228, 279.

disabling conflict of interest . . . ."[2] To the contrary, BNYM has itself placed far more at issue through the *eighteen* separate, distinct, and broad findings it seeks in the Proposed Final Order and Judgment ("PFOJ").

Among other things, BNYM seeks a ruling from this Court that the settlement was "the result of factual . . . investigation by the Trustee," that BNYM "appropriately evaluated the terms, benefits, and consequences of the Settlement and the strengths and weakness of the claims being settled," that the negotiations were "arm's-length," and that BNYM acted in "good faith," "within its discretion," and "within the bounds of reasonableness."[3] BNYM also asks that this Court "approve" the proposed Settlement Agreement "in all respects."[4] This requested finding necessarily calls for judicial review of the proposed settlement's terms.

Based on the requested findings alone, this Court can and should review all of the Trustee's conduct "in all respects," the process leading to the Settlement Agreement, and the settlement terms themselves before determining whether to approve the proposed settlement.

B. <u>BNYM's Narrow Articulation of the Standard of Review Is Unsupported By Law</u>

BNYM asserts, without any authority, that the Court may not consider the merits of the settlement unless there is a showing the "trustee acted in bad faith, or had a disabling conflict of interest, as when it seeks to purchase trust property for itself."[5] This statement is wrong in the first instance because the PFOJ findings put far more at issue, as discussed above. BNYM also ignores that under the law a trustee loses judicial deference not only in cases of bad faith and conflict, but also where the trustee acts unreasonably, violates its duty of due care, or otherwise

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[2] Doc. No. 750 at 12.
[3] Doc. No. 7 (PFOJ) ¶¶ h, i, j, k.
[4] *Id.* ¶ n.
[5] Doc. No. 750 at 12.

acts inconsistently with its fiduciary duties. *See* Restatement (Third) Trusts § 87 cmt. b & c; *see also In re Stillman*, 107 Misc. 2d 102, 110-11 (Sur. Ct. 1980) (holding that the trustee, though acting in good faith, abused its discretion by unreasonably refusing to distribute principal to the beneficiaries).[6]

In addition to misstating the general standard of review, BNYM tries to further limit review by narrowly defining, without support, what constitutes bad faith. BNYM cites no authority for its statements that bad faith "requires not just that a conflicting motive exist, but also that the trustee has awareness of the conflicting motive, and the trustee then acts on it to the detriment of beneficiaries"[7] or that "[t]o prove bad faith, the objectors would have to show that the Trustee entered into what it thought was a bad settlement in order to benefit itself."[8] In any event, the record supports a finding that BNYM operated under a continuing conflict of interest during the negotiations, engaged in self-dealing, and did not act in good faith.[9] The record is also replete with examples of BNYM failing to live up to its fiduciary duties to the certificateholders and failing to act as a prudent person would in the conduct of their own affairs.[10] For multiple reasons, therefore, BNYM's decisions with respect to the proposed settlement are not entitled to judicial deference.

C. The Inquiry is Not, As Argued by the Inside Institutional Investors, Limited to Information Known to the Trustee When It Decided To Enter Into the Settlement Agreement

The Inside Institutional Investors attempt to further limit this Court's review by arguing the "sole inquiry" concerns the Trustee's reasonableness "based on the information known to it

[6] *See also* Doc. No. 588 (Joint Opp'n) at 12.
[7] Doc. No. 750 at 16
[8] Doc. No. 750 at 18.
[9] *See* Doc. No. 588 (Joint Opp'n) at 13-28.
[10] *See id.* at 28-49; 58-66.

as of the date of the settlement."[11] This argument is misplaced. As discussed above, BNYM has squarely placed before the Court the question of the settlement's fairness and reasonableness. By its own terms, and with only a few exceptions, the settlement does not go into effect unless and until this Court approves it.[12] As the Inside Institutional Investors concede, BNYM "came to this Court *before* the proposed settlement was consummated, and made . . . finalization *dependent on* the Court's approval."[13] Furthermore, as BNYM's own trust law expert concedes, BNYM's fiduciary duties to the certificateholders continue through to today.[14] If the settlement is not fair, reasonable, and adequate (and it is not), the Trustee should not be pursuing it.

