SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IA PART 39

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), 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.

INSTITUTIONAL INVESTORS'
RESPONSE TO SETTLEMENT OBJECTIONS

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

I. Introduction 1

II. The Objectors' Attempt to Strip the Trustee of its Power to Exercise Discretionary Judgment on Behalf of Certificateholders Should be Rejected 2

A. The Trustee Owns the Trusts' Claims 4

B. Certificateholders Do Not, Save in Limited Circumstances Inapplicable Here, Have "Rights" to Enforce the PSAs 5

C. Certificateholders Agreed that the Trustee, Not Individual Certificateholders, Would Control the Trusts' Claims 7

D. Applicable Law Requires Upholding the Trustee's Discretion to Settle 9

III. The Objection by Cranberry Park that the Settlement Amount is Unreasonably Small is Meritless and Ignores Key Considerations 11

A. The Trustee's Loss Estimates Were Not Only Reasonable, They Are Nearly Identical to Cranberry Park's Estimates 12

B. Cranberry Park's "Home Run" Breach and Success Rates Ignore the Fact That Allegations of Breach Do Not Inevitably Result in Actionable Repurchase Claims or Successful Loan Repurchases. 14

C. Cranberry Park Ignores Other Legal Risks That Any Prudent Trustee Would Be Required To Consider 17

IV. The Supplemental Objection by Triaxx and the Federal Home Loan Banks Regarding Modified Loans is Meritless, and Was Considered in Connection with the Settlement 22

V. Conclusion 31

TABLE OF AUTHORITIES

Cases

Asset Securitization Corp. v. Orix Capital Mkts., LLC,
12 A.D.3d 215 (1st Dep't. 2004) 5

Assured Gty. Mun. Corp. v. Flagstar Bank, FSB,
892 F. Supp. 2d 596 (S.D.N.Y. 2012) 21

Assured Guaranty Municipal Corp. v. Flagstar Bank, FSB,
No. 11-2375 (S.D.N.Y. Feb. 5, 2013).......... 17

Bank of N.Y. v. Battery Park City Auth.,
251 A.D.2d 211 (1st Dep't 1998) 8

Bankers Ins. Co. v. DLJ Mortg. Capital, Inc.,
2010 WL 4867533 (M.D. Fla. Oct. 8, 2010) 8

Batchelder v. Council Grove Water Co.,
131 N.Y. 42 (1892).......... 7

Campbell v. Hudson & Manhattan R.R. Co.,
277 A.D. 731 (1st Dep't 1951), *aff'd*, 302 N.Y. 902 (1951) 7

CFIP Master Fund, Ltd. v. Citibank, N.A.,
738 F. Supp. 2d 450 (S.D.N.Y. 2010) 3

Colnaghi, U.S.A. Ltd. v. Jewelers Protection Svc. Ltd.,
81 N.Y.2d 821 (1993).......... 21

Cruden v. Bank of New York,
957 F.2d 961 (2d Cir. 1992) 8, 22

Elliott Assocs. v. J. Henry Schroder Bank & Trust Co.,
838 F.2d 66 (2d Cir. 1988) 3

Fed. Home Loan Bank of Boston v. Ally Fin., Inc.,
No. 1:11-cv-10952-GAO (D. Mass June 29, 2012).......... 25

Fed. Home Loan Bank of Chicago v. Banc of America Funding Corp.,
No. 10-CH-45033 (Cook Cnty. Cir. Ct. April 11, 2011).......... 25

Fed. Home Loan Bank of Indianapolis v. Banc of America Mortg. Sec., Inc.,
No. 49D05-10-10-PL-045071 (Marion Cnty Super. Ct. July 14, 2011).......... 25

Feldbaum v. McCrory Corp.,
C.A. No. 11866, 1992 WL 119095, (Del. Ch. June 1, 1992) 7

Greene v. N.Y. United Hotels, Inc.,
236 A.D. 647 (1st Dep't 1932), *aff'd*, 261 N.Y. 698 (1933) 8

Greenwich Fin. Servs. Distressed Mortg. Fund 3, LLC v. Countrywide Fin. Corp.,
Index. No. 650474/2008, slip op. at 6-7 (Sup. Ct. N.Y. Cnty. Oct. 7, 2010) 5, 7

In re Application of IBJ Schroder Bank & Trust Co.,
Index No. 101530/1998, slip op. at 6 (Sup. Ct. N.Y Cnty. Aug. 16, 2000)............................. 11

In re E.F. Hutton Sw. Props. II, Ltd.,
953 F.2d 963 (5th Cir. 1992) 3

In re Innkeepers USA Trust,
448 B.R. 131 (Bankr. S.D.N.Y. 2011).. 7

In re Stillman,
107 Misc.2d 102 (Sup. Ct. N.Y. Cnty. 1980) 11

Knights of Columbus v. Bank of New York Mellon,
Index No. 651442/11, slip op. at 17 (Sup. Ct. N.Y. Cnty. April 30, 2013) 3

LaSalle Bank, N.A. v. Nomura Asset Capital Corp.,
180 F.Supp.2d 465 (S.D.N.Y. 2001) 5

Levine v. Behn,
169 Misc. 601 (Sup. Ct. N.Y. Cnty. 1938), *rev'd on other grounds*
282 N.Y. 120 (1940).. 5

Levy v. Paramount Publix Corp.,
149 Misc. 129 (Sup. Ct. N.Y. Cnty. 1933), *aff'd*, 241 A.D. 711
(1st Dep't 1934), *aff'd*, 265 N.Y. 629 (1934)... 8

MASTR Asset Backed Sec. Trust 2006-HE3, ex rel. U.S. Bank., N.A.
v. WMC Mortgage Corp., 2012 WL 4511065 (D. Minn. 2012)... 19

MBIA Ins. Corp. v. Countrywide Home Loans, Inc.,
Index. No. 602825/08 (Sup. Ct. N.Y. Cnty. Apr. 29, 2013).. 18

MBIA Ins. Corp. v. Countrywide,
2013 WL 1296525 (1st Dep't. 2013)... 22

McMahan & Co. v. Wherehouse Entertainment, Inc.,
65 F.3d 1044 (2d Cir. 1995) 8

McMahan & Co. v. *Wherehouse Entm't, Inc.*,
859 F. Supp. 743 (S.D.N.Y. 1994) (granting summary judgment),
rev'd in part on other grounds, 65 F.3d 1044 (2d Cir. 1995)........ 8

Peak Partners, LP v. Republic Bank,
191 F. App'x 118 (3d Cir. 2006)........ 8

Reiss v. Fin. Performance Corp.,
97 N.Y.2d 195 (2001)........ 10

Relmar Holding Co. v. Paramount Publix Corp.,
147 Misc. 824 (Sup. Ct. N.Y. Cnty. 1932) (denying motion to strike defense),
aff'd, 237 A.D. 870 (1st Dep't 1933)........ 8

Schallitz v. Starrett Corp.,
82 N.Y.S.2d 89 (Sup. Ct. N.Y. Cnty. 1948)........ 8

Sterling Fed. Bank, F.S.B. v. DLJ Mortg. Capital, Inc.,
2010 WL 3324705 (N.D. Ill. Aug. 20, 2010)........ 8

Sutter v. Hudson Coal Co.,
259 A.D. 1053 (2d Dep't 1940)........ 8

Syncora Guaranty, Inc. v. EMC Mortgage Corp.,
No. 09-cv-3106 (S.D.N.Y. June 19, 2012)........ 17

Teachers Insurance & Annuity Ass'n. v. CRIIMI Mae Svcs. L.P.,
681 F.Supp.2d 501 (S.D.N.Y. 2010)........ 8

Van Wezel v. McCord Radiator & Mfg. Co.,
20 N.Y.S.2d 91 (N.Y. Cty Ct. 1939)........ 8

Victor v. Riklis,
1992 WL 122911 (S.D.N.Y. May 15, 1992)........ 8

Walnut Place LLC v. Countrywide Home Loans, Inc.,
951 N.Y.S.2d 84, (Sup. Ct. N.Y. Cnty. 2012)........ 6, 8, 9