Particularly because the settlement seeks to bind certificateholders who were unrepresented during the settlement negotiations, this Court must independently determine whether the settlement is "fair, reasonable, and adequate." *See Goldsholl v. Shapiro*, 417 F. Supp. 1291, 1295-96 (S.D.N.Y. 1976) (collecting cases); *Geltzer v. Andersen Worldwide, S.C.*, No. 05 Civ. 3339 (GEL), 2007 WL 273526, at *1 (S.D.N.Y. Jan. 30, 2007) ("In certain types of cases—generally, where the plaintiff acts in a fiduciary or representative capacity for others—more searching judicial scrutiny of a proposed settlement is required."); *Wood v. Nat'l Basketball Ass'n*, 602 F. Supp. 525, 528 (S.D.N.Y. 1984). In undertaking that analysis, the Court can and should reach "an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated" and "form an educated estimate of the complexity, expense, and likely duration of such litigation . . . and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise." *Protective Comm. for Indep. Stockholders of TMT Trailer*

[11] Doc. No. 740 at 12.
[12] Settlement Agreement (Ex. 1 to Joint Opp'n) § 2. Exhibits 1-112 were filed on May 3, 2013 concurrently with Doc. No. 588; Exhibits 113-131 are being filed simultaneously with this brief.
[13] Doc. No. 760 at 9.
[14] Ex. 113 (Langbein Dep.) at 136:17-24.

Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968) (rejecting trustee's reorganization of a company where the trustee failed to estimate future earnings); *see also Greenspun v. Bogan*, 492 F.2d 375, 378 (1st Cir. 1974) ("It is well established that a court should not merely rubber stamp whatever settlement is proposed by the parties to a shareholder derivative action. A court must, instead, exercise judgment sufficiently independent and objective to safeguard the interests of shareholders not directly involved in the action."). There is no support for the proposition that the Court should ignore developments in the law (or facts) relevant to the settlement's fairness and reasonableness.

The cases cited by the Inside Institutional Investors are readily distinguishable. Several of the cases do not even involve a trustee or a court's review of a trustee's conduct. *See*, *e.g.*, *In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d 187 (2d Cir. 2005); *Valley Drug Co. v. Geneva Pharms., Inc.*, 344 F.3d 1294 (11th Cir. 2003); *Del Noce v. Delyar Corp.*, 78 F.R.D. 325 (S.D.N.Y. 1978). Yet another case concerns a motion for reconsideration under Federal Rule of Civil Procedure 60(b), which has nothing to do with the standard to be applied in a pre-judgment situation such as the case here. *See United States. v. Bank of New York*, 14 F.3d 756, 759 (2d Cir. 1994). The cases cited by the Inside Institutional Investors that actually do concern judicial review of a trustee's decision are equally inapposite. In those cases, the Trustee had *already* consummated an action (such as investing trust funds) and that action was being challenged as an abuse of trust. *See*, *e.g.*, *Katsaros v. Cody*, 744 F.2d 270, 274 (2d Cir. 1984); *In re Chase Manhattan Bank,* 26 A.D.3d 824, 809 N.Y.S.2d 360, 364 (4th Dep't. 2006); *In re Flint's Will*, 240 A.D. 217, 269 N.Y.S. 470, 480-481 (2nd Dep't. 1934). Those cases did not involve the situation here, where the Trustee has decided on a course of action but has not consummated it because the action is expressly conditioned on Court approval.

For all of the above reasons, the scope of the Court's review is and should be robust, taking into account all known and relevant information as of the date of the Court's decision. However, even if the Court were to freeze inquiry into the Trustee's decisionmaking at the time it entered into the proposed settlement, the Trustee still would fail to meet its burden. The facts adduced in discovery were extant at the time, and the recent court decisions rejecting BofA's key defenses rest not on any new legal standards but, instead, on a plain reading of the PSAs (as to the meaning of "material and adverse effect") and a plain reading of New York law (on the issue of successor liability). The Inside Institutional Investors' insistence on viewing the proposed settlement solely through the lens of what the Trustee knew at the time makes no legal or logical sense, but tells a great deal about the Trustee's failure to acquire sufficient facts or acknowledge the governing legal standards, and likewise reveals the settlement proponents' implicit acknowledgement that the substantive terms of the proposed settlement *cannot* withstand judicial scrutiny.

II. The Settlement Amount is Inadequate and Unreasonable

In a baffling misstatement, BNYM asserts that the objecting investors "effectively concede the adequacy of the Settlement consideration[.]"[15] Quite the contrary, and as explained in more than one of the filed objections, the settlement amount unjustifiably discounts BofA/Countrywide's repurchase liability for breaches of representations and warranties and fails *entirely* to compensate the Covered Trusts for servicing failures, document exceptions, and loan

[15] Doc. No. 750 at 13.

modifications despite releasing BofA/Countrywide for those liabilities.[16] To be sure, the objecting investors strongly protest "the adequacy of the Settlement consideration" as being woefully inadequate in light of the massive losses to the Covered Trusts.

BNYM and the Inside Institutional Investors loudly tout this as the largest settlement in history, but fail to acknowledge the massive liability it will extinguish. The proposed settlement covers 530 Trusts and tens of billions of dollars in losses. In one fell swoop, BofA gets to eliminate colossal liability and [redacted][17] with respect to the Covered Trusts. It is only obvious that the consideration must be equally substantial, and as set forth in more detail below, it is not. Indeed, the settlement amount falls far short of fair, adequate, and reasonable.