Walnut Place LLC v. Countrywide Home Loans, Inc.,
96 A.D.3d 684 (1st Dep't. 2012)........ 6

Other Authorities

15 U.S.C. § 1639a(c)........ 26

26 U.S.C. § 860F(a)(2)(A)........ 28

26 U.S.C. § 860F(a)(2)(A)(ii)........ 28

Restatement (Second) of Trusts § 187 (1959) 11

Restatement (Second) of Trusts § 192 (1959) 5

I. Introduction

When the Trustee instituted this proceeding nearly two years ago seeking judicial approval of its exercise of discretion in entering into the proposed settlement, it did so with the support of certificateholders holding more than $40 billion in affected securities. The majority of certificateholders, who were notified of this proceeding by means of a rigorous notice process, chose not to appear or object to the settlement. Other certificateholders and other interested parties (including among others the Federal Housing Finance Agency ("FHFA"), the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Attorneys General of New York and Delaware) also appeared in this proceeding, seeking additional information in order to make an informed decision whether to object to the settlement. The settlement was opposed, however, almost immediately, by a small band of dissident certificateholders holding a tiny fraction of the securities at issue. The vast majority of these dissident certificateholders were also pursuing securities claims against Bank of America or had other individual interests that were served by opposing the settlement.

In the intervening two years, the Trustee's exercise of discretion in entering into the proposed settlement has been the subject of exhaustive examination and analysis. Certificateholders have been afforded the opportunity to scrutinize the settlement, the manner in which it was achieved, and the benefits it will produce, in exacting detail. Countless pages of documents have been produced, dozens of depositions have been taken, and expert reports, pro and con, on every relevant topic have been prepared and disseminated.

The result of this process has been that additional certificateholders have come forward to affirmatively support the settlement;[1] the Attorneys General have withdrawn their objections; the

[1] *See* The Institutional Investors' Statement in Support of the Settlement at 4-5 (discussing statements of support by certificateholders Fir Tree, Inc. and Monarch Alternative Capital, LP.

certificateholders who appeared to seek additional information (including the FHFA and others) have examined the exhaustive record compiled in this proceeding and elected not to object to the settlement; and the small band of dissident objectors who opposed the settlement from the beginning, led by AIG, continues to oppose it.[2]

The objections raised by these Objectors are meritless and raise no credible issues regarding the Trustee's exercise of discretion in entering into the settlement. Recognizing this fact, the Objectors instead engage in a transparent attempt to manufacture a conflict on the part of the Trustee, in the hope that the deference to which the Trustee's exercise of discretion is due will be disregarded by the Court. However, even if the Objectors claims of conflict had merit, and they do not, their objections would still fail because the settlement is manifestly fair and in the best interest of certificateholders in light of the alternative of uncertain and risky litigation. None of the meritless substantive objections raised by the Objectors, addressed below and in the statements in support of the settlement already filed, changes this fact.

II. The Objectors' Attempt to Strip the Trustee of its Power to Exercise Discretionary Judgment on Behalf of Certificateholders Should be Rejected

Central to the Objectors' joint objection is their claim that the Trustee's settlement decision is entitled to no deference, because the Trustee was allegedly conflicted or because it allegedly failed to perform its investigation and negotiation of the settlement in the way the Objectors – a small minority – would have preferred. Based on these groundless arguments, the

[2] Included among the Objectors joining AIG's brief in opposition to the settlement are: (1) the Western & Southern parties who now object to the settlement despite the fact that the Court granted their motion to withdraw from this proceeding almost a year ago, *see* Order (Doc. 358); and (2) CIFG Assurance, a party with no standing to appear in this proceeding because it is not, and does not claim to be, a certificateholder, *see* CIFG Notice of Intention to Appear (Doc. No. 155) (CIFG asserts only that it "may have an interest in the subject matter" of this proceeding because some of its financial guaranty insurance policies for certain tranches of Re-REMIC'd securities – *i.e.* not securities issued by the Settlement Trusts – may be collateralized by certain REMIC securities issued by the Settlement Trusts).

Objectors urge the Court to reject the Trustee's discretionary judgments (and the settlement) entirely, and to deprive *all* certificateholders of the settlement's significant benefits.

In any event, the Objectors' theories of conflict are meritless and have already been repeatedly rejected by this Court. *See* TR. 8/2/2012 at 160 (the Court: "I just don't understand how the indemnity provision suggests there is any kind of a conflict of interest, because the PSA provided for some indemnity"); *id.* at 161-62 (the Court: addressing Objectors' indemnity and forbearance agreement arguments, "I can't see what the colorable claim of conflict is that would allow me to let you use this fiduciary exception."); *Knights of Columbus v. Bank of New York Mellon*, Index No. 651442/11, slip op. at 17 (Sup. Ct. N.Y. Cnty. April 30, 2013) (allegations of business relationship between BNY Mellon and Bank of America did not support a claim of conflict because plaintiffs "fail to allege BNYM personally benefitted from its actions").

Numerous other courts have likewise ruled that neither ordinary business relationships with other parties nor a trustee's invocation of the indemnification rights to which it is contractually entitled are sufficient to create a conflict of interest with regard to a trustee's exercise of its discretionary powers. *See, e.g.*, *CFIP Master Fund, Ltd. v. Citibank, N.A.*, 738 F. Supp. 2d 450, 475 (S.D.N.Y. 2010) (neither trustee's demand for its contractual indemnity nor its repeat business relationship with a particular issuer creates a conflict of interest); *see also In re E.F. Hutton Sw. Props. II, Ltd.*, 953 F.2d 963, 972 (5th Cir. 1992) ("a mere hypothetical possibility that the indenture trustee might favor the interests of the issuer merely because the former is an indenture trustee does not suffice" to allege a conflict). As the Second Circuit has held, such "bald assertions of conflict" – as here, unsupported by any tangible evidence whatsoever – are not enough to establish trustee conflict. *Elliott Assocs. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 71 (2d Cir. 1988).

Thus, the Objectors seek to have this Court disregard the deference due to a trustee in the exercise of its discretionary powers, on the basis of specious allegations of conflict. But this strikes at the heart of the PSAs and is contrary to both common sense and decades of settled law concerning the power and authority of trustees. If accepted, the Objectors' narrow view of trustee authority would paralyze trustees, allow a vocal minority of certificateholders to disrupt the Trusts' workings – for their own self-interested reasons – to the detriment of the vast majority of other holders, and imprison tens of thousands of certificateholders in these and all other securitization trusts whose neutered trustees would be incapable of enforcing or resolving representation and warranty (and other) claims involving billions of dollars of defective mortgages. Neither the contracts nor the law permit such an extraordinarily damaging result. As we demonstrate below, the Objectors' arguments ignore – or ask the Court to read out of existence – key provisions of the PSAs that bind *all* certificateholders and that empower the Trustee (and *not* certificateholders) to control the Trusts' assets, including their litigation claims, for those holders' benefit.

A. The Trustee Owns the Trusts' Claims

The Objectors misspeak each and every time they contend that the Trustee is "releas[ing]" "certificateholder claims." Joint Mem. in Supp. Jury Demand ("Joint Mem.") at 7. The Trustee is not. The claims that will be released in the Settlement are the *Trustee's* claims, *not* claims that belong to certificateholders.

Under the PSAs, the contract claims resolved in the Settlement belong to the Trustee. *See, e.g.*, PSA §§ 2.01(b), 2.04. The Trustee holds those contract claims for the ultimate benefit of the certificateholders, but the claims do not belong to those certificateholders. The representations and warranties regarding the mortgage loans are made *to the Trustee*, and the PSAs *expressly* authorize the Trustee to effect the repurchase of breaching loans, *see* PSA §§

2.03(a), (c), 2.04, 3.03[3]; under well-settled law, the Trustee – and the Trustee alone – thus has the power to bring, or settle, these claims. *Id.*; *see also Levine v. Behn*, 169 Misc. 601, 605 (Sup. Ct. N.Y. Cnty. 1938), *rev'd on other grounds* 282 N.Y. 120 (1940) ("An incident to the right to sue or be sued is the power to compromise or settle suits."); Restatement (Second) of Trusts § 192 (1959) (noting that "[t]he Trustee can properly compromise . . . claims affecting the trust property"). The Trustee is not required to investigate these claims absent a direction from 25% of the certificateholders, *see* PSA § 8.02(iv), or to expend its own funds to do so, *see* PSA § 8.02(vi). But there can be no question that these claims belong to the Trustee, not certificateholders.