A. <u>The $8.5 Billion Includes No Compensation for the Servicing Failures, Document Exceptions, and Loan Modification Claims that are Nonetheless Being Released by the Settlement</u>

One of the most fundamental reasons why the settlement amount is inadequate is that it provides no compensation to the Covered Trusts for whole categories of liabilities that are being released. As explained in the filed objections, the Trustee did not value or receive any compensation for claims stemming from servicing misconduct, document exceptions, or loan modifications. Nonetheless, those liabilities are released by the settlement.[18] These facts, alone, demonstrate the unreasonableness of the settlement and why it should not be approved.[19] While it does not take many words to describe this glaring deficiency, its significance is enormous.

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[16] *See generally* Doc. Nos. 588; 719; 735.
[17] Ex. 114 (Golin Dep.) at 120:15-121:4.
[18] *See* Doc. No. 588 at 66-70; Doc. No. 735 at 13-14; Ex. 115 (Levitin Report) ¶¶ 170-71.
[19] Significantly, [redacted] BNYM's experts testified that they are capable of evaluating the losses due to servicing failures. *See* Ex. 116 (Sabry Dep.) at 31:22-36:5; Ex. 117 [redacted].

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Giving away claims for free is not appropriate conduct by any measure, and cannot possibly satisfy the Trustee's duties to the 530 Covered Trusts.

B. <u>A Fair and Reasonable Settlement Amount Should be Significantly Larger than $8.5 Billion</u>

As a threshold matter, it is disingenuous for the settlement proponents to accuse the objecting parties of "offer[ing] no evidence that the claims are worth more than $8.5 billion."[20] As the Court is aware, the settlement proponents—including BofA—vigorously fought against the production of information that would allow Intervenors to independently analyze damages to the Covered Trusts. They refused to produce a statistically significant sample of loan files and they refused to provide any information about BofA's repurchase, servicing, or other liabilities to the Covered Trusts.[21] Moreover, identifying an accurate estimate of damages to the Covered Trusts was and is the *Trustee's* responsibility, and something the *Trustee* should do before it receives a blessing for its conduct, and before the Court can find that "[t]he Trustee appropriately evaluated the . . . strengths and weaknesses of the claims being settled."[22]

In any event, there is ample support for the conclusion that the $8.5 billion Settlement Payment (which, again, is not guaranteed but a cap controlled by BofA) is not fair or reasonable compensation for the claims being released. Among other things:

- Mr. Lin applied "facially unsupported default rates," "severity rates [that] are grossly short of the numbers found in his reliance materials," and a breach rate that is "fundamentally wrong."[23] The cumulative effect of these errors drives down of Mr. Lin's settlement range. If Mr. Lin's purportedly reasonable settlement range is improperly and insupportably depressed, the settlement amount (which is even lower than Mr. Lin's range) is too low.

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[20] Doc. No. 750 at 25.
[21] *See e.g.*, Ex. 118; Ex. 119 [redacted].
[22] Doc. No. 7 (PFOJ) ¶ i.
[23] Ex. 120 (Cowan Report) at 10-12.

- Neither the Trustee nor Brian Lin looked at a single loan file to determine breach rate, relying instead on unverified and unsupported assumptions that uniformly favored BofA and were based on fundamentally different types of loans;[24]

- As Professor Coates opines, "[h]ad the Trustee sought to do more than simply accept BAC's word on crucial facts, and had it not imposed such strong limits on the efforts of its advisors, the Trustee would have discovered facts . . . which would tend to show that the successor liability elements of the Claims had a materially greater chance of success than the Trustee appears to have believed[.]"[25] Thus, the Trustee's approach to the successor liability arguments diminished the leverage it had and resulted in an unreasonably low settlement amount.

The objection filed by Cranberry Park further details the ways in which the settlement range calculations that the Trustee relied upon were facially inadequate, misinformed, and unreasonable, and offers a re-calculated settlement range.[26]

Tellingly, the $8.5 billion settlement amount is substantially out of line with the analyses of parties whose work—unlike the Trustee and Brian Lin's—was *not* driven by BofA's self-serving and unverified representations. First, the original analysis proffered by the Inside Institutional Investors confirms a settlement range between $32-53 billion, with a repurchase liability ranging from $64.68 billion to $70.07 billion.[27] BNYM's statement that $32.3 billion was the Inside Institutional Investors' estimation of how high "potential damages could reach," and that this number was their "initial demand" is wrong.[28] [redacted]

[24] The best way to derive accurate Covered Trust data is to review the actual loan files in the 530 Covered Trusts. *See* Ex. 120 (Cowan Report) at 1, 4-5. [redacted] *See* Ex. 28 to Joint Opp'n at ¶3.
[25] Ex. 121(Coates Report) at 3.
[26] Doc. No. 719.
[27] Ex. 96 to Joint Opp'n. Repurchase liability is equal to losses times the breach rate.
[28] Doc. No. 750 at 32.

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[redacted][29] [redacted][30] Second, using Mr. Burnaman's losses estimate, which is significantly lower than the Inside Institutional Investors' losses estimate, and applying a more realistic breach rate of 60%,[31] the repurchase liability is $50.8 billion.[32] Third, Cranberry Park, an objecting investor, conducted an independent analysis of relevant data and determined that a reasonable settlement should be between $43.8 billion and $52.7 billion.[33]

Finally, the parties and the Court can also now take into account the very recent settlement between BofA and MBIA of the case that was pending before Justice Bransten. As BNYM correctly points out, *MBIA* involved "similar claims (albeit limited to 15 trusts . . .)" as those being released by the proposed settlement here.[34] Under the cash portion of the *MBIA*

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[29] Ex. 122 (Laughlin Dep.) at 224:15-17.
[30] Ex. 117 (Burnaman Dep.) at 247:9-19.
[31] [redacted] *See* Ex. 123 (Burnaman Report) at 28 [redacted] Moreover, as Cranberry sets forth in its recent objection, there is ample evidence that breach rates in these Covered Trusts are likely to exceed 60% and certainly are far from the 36% breach rate gathered from BofA data. [redacted] Ex. 119 (Scrivener Dep.) at 199:16-24. Included within these assumptions is the now thoroughly rejected proposition that before BofA would have any repurchase liability, the claimant would have to prove that the loan went into default. And any argument by the Settlement Proponents that those rulings post-date the settlement should fall on deaf ears since those rulings were based on a plain reading of the PSAs. These and the other utter failures of the GSE experience and BofA's self-serving use of that experience as a proxy for the Covered Trusts' claims has been extensively documented. *See generally* Doc. No. 588 at 54-58; Doc. No. 537 (Cowan Report).
[32] Doc. No. 588 at 57.
[33] Doc. No. 719 at 16.
[34] Doc. No.750 at 30.

settlement, MBIA recovered $1.6 billion on 15 Countrywide RMBS trusts.[35] That translates to an average of approximately $106 million per trust. A comparable settlement here, with an average payout of $106 million per trust, would total $56.2 billion—a number well in-line with the settlement ranges of everyone *other than* the Trustee. This is a crucial fact that the Trustee should evaluate *now* when deciding whether to continue to press approval of the settlement.

The Settlement Amount effectively incorporates a massive $35.3 to $61.6 billion litigation risk discount[36] that is entirely unreasonable under the circumstances. With respect to causation, the Trustee ignored—among other things—the fact that BofA's legal arguments were entirely inapplicable to certain types of breaches as set forth in the particular PSAs.[37] And, as the Inside Institutional Investors seem to acknowledge, recent judicial decisions have soundly rejected BofA's causation theories.[38]

As discussed in the Joint Opposition, the Trustee also unreasonably discounted the Settlement Amount because of successor liability concerns.[39] It is undisputed that the Trustee never performed *any* probability weighting with respect to its likelihood of success on claims against Countrywide and BofA. The extent of the Trustee's "effort" to quantify the probability of success on successor liability claims was a determination that it "would have difficulty

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[35] Ex. 124 (Karen Freifeld & Dan Wilchins, "MBIA, Bank of America reach $1.6 billion cash settlement," *available at* http://www.reuters.com/article/2013/05/06/us-mbia-bankofamerica-deal-idUSBRE9450L020130506).

[36] Measuring the $8.5 billion Settlement Payment against Cranberry Park's lowest number ($43.8 billion) and the Inside Institutional Investors' highest number ($70.1 billion).

[37] Doc. No. 588 at 60-63.

[38] *See, e.g.*, *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 105 A.D.3d 412, 963 N.YS.2d 21, 22-23 (1st Dep't Apr. 2, 2013); *Assured Guaranty Mun. Corp. v. Flagstar Bank FSB*, 892 F. Supp. 2d 596, 602 (S.D.N.Y. 2012); *Syncora Guarantee Inc. v. EMC Mortgage Corp.*, 874 F. Supp. 2d 328, 334-35 (S.D.N.Y. 2012); *see also* Doc. No. 740 at 37 ("The Objectors seize *on the fact* that decisions in monoline cases . . . *have pared back* aspects of the causation defense Countrywide could have asserted . . .") (emphasis added); Doc. No. 719 at 16-20.