B. Certificateholders Do Not, Save in Limited Circumstances Inapplicable Here, Have "Rights" to Enforce the PSAs

With narrow exceptions not relevant here, the certificateholders are not empowered to pursue the Trustee's claims on behalf of the Trusts. Section 10.08, the "no-action" clause in the PSAs, states plainly that certificateholders "are barred from bringing [an] action" that does not strictly comply with the terms of the no-action clause. *Greenwich Fin. Servs. Distressed Mortg. Fund 3, LLC v. Countrywide Fin. Corp.*, Index. No. 650474/2008, slip op. at 6-7 (Sup. Ct. N.Y. Cnty. Oct. 7, 2010). *This* Court has noted this very proposition in rejecting the effort by one of the former objectors to *this* Settlement – Walnut Place – to thwart the Settlement and to bring suit itself on the settled repurchase claims, a decision unanimously affirmed by the First Department. *See Walnut Place LLC v. Countrywide Home Loans, Inc.*, 951 N.Y.S.2d 84, at *5-

[3] Courts have recognized that language virtually identical to that in the PSAs here gives an RMBS trustee the power to sue the seller of the loans for breaches of representations and warranties. *See, e.g., LaSalle Bank, N.A. v. Nomura Asset Capital Corp.*, 180 F.Supp.2d 465, 471 (S.D.N.Y. 2001) ("the plain meaning" of a conveyance of "all right, title, and interest in the mortgages to LaSalle as Trustee . . . ordinarily includes the power to bring suit to protect and maximize the value of the interest thereby granted."); *Asset Securitization Corp. v. Orix Capital Mkts., LLC*, 12 A.D.3d 215, 215 (1st Dep't. 2004) (under PSA, authority to sue "is committed solely to the trustee of the pooled loans").

*6 (Sup. Ct. N.Y. Cnty. 2012); *see also Walnut Place LLC v. Countrywide Home Loans, Inc.*, 96 A.D.3d 684, 684 (1st Dep't. 2012) ("The court correctly held that plaintiff certificate holders' action is barred by the 'no-action' clause in the PSAs, which plainly limits certificateholders' right to sue to an 'Event of Default,' which under section 7.01 of the PSAs, involves only the Master Servicer"). Even in the limited circumstances in which certificateholders are permitted to bring suit – for an Event of Default related to failures by the Master Servicer – they may only do so after 25% of them have first requested that the Trustee do so and the Trustee has refused, PSA § 10.08, confirming that the Trustee controls all of the Trust's claims in the first instance.

The Objectors concede that they did not comply with the PSAs' no-action clause, § 10.08, and that the settled claims were not theirs to bring. But, just as fundamentally, their actions here violate two other, equally important premises of the PSAs, each also reflected in § 10.08: (1) that "no certificateholder shall have *any* right . . . in *any* manner" to "control the operation and management of the Trust Fund, or the obligations of the parties hereto," and (2) that "no one or more Holders of Certificates shall have *any* right in *any* manner . . . to disturb or prejudice the rights of the Holders of any other of the Certificates, or to obtain or seek to obtain priority over or preference to any other such Holder" except "for the common benefit of all Certificateholders." Thus, under the plain terms of the PSAs, the Objectors are barred from doing precisely what they are doing here. The Objectors cannot be permitted, in the guise of a settlement objection and for their own benefit, to *displace* the Trustee's contract right to control the prosecution and settlement of the Trustee's claims. We do not, by this point, suggest that the objections should not be heard at all; rather, the Court must evaluate the objections *against* the backdrop of the PSAs' plain statement that it is the Trustee, *not* a tiny minority of certificateholders, that is empowered to decide what to do regarding the pursuit or settlement of the Trusts' litigation claims.

C. Certificateholders Agreed that the Trustee, Not Individual Certificateholders, Would Control the Trusts' Claims

The PSAs do not merely set forth the Trustee's powers; they are a contract *among* the certificateholders. As this Court has noted, each time an investor purchases a certificate, it *agrees* to be bound by the terms of the Trust that issues it. *See Greenwich*, slip op. at 7 (certificateholders "agree[] to" the restrictions of a no-action clause "when they purchase[] the certificates.").

No-action clauses, like the one contained in Section 10.08 – to which all certificateholders agreed to be bound when they purchased their certificates – ensure that "the *judgment* of the Trustee concerning whether to resort to the courts is *controlling* upon all of the bondholders." *Campbell v. Hudson & Manhattan R.R. Co.*, 277 A.D. 731, 734 (1st Dep't 1951), *aff'd*, 302 N.Y. 902 (1951). These clauses "prevent[] individual bondholders from pursuing an individual course of action." *Batchelder v. Council Grove Water Co.*, 131 N.Y. 42, 46 (1892). Of particular relevance here, courts have recognized that no-action clauses also "protect[] against the risk of strike suits," and against the risk that "a single bondholder or a small group of bondholders . . . might otherwise bring a suit against the issuer that most bondholders would consider not to be in their collective economic interest." *Feldbaum v. McCrory Corp.*, C.A. No. 11866, 1992 WL 119095, at *6 (Del. Ch. June 1, 1992) (applying New York law). When they purchased securities governed by one of the PSAs at issue in this proceeding, each of the certificateholders became "contractually obligated to speak with one voice." *In re Innkeepers USA Trust*, 448 B.R. 131, 145 (Bankr. S.D.N.Y. 2011). The voice through which certificateholders speak, absent compliance with the no-action provision, is the Trustee's voice.

See id. No-action clauses are “strictly construed,” *Cruden v. Bank of New York*, 957 F.2d 961, 968 (2d Cir. 1992), and have been “enforced in a variety of contexts in both state and federal courts.” *McMahan & Co. v. Wherehouse Entertainment, Inc.*, 65 F.3d 1044, 1050-51 (2d Cir. 1995); *see also Teachers Insurance & Annuity Ass’n. v. CRIIMI Mae Svcs. L.P.*, 681 F.Supp.2d 501, 506 (S.D.N.Y. 2010) (no-action clauses “are common features of trust indentures” that bar suits by certificateholders in the absence of compliance with the required conditions).[4]

No-action provisions make perfect sense, and it is clear why New York courts have enforced such clauses for decades: “Granting standing to a certificateholder would not only override the terms of the [agreement] and alter the bargained for-terms and risks investors undertook when they bought certificate[s], . . . it would encourage and embolden other certificateholders to hire their own counsel . . . and to advance their individual and conflicting pecuniary interests.” *Innkeepers*, 448 B.R. at 145; *see also* Tr. 5/8/2012 at 36 (the Court: “I think I have said that in the past,” in response to statement by Ms. Patrick that the certificateholders “all agreed that the trustee would decide”). Tellingly, many of the Objectors have filed individual securities claims or securities class actions against Bank of America. But both the PSAs and applicable law strictly prohibit these certificateholders from using this proceeding – which concerns only the Trustee’s claims – to “advance their individual and

[4] Courts applying New York law have repeatedly dismissed complaints on the basis of plaintiffs’ failure to comply with no-action clauses. *See, e.g., Walnut Place*, 951 N.Y.S.2d at *5-*6, *aff’d*, 96 A.D.3d 684; *Peak Partners, LP v. Republic Bank*, 191 F. App’x 118, 126-27 (3d Cir. 2006) (arising in RMBS context); *Bankers Ins. Co. v. DLJ Mortg. Capital, Inc.*, 2010 WL 4867533, at *2-*4 (M.D. Fla. Oct. 8, 2010) (same); *Sterling Fed. Bank, F.S.B. v. DLJ Mortg. Capital, Inc.*, 2010 WL 3324705, at *3-*5 (N.D. Ill. Aug. 20, 2010) (same); *Bank of N.Y. v. Battery Park City Auth.*, 251 A.D.2d 211 (1st Dep’t 1998); *Greene v. N.Y. United Hotels, Inc.*, 236 A.D. 647, 648 (1st Dep’t 1932), *aff’d*, 261 N.Y. 698 (1933); *Levy v. Paramount Publix Corp.*, 149 Misc. 129, 133-34 (Sup. Ct. N.Y. Cnty. 1933), *aff’d*, 241 A.D. 711 (1st Dep’t 1934), *aff’d*, 265 N.Y. 629 (1934); *see also Sutter v. Hudson Coal Co.*, 259 A.D. 1053 (2d Dep’t 1940) (denying plaintiff’s motion for summary judgment); *Schallitz v. Starrett Corp.*, 82 N.Y.S.2d 89, 91 (Sup. Ct. N.Y. Cnty. 1948) (directing judgment); *Relmar Holding Co. v. Paramount Publix Corp.*, 147 Misc. 824, 825 (Sup. Ct. N.Y. Cnty. 1932) (denying motion to strike defense), *aff’d*, 237 A.D. 870 (1st Dep’t 1933); *Van Wezel v. McCord Radiator & Mfg. Co.*, 20 N.Y.S.2d 91, 99-100 (N.Y. Cty Ct. 1939) (granting summary judgment); *McMahan & Co.* v. *Wherehouse Entm’t, Inc.*, 859 F. Supp. 743, 748-79 (S.D.N.Y. 1994) (granting summary judgment), *rev’d in part on other grounds*, 65 F.3d 1044 (2d Cir. 1995); *Victor v. Riklis*, 1992 WL 122911, at *6 (S.D.N.Y. May 15, 1992) (denying leave to amend complaint).

conflicting pecuniary interests" at the expense of the vast majority of sophisticated certificateholders who support this Settlement. Again, we do not suggest that these Objectors should not be heard; rather, we submit that the Court should be vigilant to ensure that the individual pecuniary self-interests of the minority Objector group do not deny the Trusts and their certificateholders the common benefit of a highly favorable, and otherwise unobtainable, settlement.

D. Applicable Law Requires Upholding the Trustee's Discretion to Settle

As noted above, the fundamental premise of a securitization trust – such as those at issue in this proceeding – is that the Trustee, not individual certificateholders, controls the Trusts' assets. The fundamental premise of the PSAs' no-action clause is that, in the circumstances at issue here, the Trustee, not the certificateholders, controls the litigation of the Trusts' claims. These premises, and none other, are the foundation on which this Court's analysis of the settlement must rest.

The Objectors concede[5] at least this much: the Trustee had the *power* to settle these claims. *See* Joint Mem. at 5 (the Trustee could have settled the claims "without court approval"). The PSAs confirm this is so, because under their plain terms it is the Trustee – and *only* the Trustee – who controls the decision to prosecute or settle litigation claims. This Court recognized as much in its *Walnut Place* decision, noting that "the Trustee did, in fact, act upon plaintiffs' complaints, as demonstrated by the settlement agreement reached with the defendants and submitted to this Court" in this proceeding. *Walnut Place*, 951 N.Y.S.2d 85, at *6. And the PSAs, throughout, reflect the discretion afforded to the Trustee in its exercise of this power. *See, e.g.*, PSA § 8.01(ii) (the "Trustee shall not be liable for an error of *judgment* made in good faith

[5] Two of Objector AIG's experts, Professors Frankel and Levitin, appear to espouse the extreme position that, though the Trustee has the power to *litigate* the Trusts' claims, it is powerless to settle them. Even the Objectors, apparently, believe this is a bridge too far.

by a Responsible Officer . . . of the Trustee, unless it shall be finally proven that the Trustee was negligent in ascertaining the pertinent facts"); § 8.02(iii) (the "Trustee shall not be liable for any action taken, suffered or omitted by it in good faith and *believed by it to be authorized* or *within the discretion* or rights or powers conferred upon it by this Agreement."); § 8.02(ii) (the Trustee may, in the exercise of its discretion, consult with counsel, financial advisers, or accountants, "and the advice of such counsel, financial advisers or accountants . . . shall be full and complete authorization and protection in respect of any action taken or suffered or omitted by it hereunder in good faith").

In a fundamental way, each objection misses this central point. Even as they concede that the PSAs give the Trustee *discretion* to settle, they urge the Court to rewrite the PSAs to prohibit the Trustee from *exercising* that discretion, so long as any minority, no matter how small, objects. But the Court cannot accept the Objectors' invitation to re-write the certificateholders' bargain with *each other and the Trustee* to create a "veto" right in the minority, in the guise of "interpreting" the writing. *See Reiss v. Fin. Performance Corp.*, 97 N.Y.2d 195, 199 (2001). In this Article 77 proceeding, the Court must enforce the PSAs as written – and under those PSAs, the *only* issue before the Court is whether the Trustee appropriately exercised its *contractually authorized, discretionary authority* to settle its claims. That question does not turn *at all* on whether the Objectors would have preferred a different settlement. It does not turn *at all* on whether AIG's experts can hypothesize some other analysis that might have led, hypothetically, to a different settlement.

The sole issue, as this Court has already ruled, is whether the Trustee's decision was reasonable. *See* Tr. 6/14/2012 at 43-44 (the standard in this proceeding is "whether what was done is fair and reasonable. It doesn't mean this is the best thing in the whole world, it couldn't possibly be a better deal. It's whether it was fair and reasonable under all the circumstances."). The Objectors concede as much. *See* Obj. of Cranberry Park LLC, Doc. No. 719 ("Cranberry Park Obj."), at 2 ("[T]he essential issue in this proceeding is whether the Trustee by entering into the Proposed Settlement has acted 'within the bounds of a reasonable judgment.'") (quoting *In re Stillman*, 107 Misc.2d 102, 110 (Sup. Ct. N.Y. Cnty. 1980)); *see also In re Application of IBJ Schroder Bank & Trust Co.*, Index No. 101530/1998, slip op. at 6 (Sup. Ct. N.Y Cnty. Aug. 16, 2000) (in context of securitization trustee's settlement of trust claims, concluding that "the trustee's decision to compromise the . . . action is within the scope of the trustee's powers, is reasonable and prudent, and is entitled to judicial deference"); Restatement (Second) of Trusts § 187 (1959) ("Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion."). By that standard, which is the only standard that applies, all of the Objectors' arguments concerning the Trustee's actions fail utterly.

III. The Objection by Cranberry Park that the Settlement Amount is Unreasonably Small is Meritless and Ignores Key Considerations

Cranberry Park, an anonymous Delaware LLC created three weeks after this settlement was reached (apparently for the *sole purpose* of objecting to it),[6] asserts that the settlement amount is unreasonably low, and offers its own analysis of a reasonable settlement amount. This analysis is meritless. It is premised on unreasonably optimistic assumptions and willful blindness to the significant factual, legal, and logistical impediments that the Trustee would have faced had it chosen to walk away from the proposed settlement and attempted to obtain a better

[6] Cranberry Park LLC and Cranberry Park II LLC were incorporated as limited liability companies in Delaware on July 20, 2011. Their initial papers were filed in this proceeding on August 2, 2011 [Doc. No. 90]. A review of public records and court dockets indicates that these entities are not engaged in any activities other than objecting to this Settlement.

result through litigation (and that it would face today if the Settlement is not approved). When asked to stand behind its objection, Cranberry Park refused to produce any documents (even those cited *in* its objection), refused to produce a witness to be cross examined about its objection, and announced that it did not intend to call *any* corporate representative or other witness to testify at the final hearing about its objection. Cranberry Park is attempting to offer what amounts to a belated expert report on valuation without any evidentiary support – and without even the name of a person or the real entity that stands behind the opinion. For this reason, the Court should not give any weight to Cranberry Park's objection. But even if the Court does consider the objection on the merits, as discussed below, even a *cursory* review of the record and the law demonstrates that the Trustee's consideration of lifetime losses, its analysis of breach and success rates, and its assessment of the legal risks associated with the Trusts' claims – all points attacked by Cranberry Park – were the result of a reasonable, well-informed analysis that is not undermined in any way by Cranberry Park's objection.