[39] *See* Doc. No. 588 at 63-66.

prevailing on such legal theories, and that the legal positions of Countrywide and Bank of America [were], at the very least reasonable."[40] Certainly this does not reflect the type of qualitative and quantitative considerations that should be included in "any prudent comprehensive business decision[.]"[41] A more careful analysis would likely have placed the probability of success on successor liability in the 65-75% range.[42] Moreover, as described in other objections, BofA has repeatedly and consistently paid billions upon billions of dollars to settle repurchase claims against Countrywide.[43] This is a fact the Trustee could and should have leveraged against BofA, as the threat of successful successor liability claims surely created—and continues to create—significant enterprise risk for BofA.

Finally, BNYM's claim that $8.5 billion represents a 77% recovery on damages measured against Mr. Lin's calculations, or a 66% recovery against Mr. Burnaman's calculations, is misleading and should be disregarded.[44] Mr. Lin himself called his range a *settlement* range, not a damages range. To the extent the Trustee seeks to measure its recovery against Mr. Lin's calculation of *damages*, it would need to compare its recovery to Mr. Lin's *damages* range of $22.07-$27.65 billion.[45] Even then, Mr. Lin's supposed settlement range is a self-serving concoction brewed by BofA and served to the Trustee and Mr. Lin. The Trustee cannot acquiesce to an unreasonably low bar and then proclaim itself victorious by (not quite) reaching it. To the extent the Trustee seeks to measure the Settlement Payment against Mr. Burnaman's

[40] Doc. No. 1 ¶ 89.
[41] Ex. 123 (Burnaman Report) at 9.
[42] Ex. 125 (Coates Aff.) ¶ 5(c). This affirmation is being submitted in response to the settlement proponents' misleading use of Professor Coates' deposition testimony.
[43] Doc. No. 719 at 20-21.
[44] Doc. No. 750 at 32.
[45] Mr. Lin's estimate of total losses x 36% breach rate. *See* Ex. 68 to Joint Opp'n (Lin Report) at 8.

damages estimate, it would need to compare \$8.5 billion to \$50.8 billion,[46] which would not even remotely approach a 66% recovery.

C. The Purported Servicing Improvements and Document Cures Add No Value

The settlement proponents' emphasis on the so-called servicing improvements misses the point entirely. The reason servicing improvements are necessary is because Countrywide's and BofA's servicing is so bad. According to the Inside Institutional Investors, "Bank of America was by far the worst of the major bank loan servicers."[47] This substandard servicing is a breach of the PSAs' prudent servicing requirement[48] but, as discussed in the Joint Opposition, the Trusts receive no compensation for it.[49]

More importantly, there is a sleight of hand in play that the Court must be made aware of: servicing liability is not subject to any alleged successor liability defense.[50] When BNYM failed to obtain compensation for it, it let BofA off the hook for the entire, undiscounted amount. This liability includes, among other things, the Master Servicer's liability for failing to give notice of breaches of representations and warranties as required under the PSAs, which could amount to many billions of dollars since the servicer is in the best position to discover the existence of breaches. In addition, if BNYM's expert Mr. Burnaman is to be taken at face value, the alleged

[46] Mr. Burnaman's losses estimate of \$84.7 billion x 60% breach rate. *See* Ex. 123 (Burnaman Report) at 25 (calculating losses); *Id.* at 28 [redacted]

[47] Ex. 8 to Joint Opp'n at 27.

[48] Ex. 115 (Levitin Report) ¶¶ 218-253.

[49] Doc. No. 588 at 66-70.

[50] Ex. 121 (Coates Report) at 10-11.

$3 billion benefit from improvements alone demonstrates the massive degree to which the trusts have been harmed by bad servicing.[51]

In any event, the level of servicing required under the Settlement Agreement is already required under the PSAs and other settlement agreements BofA has entered into,[52] and would have been required had the Trustee not turned a blind eye to the Event of Default.[53] Thus, the Covered Trusts receive nothing more than they are already entitled to. Even the Trustee's advisor, Mr. Lin, reported that BofA had to be incentivized to bring its servicing up to industry standards.[54] Further, *BofA*—and not the certificateholders—may receive substantial value by using the Settlement Agreement to permit passing certain costs and losses on to the Covered Trusts rather than bear those costs and losses itself.[55]

Similarly, the so-called document cures ensure that the Covered Trusts will receive substantially *less* than they were entitled to under the PSAs. The PSAs require cure of material omissions from the loan files.[56] The Settlement Agreement, however, contains material exclusions, including for loans registered through MERS,[57] and adds requirements found nowhere in the PSAs.[58] The settlement therefore alters BofA's obligations under the PSAs to the Covered Trusts' detriment.