A. The Trustee's Loss Estimates Were Not Only Reasonable, They Are Nearly Identical to Cranberry Park's Estimates

With respect to lifetime losses, Cranberry Park claims to "adjust [the Trustee's loss estimate] to reality" by increasing certain loss severity assumptions. *See* Cranberry Park Obj. at 2. These "adjustments" are demonstrably incorrect.

First, without citation, Cranberry Park purports to increase the Trustee's loss severities to account for "losses due to principal modifications and other pre-liquidation events." *See id.* at 8. This adjustment was not necessary: the loss severities used in the Trustee's analysis were obtained from public databases derived from the Trusts' monthly remittance reports, which unequivocally take into account realized losses due to principal modifications. The Institutional Investors' analysis – which the Trustee also considered – used a similarly robust data set that compiled the effect of principal modifications, foreclosure delays, re-default rates, and other factors that affect loss severity.[7] Cranberry Park's critique is simply wrong: the Trustee's loss severities *do* account for realized losses due to principal modifications.

Second, Cranberry Park criticizes the use of historic loss severities as of March 2011 to estimate future loss severities to the Trusts, because "market participants in March 2011 fully expected that Loss Severity Rates would continue to increase." *See* Cranberry Park Obj. at 9-10. This critique assumes that past is inevitably prologue. It is not: in reality, the housing market cycles down and up in rough relationship to other economic factors. In good times, values are more robust and severities are lower; in bad times, home prices fall and severities tend to increase. Accordingly, any reasonable projection of future losses to the Trusts had to consider expected severities over the *entire life* of the Trusts, which, for many Trusts, may extend to 2047. Indeed, as even Cranberry Park's Figure 3 demonstrates, loss severities have begun to fall. This is a matter of common sense: as the housing market continues its recovery, loss severities will continue to decrease.[8] Thus, the Trustee's use of three-month historic loss severities was arguably an *aggressive* metric for estimating future losses, given the depressed state of the housing market in March 2011, and the expectations of a housing recovery over the long lives of the Trusts.

Even after making these incorrect "adjustments" to the Trustee's severities, however, Cranberry Park's loss estimates are *nearly identical* to the Trustee's estimates. Specifically, Cranberry Park's "*high end*" estimate of $85.3 billion in lifetime losses for the Trusts is only *1%*

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[7] *See* Institutional Investors' Statement in Support of Settlement and Consolidated Response to Objections, filed in C.A. No. 2011-cv-5988, *In re the Bank of New York Mellon*, in the United States District Court for the Southern District of New York at 26 -28 and n. 14 (citing servicing statistics).

[8] *See, e.g.*, *CoreLogic Home Price Index Rises by Almost 10 Percent Year Over Year in January*, PR Newswire, March 5, 2013, available at http://www.corelogic.com/about-us/news/corelogic-home-price-index-rises-by-almost-10-percent-year-over-year-in-january.aspx.

higher than Mr. Burnaman's estimate of $84.7 billion. *Compare* Objection at 16 *with* Burnaman Report at 25. Similarly, Cranberry Park's "low end" estimate is $69.3 billion, only *2% higher* than Bank of America's $67.8 billion estimate. *See* BOA_Art77_00018331. The close similarity between Cranberry Park's "low end" estimate and Bank of America's estimate, on the one hand, and between Cranberry Park's "high end" estimate and the Trustee's estimate, on the other hand, directly refutes Cranberry Park's assertion that the Trustee's assumptions were "entirely unsupportable." *See* Cranberry Park Obj. at 7.

B. Cranberry Park's "Home Run" Breach and Success Rates Ignore the Fact That Allegations of Breach Do Not Inevitably Result in Actionable Repurchase Claims or Successful Loan Repurchases.

Next, Cranberry Park purports to assign a value to the Trusts' claims by analyzing the rate at which loans that are purportedly defective and subject to repurchase, appear in the Trusts. However, in doing so, Cranberry Park not only uses unreasonable assumptions to arrive at an inflated "home run" estimate, it also ignores all of the significant legal issues that bear directly on the value of the Trusts' claims. It then inexplicably equates this bloated, undiscounted "home run" scenario with a reasonable "settlement range" that, by necessity, must give due consideration to numerous, substantial, and specific legal risks and uncertainties for which any rational trustee evaluating these claims would have to account. In other words, Cranberry Park's analysis is premised on the notion that the Trustee should have irrationally assumed that it would prevail on *every* one of the numerous unsettled and highly consequential legal issues presented. Such a foolhardy approach would not have been in the best interest of certificateholders, nor is it the standard by which the Trustee's decisionmaking should be judged.

A word of explanation is necessary to understand one of the many significant flaws in Cranberry Park's analysis. Though Cranberry Park does not explain them, the terms "breach rate" and "success rate" have discrete meanings. A "breach rate" is the rate at which loans in a given pool are identified as having some kind of breach of a representation or warranty, regardless of its materiality and regardless of whether the breach can be cured, *i.e.* regardless of whether the breach could in fact form the basis for a repurchase claim. A "success rate," by contrast, is the rate at which loans that have been identified as having breaches are *actually* repurchased, because the breach in question had a "material and adverse" effect on the certificateholders' interests and could not otherwise be cured (for example, through the location of a missing document).

The first step in Cranberry Park's breach and success rate analysis is straightforward. Based on *allegations* in five repurchase suits against various RMBS sponsors (including non-Countrywide sponsors), Cranberry Park asserts, without explanation, that the appropriate breach rate for the liquidated, delinquent, and modified loans in the Covered Trusts is 66%, and that the appropriate breach rate for current, unmodified loans is 33%. *See* Cranberry Park Obj. at 12-15. When weighted by delinquency bucket, it can be shown that Cranberry Park's "blended" breach rate assumptions for the Covered Trusts range from 61.7% to 63.1%.[9] This is not, we note, significantly different from the Institutional Investors' 60% breach rate, which the Trustee received and considered prior to entering into the Settlement.

The second step in Cranberry Park's breach and success rate analysis is truly remarkable: Cranberry Park assumes that the Trustee had a *100% chance* of proving that each and every one of those alleged breaches, no matter what they were, constituted an actionable repurchase claim.

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[9] In Cranberry Park's "low range" estimate, current unmodified loans account for 8.6% of total losses. Therefore, the "blended" breach rate is 8.6% * 33% + (1 – 8.6%) * 66% = **63.1%.**

In Cranberry Park's "base range" estimate, current unmodified loans account for 9.1% of total losses. Therefore, the "blended" breach rate is 9.1% * 33% + (1 – 9.1%) * 66% = **63.0%**.

In Cranberry Park's "high range" estimate, current unmodified loans account for 12.9% of total losses. Therefore, the "blended" breach rate is 12.9% * 33% + (1 – 12.9%) * 66% = **61.7%**.

In other words, Cranberry Park assumes that, for nearly *two out of every three* defaulted loans in the Covered Trusts, the Trustee would have a *100% chance of proving at trial that*:

(1) there was *actually* a breach of a representation and warranty; **AND**

(2) the breach could *not* be cured; **AND**

(3) the breach had a "*material and adverse*" effect on the interests of certificateholders in that mortgage loan.