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[51] Ex. 123 (Burnaman Report) at 39-44.
[52] Ex. 115 (Levitin Report) ¶¶ 218-259.
[53] Ex. 126 (PSA) § 7.01 (requiring cure of servicing failures).
[54] Ex. 67 to Joint Opp'n at 3.
[55] Ex. 115 (Levitin Report) ¶¶ 254-259.
[56] Ex. 126 (PSA) § 2.02(a).
[57] Settlement Agreement (Ex. 1 to Joint Opp'n) ¶ 6(a)(i).
[58] *Compare* PSA (Ex. 126) §§ 2.01-2.02 *with* Settlement Agreement (Ex. 1 to Joint Opp'n) ¶ 6 *and* Ex. 127 (Crosson Dep.) at 233:16-234:22; 237:23-238:16; 240:4-21.

III. BNYM's Conduct Breached the Applicable Duty of Care By Failing to Investigate the Issues or Take the Steps Necessary to Maximize Recoveries

BNYM's claim that it engaged in "an exceptionally thorough evaluation of the Settlement," is manifestly wrong.[59] At every turn, the Trustee squandered opportunities to maximize recovery to the Covered Trusts, and in many ways it attempted to devalue the Covered Trusts' claims. As detailed in the Joint Opposition, BNYM's investigation of the facts, the legal issues, and the strengths and weaknesses of the underlying claims was either missing altogether or was so anemic as to be unreasonable.[60] The record demonstrates that BNYM, among other things:

- [redacted]
- Failed to demand the loan files that would allow for an informed analysis of the breach rates, and to which the Trustee had a contractual right under the PSAs without cost;
- Relied on second-hand data and allowed Brian Lin to identify a purportedly reasonable settlement range based on unverified information and significantly limiting assumptions instead of obtaining and using actual evidence to assess a settlement amount;
- Released servicing, document exception, and loan modification liabilities without investigating those claims, without valuing the harm caused to the Covered Trusts, and without obtaining any compensation for those harms;
- Did not hire advisors to develop arguments *against* BofA, but instead hired them to *justify* BofA's self-interested arguments and the agreed-upon settlement;
- [redacted]
- Limited the scope of information provided to the advisors so as to limit the scope of their work;
- Never seriously evaluated the possibility of bringing a lawsuit against Countrywide/BofA;

[59] Doc. No. 750 at 22.
[60] *See* Doc. No. 588 at 28-66; *see also* Doc. No. 718.

- Allowed a minority group of investors to negotiate the settlement amount, even though those investors admittedly lacked 25% voting rights in the majority of trusts; and

- Took a passive role in the settlement negotiations, except where BNYM needed to obtain a benefit for itself, in which case its counsel negotiated on its behalf (such as with the side letter, guaranty, and ultimately-rejected release that would have gone well beyond BNYM's settlement conduct);[61]

- Hired Trust counsel whose firm simultaneously represented BNYM, BofA, and several of the Inside Institutional Investors – and, thus, had glaring conflicts that should have been disclosed to all certificateholders.

By no stretch of the imagination did BNYM conduct itself as a prudent person would in the conduct of its own affairs under these circumstances, which is the standard to which BNYM must be held.[62]

BNYM's reluctance to devote time and resources—even if that resulted in a stronger negotiation position—is bewildering at best. First, BNYM and the Inside Institutional Investors repeatedly identify this as a "landmark Settlement," the "largest private litigation settlement ever,"[63] "the largest private litigation settlement in history, in any case, of any kind, anywhere,"[64] yet they take issue with the Intervenors' position that the time and resources devoted to this matter should have been equally significant. The money, time, and level of care devoted to this case should have been commensurate with the enormity of the claims, the size of the potential recovery, the high standard to which a fiduciary must be held, and the heavy weight of the losses at issue.

[61] Doc. No. 588 at 26-28, 39-46; *see also* Ex. 128; Ex. 83 to Joint Opp'n (email dated 4/18/2011, from J.P. Kravitt to M.G. Koplow and K. Patrick stating, "We're fine with the 'lawyers talking with lawyers' process, provided Matt and/or I can sit in as well. Again we'd like to be able to say that we 'watched' the whole thing and it was clearly hard fought arms length.").
[62] Doc. No. 588 at 28-33.
[63] Doc. No. 750 at 1.
[64] Doc. No. 740 at 18.

Second, any arguments concerning cost are entirely out of place here because BofA agreed to cover 100% of BNYM's costs in connection with any settlement activities.[65] There would have been no cost to BNYM or to the Covered Trusts to, for example, investigate the Inside Institutional Investors' allegations, review loan files, or hire experts to develop the Covered Trusts' claims. All of those expenses would have been borne by BofA. Inexplicably, the Trustee chose not to use BofA's blank check to conduct *any* meaningful investigation. BofA has, however, paid all of the expenses of all the settlement proponents in trying to obtain judicial approval of the settlement (including all costs of the litigation experts). BofA will further reward the Inside Institutional Investors' counsel with an $85 million fee if the settlement is approved.

It is also worth noting that this Article 77 proceeding has continued for almost two years (in large part due to the Trustee's and the Inside Institutional Investors' resistance to transparency and discovery). In the time it has taken the parties to uncover the conflict and lack of care that surrounded the negotiations, the Trustee could have adequately investigated the claims, properly notified certificateholders of settlement negotiations, and taken the steps necessary to maximize recovery to the Covered Trusts.

BNYM's "proof" that it acted reasonably and in accord with its fiduciary duties rests on the fact it hired some advisors prior to entering the settlement[66] and that the Inside Institutional Investors support the settlement.[67] As detailed in the Joint Opposition, the Trustee can find no safe haven in the reports of its advisors. A trustee must not blindly rely on the advice of its purported experts but must prove that its reliance on such experts is justified under the circumstances. Those advisors were not hired to help the Trustee evaluate and develop the

[65] Ex. 49 to Joint Opp'n.
[66] Doc. No. 750 at 21-23.
[67] *Id.* at 18-19.

Trusts' claims against Bank of America. Rather, they were hired to provide opinions that would justify the Trustee's decision to agree to the proposed settlement, [redacted][68]

Nor does the Inside Institutional Investors' support of the settlement establish that the Trustee acted reasonably or in accord with its fiduciary duties. The Trustee has made no showing that the Inside Institutional Investors are representative of other investors in the Covered Trusts, and as discussed in the Joint Opposition there are plenty of reasons why they may not be.[69] Further, it is undisputed that the Inside Institutional Investors and their counsel only represented their own interests in the negotiations. It is also undisputed that they lack 25% of the voting rights in the majority of trusts. The Trustee's admitted failure to represent the interests of the other certificateholders is not excused by the fact that some holders in some trusts had counsel at the table.

The record also does not support an assumption that the Inside Institutional Investors made negotiating decisions with the aim of maximizing recoveries. [redacted] The repeated acquiescence to BofA's demands is a far cry from the original statements by the Inside Institutional Investors' counsel following the October 18 Notice of Non-

[68] Doc. No. 588 at 41-44.
[69] *Id.* at 70-72.
[70] Ex. 129 [redacted]

Performance that the investor group was "willing to take it as far as it needs to go in order to get the contracts enforced in the way that they're supposed to be performed."[71]

Between the time of those statements and the signing of the Settlement Agreement the Inside Institutional Investors received at least two sizable benefits: (1) in consideration for the forbearance agreement, they were relieved of their obligation to indemnify the Trustee and cover the costs for pursuing recovery against BofA (a multi-million dollar expense),[72] and (2) their attorney's fees are being paid by BofA, unlike any other certificateholder—which notably violates the clear terms of the PSAs stating that no certificateholder will be treated differently or have any rights that take preference over the rights of others.[73] Indeed, counsel for the Inside Institutional Investors negotiated for itself an $85 million fee, for which there has been no showing of reasonableness. The unjustified size of the fee alone merits this Court's close scrutiny of the settlement's fairness. *See In re Cmty. Bank of N. Va.*, 418 F.3d 277, 315 (3d Cir. 2005) (settlement required closer scrutiny where class counsel "negotiated an extremely generous fee").

In sum, the Trustee's conduct fell woefully short of the fiduciary standards to which it must be held. The settlement proponents' attempts to have this Court gloss over these shortcomings should be rejected. Not only are the Trustee's requested findings in the PFOJ unwarranted, but the settlement should not be approved under the circumstances. Rather, the Trustee should be required to conduct itself like a fiduciary, and use the tools at its disposal (including the recent judicial decisions that cut the legs out from under BofA's causation and successor liability defenses) to actively pursue maximized recoveries for the Covered Trusts.

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[71] Ex. 130 at 3: 22-24 (Transcription of 10/19/10 Interview with Kathy Patrick; video available at (http://video.cnbc.com/gallery/?video=1781318655) (last checked Sept. 9, 2011).
[72] Ex. 43 at BNYM_CW-00271276.
[73] Ex. 126 (PSA) § 10.08.

IV. The Trustee's Conflict and Self-Dealing Breached the Duty of Undivided Loyalty, Tainted the Settlement Process, and Is Yet Another Reason the Settlement Cannot Be Approved As It Currently Stands

The Joint Opposition details the Trustee's conflict and self-dealing, and the undersigned incorporate that discussion here.[74] Notably, New York courts have previously recognized the problems inherent in the "exaction" by a corporate trustee of an indemnity agreement in exchange for conduct of "doubtful propriety." *Harvey v. Guaranty Trust Co. of N.Y.*, 134 Misc. 417, 426 (N.Y. Sup. Ct. 1929) ("The trustee appears to have been cognizant of the fact that it was doing something irregular, calculated to imperil the rights of possible bona fide holders . . . and quite likely to result in its being held liable to the latter. This recognition by the trustee of the doubtful propriety of its conduct is indicated by its exaction of the indemnity agreement previously referred to.").