Seen in this way, Cranberry Park's success rate assumptions are more than merely absurd: they are entirely divorced from reality. We are aware of no case, and Cranberry Park cites none, in which any party pursuing repurchase claims has alleged – much less achieved – a 100% success rate on loan repurchases. Even certain of the monoline cases decided *after* the Settlement – which hold that performing loans may be eligible for repurchase[10] – pointedly do not eliminate the three *basic* requirements to prove a repurchase claim. Cranberry Park's objection irrationally assumes the Trustee was going to pursue a metaphorical "Lake Wobegon-style" litigation, where all the claims were strong, all the defects were actionable, and all the recoveries were above average.[11] This argument ignores the real-time evidence the Trustee had to (and did) consider in deciding whether the certificateholders' best interests were better served by litigating or settling. This evidence demonstrated that the litigation of repurchase claims is fraught, fact-intensive, expensive, and highly uncertain. *See* Institutional Investors' Brief in Support at 36-38.

[10] Indeed, the only two cases cited by Cranberry Park in its legal analysis of the Trusts' repurchase claims are *Assured Guaranty Municipal Corp. v. Flagstar Bank, FSB*, No. 11-2375 (S.D.N.Y. Feb. 5, 2013) ("*Flagstar*") and *Syncora Guaranty, Inc. v. EMC Mortgage Corp.*, No. 09-cv-3106 (S.D.N.Y. June 19, 2012). *See* Objection at 18-20. Both these cases concern monoline insurers, whose "interests" in the loans are not identical to certificateholders' interests, and thus may be subject to a different "material and adverse" effect test.

[11] *Compare* G. Keillor, "Welcome to Lake Wobegon, where all the women are strong, all the men are good-looking, and all the children are above average."

Justice Bransten's recent opinion denying MBIA's motion for summary judgment confirms just how difficult it can be to actually *prove* a repurchase claim.[12] After five years of litigation, and millions of dollars spent on re-underwriting, experts, and motion practice, MBIA was denied summary judgment on *every single* repurchase claim it brought on every single loan. As that opinion makes clear, merely *alleging* a breach is a far cry from proving that a breach (1) actually exists; (2) is not curable; and (3) has a material and adverse on the interests of certificateholders.

C. Cranberry Park Ignores Other Legal Risks That Any Prudent Trustee Would Be Required To Consider

The final step in Cranberry Park's analysis is to apply its breach rates (61.7% to 63.1%) and its extremely optimistic 100% success rate to its loss estimates of $69.3 billion to $85.3 billion. Cranberry Park labels the resulting range of $43.8 billion to $52.7 billion its "settlement range." This, too, bears no relationship to reality. Cranberry Park can only reach this result by adding a number of additional, extreme assumptions to its earlier tenuous premise that every loan with a breach would, inevitably and without litigation risk, be repurchased. These extreme assumptions include that the Trustee *had a 100% chance of*:

(1) imposing successor liability on Bank of America (since Cranberry Park does not dispute that Countrywide could not have paid a judgment of this size); **AND**

(2) succeeding in the argument that the "material and adverse effect" clause does not require proof of loss causation[13]; **AND**

[12] *See MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, Index. No. 602825/08, slip op. (Sup. Ct. N.Y. Cnty. Apr. 29, 2013) [Doc. No. 4093] (attached as Ex. 6 to Patrick Affidavit in Support of Institutional Investors' Statement in Support of Settlement [Doc. No. 747]).

[13] To be clear, the loss causation question here is separate and apart from the threshold requirement that the breach of the representation and warranty be proven to have a "material and adverse" effect on the interests of certificateholders in a mortgage loan.

(3) making its case using sampling, regardless of the PSAs' loan-by-loan sole remedy provision and requirement to demonstrate a defect as to "that Mortgage Loan"; **AND**

(4) succeeding on every other issue, both known and unknown, that would inevitably arise in the hotly contested, massive, complex, and time consuming litigation that Cranberry Park's scenario contemplates.[14]

When seen in this light, Cranberry Park's settlement range is nothing more than an attempt to derive a "headline number," devoid of any analysis of litigation risks or the burden and expense of proving the Trusts' claims. Cranberry Park's argument is, at bottom, an abstract academic claim that the Trustee should have rejected the Settlement had it been living in a world where litigating the Trusts' claims was free of cost, free of risk, and certain to result in a judgment worth tens of billions of dollars. This is not realistic.

Cranberry Park's rosy view of litigation does not obscure the hard facts that the Trustee had to consider in deciding whether to settle or litigate (*i.e.*, in determining which course of action would be most beneficial to certificateholders). Both the record in this case and applicable law created (and still create) substantial risks for recoveries on these claims. As discussed in detail in the Institutional Investors' Brief in Support, each of these risks was significant in June 2011, and remains so today.

With respect to successor liability, for example, the *Objectors'* own expert, John C. Coates, testified that, in his opinion, the likelihood of imposing successor liability on Bank of

[14] An example of this type of litigation risk – unknown at the time of the Settlement, but that could be expected to arise in litigation as hotly contested and complex as this – is illustrated by the recent holding in *MASTR Asset Backed Sec. Trust 2006-HE3, ex rel. U.S. Bank., N.A. v. WMC Mortgage Corp.*, 2012 WL 4511065, at *5-6 (D. Minn. 2012). In that case, the court held that mortgages that had been liquidated, through foreclosure or otherwise, were not eligible for repurchase under a PSA (even where there were otherwise actionable breaches of representations and warranties) because there was no longer a "mortgage" that could be repurchased. If such an interpretation were adopted by a court hearing the Trusts' claims, the value of those claims would be impacted dramatically, as losses associated with defective mortgages that had already been liquidated would no longer be recoverable.

America is (and was) highly uncertain, being no more than 45% to 65%. Mr. Coates admitted in his deposition that "a reasonable person looking at this could conclude that it was more likely than not that successor liability would fail." *See* Coates Tr. at. 224-230, attached as Exhibit 1 to the Institutional Investors' Brief in Support. Likewise, based on an extensive analysis, the Trustee's successor liability expert, Professor Daines, concluded that it would be very difficult to impose liability on Bank of America, determining that "[a] veil piercing claim would likely fail" and that "[Bank of America] has a reasonable argument that any successor liability claim would be defeated." *See* Daines Rep. at 5, 6. Justice Bransten's recent opinion denying summary judgment to MBIA on its successor liability claims against Bank of America, and the score of other cases rejecting similar claims against Bank of America, have served only to confirm the difficulties associated with pursuing such claims.

While Cranberry Park makes the cursory statement that "BAC HLS's non-performance of its servicing obligations generated much the same harm as caused by CHL's failure to meet loan repurchase obligations," Cranberry Park Obj. at 3, it provides no support for that statement, nor could it, since the two parties' obligations and remedies are distinct. As the PSAs make clear, the repurchase obligation for breaches of the Seller's representations and warranties runs only against the Seller, subject to appropriate notice of breaches and failure to cure within a contractually required time period. *See* PSA § 2.03(c) ("Each Seller hereby covenants that . . . it shall cure such breach in all material respects, and if such breach is not cured, . . . repurchase the affected Mortgage Loan."). The Master Servicer, on the other hand, has no obligation to repurchase loans with breaches of representations and warranties. The Master Servicer's duties are to service and administer the Mortgage Loans in accordance with the terms of the PSAs and the customary and usual standards of practice of prudent mortgage loan servicers. *See id.* § 3.01.

Under the PSAs, moreover, the Master Servicer is exempt from "any liability to the Certificateholders for any action taken or for refraining from the taking of any action in good faith . . . or for errors in judgment" and is not liable for breach of its servicing obligations unless it acted with "willful misfeasance, bad faith or gross negligence in the performance of duties or . . . reckless disregard of obligations and duties thereunder." *Id.* § 6.03; *see also Assured Gty. Mun. Corp. v. Flagstar Bank, FSB*, 892 F. Supp. 2d 596, 606-07 (S.D.N.Y. 2012) (describing this standard and expressing "skept[icism] that plaintiff can meet this standard at trial"); *MBIA Ins. Corp.*, Doc. No. 4093 at 32 ("the Agreements at issue limit the Trusts' ability to recover to 'misfeasance, bad faith, or gross negligence in the performance of the duties of the Master Servicer or for reckless disregard of the obligations of the Master Servicer . . . ..."). Gross negligence is an onerous standard that requires proof of "conduct that evinces a reckless disregard for the rights of others or 'smacks' of intentional wrongdoing." *Colnaghi, U.S.A. Ltd. v. Jewelers Protection Svc. Ltd.*, 81 N.Y.2d 821, 823-24 (1993). There is thus no merit to Cranberry Park's cursory assertion that the Master Servicer's alleged servicing failures generated equivalent harm to the Trusts as the originators' breaches of representations and warranties, and no support for the conclusion that the Trusts would have been able to look to any entity other than Countrywide to satisfy their claims.

If the Trusts had been required to look solely to Countrywide Financial Corporation to satisfy their repurchase claims, their maximum potential recovery would not (and could not) have exceeded $4.8 billion – just 56% of the $8.5 settlement amount, setting aside the servicing improvements and document cure – assuming that the Trustee was Countrywide's only unsecured creditor to recover against its assets (which it would not be). *See* Capstone Report at 3, 11. In other words, if the Trustee *lost* on successor liability, any "headline number" for the repurchase claims greater than $4.8 billion would be irrelevant and unattainable. Whether the headline number is $8.8 – $11 billion (Brian Lin), $8.2 - $12.9 billion (Phillip Burnaman), $32 billion (Institutional Investors), or $43.8 to $52.7 billion (Cranberry Park), if Bank of America was not liable as Countrywide's successor, the absolute maximum recovery was exactly the same: *$4.8 billion*. In reality, though, it would likely be much less, because of claims by other creditors. The Trusts would be forced to compete for Countrywide's assets against the Objectors' own, individual securities suits against Countrywide.

With respect to loss causation, Professor Adler's report from June 2011 reasonably concluded that "it appears to be a reasonable position that a determination of whether a breach materially and adversely affects the interests of Certificateholders should turn on the harm caused by the breach." *See* Adler Report at 13. The Trustee was entitled to rely on that opinion in June 2011, PSA §8.02 (ii), and is entitled to rely on it today. *Id.*; *see also Cruden*, 957 F.2d at 972. And, although the First Department recently held that performing loans may be subject to repurchase, "to the extent [a] plaintiff can prove that a loan which continues to perform 'materially and adversely affect[ed]' its interest," it declined to address "[w]hether or not such proof is *actually possible*." *MBIA Ins. Corp. v. Countrywide*, 2013 WL 1296525 at * 2 (1st Dep't. 2013) (emphasis added). Thus, as the First Department noted, the requirement remains that a plaintiff seeking repurchase must demonstrate that a representation and warranty breach had a material and adverse effect on certificateholders' interests, and it remains unclear precisely what is needed to make such a showing. Notably, Justice Bransten, in her subsequent summary judgment opinion, held that the question of whether there had been a material and adverse effect was not susceptible to resolution on summary judgment, but required a trial on each loan in question.

Thus, Cranberry Park's objection, and the overly optimistic and irrational analysis on which it is premised, are meritless. As it should have, the Trustee conducted a reasonable, fact-based analysis that gave due regard to the significant, factual, legal, and logistical hurdles that stood between it and any prospect of a recovery for the Trusts that exceeded the value of the settlement – with its $8.5 billion cash payment and valuable servicing improvements, made possible by months of vigorous, contentious, arm's length negotiations. Far from calling into question the Trustee's judgment in entering into the settlement, Cranberry Park's analysis demonstrates precisely the opposite: the type of flawed and irrational reasoning necessary to reach a conclusion that the settlement is not in the best interest of the Trusts' and their certificateholders.

IV. The Supplemental Objection by Triaxx and the Federal Home Loan Banks Regarding Modified Loans is Meritless, and Was Considered in Connection with the Settlement

Two objectors—Triaxx and the Federal Home Loan Banks of Boston, Chicago, and Indianapolis—lodge an objection supported by no other objector: they claim the Trustee "improperly released" claims that the Master Servicer failed to perform an alleged obligation "to repurchase modified loans as required by approximately 90% of the applicable Pooling and Servicing Agreements." Supp. Br. at 2. This is not a new claim, nor was it one the Trustee failed to consider or evaluate in the settlement negotiations.

This "new" liability theory is a recycled version of an old argument central to the *Greenwich* litigation. We quote extensively from the Court's *Greenwich* opinion to illustrate the disputed and well-known nature of this claim:

> Plaintiffs Greenwich Financial Services Distressed Mortgage Fund 3, LLC and QED LLC bring this action, on behalf of themselves and all other persons similarly situated, seeking a declaratory judgment that, under the Pooling and Servicing Agreements ('PSAs') that govern the administration of the mortgage loans sold by the defendants in two series of securitizations, known as the CWL

> and CWALT series, to the trusts that issued the securities owned by plaintiffs—and under the allegedly substantially identical agreements that govern the 373 other trusts that issued the securities owned or held by other members of the plaintiffs' class—defendants Countrywide Home Loans or Countrywide Servicing are required to purchase any mortgage loan on which defendant Countrywide Financial has agreed to reduce the payments pursuant to a Multistate Settlement Term Sheet dated October 6, 2008, settling claims of predatory lending brought against it by the Attorneys General of California, Illinois, and several other States. Plaintiffs also seek a declaration that the price at which Countrywide Home Loans or Countrywide Servicing must purchase every modified loan is not less than 100 percent of the unpaid principal balance of, and any accrued interest on, that loan immediately before modification . . . .

Greenwich Fin. Servs. Distressed Mortg. Fund 3, LLC v. Countrywide Fin. Corp., Index. No. 650474/2008, slip op. at 1-2 (Sup. Ct. N.Y. Cnty. Oct. 7, 2010). After summarizing the plaintiffs' argument, the court also noted the defendants' arguments that the plain language of the contracts foreclosed this claim:

> Defendants further contend that even if plaintiffs had the capacity to sue for declaratory relief, PSA §3.01 unambiguously authorizes Countrywide to engage in loss-mitigation modifications and does not require that loans modified for that purpose be repurchased. Further they assert that §3.11 of the PSA governs only loan modifications that are 'in lieu of refinancing' (i.e., modifications Countrywide's lending affiliates make when borrowers indicate they are prepared to refinance their loans elsewhere) and requires Countrywide, as Master Servicer to repurchase those modified loans.

Id. at n. 5. The specific contract provisions cited in the court's opinion confirm that the "modification repurchase" argument Triaxx seeks to resurrect was far from clear.

Section 3.01 mandates that the Master Servicer shall "service and administer" loans held in the trust in accordance with "customary and usual standards of practice of prudent mortgage loan servicers." In other words, Section 3.01 authorizes (indeed directs) the Master Servicer to perform loss mitigation loan modifications if they are part of the customary and usual standards of practice of prudent mortgage loan servicers.[15] Critically, nothing in Section 3.01 requires the Master Servicer to repurchase the modified mortgage loan.

This is confirmed by the Prospectus Supplements, which summarized for investors at the time of purchases of their certificates the terms of the PSAs.[16] For instance the Prospectus Supplement for CWHL 2006-13 provides:

> The master servicer is permitted to make a modification . . . of a mortgage loan so long as the modification . . .would comply with the general servicing standard described above . . . . A modification . . . may initially result in a reduction in the payments made under a mortgage loan, but it is expected that a modification . . . will increase the payments made under the mortgage loan over the life of the mortgage loan.[17]

Thus, as explained by the Prospectus Supplement, Section 3.01—far from requiring repurchase—expressly contemplates that the modified mortgage loan will continue to be held by the trust so that Certificateholders can receive the benefit of the greater "payments made under the mortgage loan over the life of the mortgage loan."