BNYM attempts to undercut the evidence of conflict by making statements regarding the relevant provisions of the PSAs, the forbearance agreement, and Events of Default that are simply wrong. First, the Trustee claims that "[f]ollowing the expiration of the 60-day cure period, the noticing parties—and only the noticing parties—may serve on the Trustee a notice of an Event of Default."[75] The PSAs say no such thing.

Section 7.01(ii) of the PSA addresses the various ways in which an Event of Default occurs. One way is for a group of certificateholders "evidencing not less than 25% of the Voting Rights" to provide notice to the Master Servicer and Trustee of failures by the Master Servicer to "observe or perform in any material respect any other of the covenants or agreements on the part of the Master Servicer" under the PSA. If the 60-day cure period triggered by such a notice

[74] Doc. No. 588 at 13-28.
[75] Doc. No. 750 at 5.

elapses without the Master Servicer curing the problems, an Event of Default occurs. This then triggers the Trustee's mandatory obligation to notify all certificateholders of the Event of Default.[76] Section 10.08 of the PSA, in turn, identifies the procedural steps a group of certificateholders must satisfy before they can directly sue the Master Servicer. One of the required steps is to provide the Trustee with written notice of the Event of Default and demand the Trustee institute action.[77] *Nothing* in either § 10.08 or § 7.01(ii) says that only the certificateholders who triggered the original 60-day cure period under § 7.01(ii) can pursue post-Event of Default remedies under § 10.08. That purported requirement is a figment of BNYM and the Inside Institutional Investors' collective imagination.

Second, BNYM's description of the Inside Institutional Investors as [redacted] is equally erroneous.[78] BNYM cites no contractual support for this assertion. Indeed, multiple BNYM witnesses—both fact witnesses [redacted]—conceded that there is no authority in the PSAs allowing for a forbearance agreement of the sort entered into by the parties here.[79] Nor would it make any sense for the expiration of the cure period and occurrence of an Event of Default to be dependent on [redacted] An Event of Default under § 7.02(ii) occurs as a result of "any failure by the

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[76] Ex. 126 (PSA) § 7.03(b).
[77] *Id.* § 10.08.
[78] Doc. No. 750 at 6.
[79] *See, e.g.*, Ex. 15 to Joint Opp'n [redacted] Ex. 70 to Joint Opp'n [redacted]; see also Ex. 71 to Joint Opp'n (Lundberg Dep.) at 411:14-24; Ex. 46 to Joint Opp'n (Griffin Dep.) at 148:22-25.

Master Servicer to observe or perform in any material respect any other of the covenants or agreements" under the PSA, "which failure materially affects the rights of Certificateholders" and which "failure continues unremedied for a period of 60 days after the date on which written notice of such failure shall have been given to the Master Servicer . . . ." Whether the Master Servicer has failed to perform is a *fact* that exists or does not exist—it is not something that turns on the decision of a group of certificateholders. If notice is given and the 60-day cure period runs without a cure an Event of Default is triggered,[80] the Trustee must give notice to all certificateholders, and certificateholders may seek to exercise their rights under § 10.08.

The Trustee's decision to enter the forbearance agreement in order to purportedly stop the 60-day cure period and prevent an Event of Default finds no support in the PSAs. The Trustee had no power to do so.[81] Yet doing so benefitted BNYM, BofA, and the Inside Institutional Investors, as explained in the Joint Opposition, while depriving other certificateholders of their rights.[82] This self-interested and conflicted conduct squarely violated the Trustee's fiduciary duty of undivided loyalty, tainting the entire settlement process. In such circumstances, there is no justification for deference to the Trustee's judgment.

CONCLUSION

For the reasons set forth above, the undersigned respectfully request this Court not approve the proposed settlement as it currently stands.

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[80] A press release issued by Gibbs & Bruns on 10/18/10, concerning the Notice of Non-Performance, confirms that this is the correct reading of the PSAs. *See* Ex. 131 ("Under Section 7.01 of the PSAs, if any of the cited failures 'continues un-remedied for a period of 60 days after the date on which written notice of such failure has been given . . . to the Master Servicer and the Trustee by the Holders of Certificates evidencing not less than 25% of the Voting Rights evidenced by the Certificates,' that failure *constitutes an Event of Default under the PSAs*.") (emphasis added).
[81] Doc. No. 588 at 30-32.
[82] *Id.* at 19-21

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