Furthermore, Triaxx and the FHLBs do not—and cannot—argue that providing economically distressed borrowers with loan modifications is not a part of the "customary and

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[15] The Master Servicer's power to perform loan modifications is firmly grounded in the general servicing standard set forth in Section 3.01. Further support for this authority, however, can be seen throughout the PSAs. *See, e.g.*, Affirmation of [--], Exhibit [-] (citing PSA for CWHL 2006-13§ 3.01 (forbidding the Master Servicer from making any modification to a Mortgage Loan that would cause adverse REMIC tax consequences for the trust, confirming that the Master Servicer has the power to modify loans in the first place); *id.* (authorizing the Master Servicer to execute instruments "of partial or full release or discharge" with respect to the Mortgage Loans); § 3.11(a) (authorizing the Master Servicer to foreclose on properties when "no satisfactory arrangements can be made for collection of delinquent payments")).

[16] Each of the FHLBs are undeniably familiar with these documents because they have each brought lawsuits claiming that they were harmed by alleged misrepresentations in these Prospectus Supplements, including Countrywide RMBS Prospectus Supplements. *See, e.g.* Amended Complaint, *Fed. Home Loan Bank of Boston v. Ally Fin., Inc.*, No. 1:11-cv-10952-GAO (D. Mass June 29, 2012); Corrected Amended Complaint, *Fed. Home Loan Bank of Chicago v. Banc of America Funding Corp.*, No. 10-CH-45033 (Cook Cnty. Cir. Ct. April 11, 2011); Amended Complaint, *Fed. Home Loan Bank of Indianapolis v. Banc of America Mortg. Sec., Inc.*, No. 49D05-10-10-PL-045071 (Marion Cnty Super. Ct. July 14, 2011).

[17] *See* Madden Affidavit, Exhibit 1 (Pro. Supp. for CWHL 2006-13, at S-39).

usual standard of practice" of mortgage loan servicing, one that benefits borrowers and investors alike. A Treasury Department Report from April 2013 calculated that, since the inception of HAMP in 2008 and through February 2013, approximately 1.16 *million* borrowers have received permanent loan modifications from more than 75 participating servicers under HAMP, including on loans sold to private investors, to securitization trusts, and to GSEs, as well as on loans that banks hold for investment.[18] Moreover, federal statutory law recognizes that that loan modifications are a "standard industry practice" in mortgage servicing, a practice that is strongly encouraged.[19]

Triaxx and the FHLBs ignore Section 3.01 and instead point to sections of the PSA that deal with a very different kind of loan modification: a modification in lieu of refinancing, *i.e.*, a loan modification not to help a distressed borrower by reducing the principal or other terms of the loan but a "refi" sought by a borrower to take advantage of lower interest rates. *See* Supp. Br. at 3 (citing PSA § 3.11(b) and PSA § 3.12(a)). Section 3.11(b) of some PSAs requires the purchase of modified loans if the "modification is in lieu of a refinancing."[20] In other PSAs, the obligation to purchase loans modified in lieu of a refinancing appears in Section 3.12(a).[21]

Modifications "in lieu of a refinancing" are done when *performing* borrowers want to take advantage of a favorable change in the interest rate environment and refinance their loans at

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[18] *See* U.S. Dep't of Treasury, *February 2013 Making Home Affordable Program Performance Report*, at 9, 17 (Apr. 5, 2013), available at http://www.treasury.gov/initiatives/financial-stability/reports/Documents/February%202013%20MHA%20Report%20Final.pdf .

[19] *See, e.g.,* 15 U.S.C. § 1639a(c) ("Housing and Economic Recovery Act of 2008" and the "Helping Families Save Their Homes Act of 2009") (providing that qualified loss mitigation plans, including loan modifications thereunder, "shall constitute standard industry practice for all Federal and State laws").

[20] In some of these trusts, the repurchase obligation belongs to Countrywide Home Loans, Inc., as the Seller of the mortgage loans, not to the Master Servicer.

[21] Although the PSAs in these trusts do not use the words "in lieu of a refinancing," as explained below, the Prospectus Supplements confirm that they refer to modifications in lieu of refinancing.

lower interest rates. *See* Supp. Br. at 3, *citing* Section 3.11(b) (requiring that "the Mortgage Rate on the Modified Mortgage Loan [be] approximately a prevailing market rate for newly-originated mortgage loans having similar terms"). In contrast, loss-mitigation modifications involve modifying a *non-performing* borrower's loan to seek more recovery than a foreclosure, that is, to create positive NPV.

The Prospectus Supplements for these trusts once again contradict Triaxx and the FHLBs' position. Even where the PSAs do not explicitly use the words "in lieu of a refinancing," the Prospectus Supplement states that "[p]urchases of Mortgage Loans may occur when prevailing interest rates are below the Mortgage Rates on the Mortgage Loans and borrowers request modifications *as an alternative to refinancings*."[22] This language, again, appears in hundreds of the Prospectus Supplements, including the Prospectus Supplement that the FHLBs and Triaxx cite in their objection.[23] No Prospectus Supplement so much as hints at the possibility of loans being repurchased simply because they were modified; the *only* reference is to the repurchase of loans modified as a means of *refinancing*.

The PSAs thus draw a distinction between modifications in lieu of refinancing (which require repurchase) and loss mitigation modifications (which do not). This distinction is based, in part, on the benefits to be derived from the modification as between the lender and certificateholders. A modification in lieu of refinancing is typically done for the benefit of the *lender* to keep the borrower as a customer of the bank by reducing the interest rate to market conditions; the PSA repurchase requirement ensures that the trust will not take a loss under such circumstances. By contrast, a loss mitigation modification is typically done for the benefit of

[22] *See* Madden Affidavit, Exhibit 2 (Pro. Supp. for CWL 2006-15, at S-42.)

[23] *Id.*, Exh. 3 (Pro. Supp. for CWALT 2005-86CB, at S-35).

certificateholders to increase proceeds versus foreclosure at distressed prices; the *lack* of a PSA repurchase requirement ensures that the servicer will not be forced to suffer a loss to perform the modification——it would obviously make no sense to forbid servicers from doing loan modifications except on pain of an automatic repurchase obligation. The distinction also lies, in part, in federal tax law.[24]

For all of these reasons, there were serious doubts that Countrywide or the Master Servicer was required to repurchase *any* mortgage loan it modified for loss mitigation purposes in the absence of a showing that the loan *independently* violated a representation or warranty.

The Objectors are also wrong when they suggest the Trustee simply ignored this issue during the negotiations. The issue of *when* and in *what circumstances* the Servicer was required to repurchase loans it modified was raised in the Institutional Investors' October 18, 2010 Notice of Non-Performance.[25] The Objectors' contention that "there is no evidence that indicates that the Trustee did anything to investigate, value, or obtain compensation on behalf of the Certificateholders as a result of the failure of the Master Servicer to repurchase Modified

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[24] Any income a trust receives from a loan modification in lieu of a refinance is subject to a 100% prohibited transaction tax unless the loan is repurchased from the trust. *See* 26 U.S.C. § 860F(a)(2)(A). In contrast, modifications "incident to … foreclosure, default, or imminent default" are explicitly excluded from the definition of prohibited transactions. *Id.* at § 860F(a)(2)(A)(ii).

[25] *See* Notice of Non-Performance at ¶¶ 2-4, alleging specific failures by the Servicer with regard to the modification of mortgage loans, including the Servicer's alleged failure to comply with Section 3.11 of the PSA:

> The Holders do not seek to halt bona fide modifications of troubled loans for borrowers who need them. When, however, modifications are required to remedy predatory lending violations, Section 2.03(c) of the PSAs requires that the offending seller of the mortgage bear the costs to 'cure such breach in all material respects…' Nowhere do the PSAs permit the costs of curing predatory loans to be imposed on the Trusts or the Certificateholders. Despite these provisions, the Master Servicer has breached the PSAs by agreeing to modify loans held in the Trusts for the purpose of settling predatory lending claims made by various Attorneys General against its parent company while breaching its obligation to demand that the offending mortgage seller (its parent company) bear the costs of curing the violation, as well as the expenses reasonably incurred in enforcement of the mortgages seller's obligation to cure predatory mortgages.

Id.

Mortgage Loans," Supp. Br.. at 4, cannot be squared with this letter. It also cannot be squared with the evidence of intense negotiations surrounding *both* the repurchase remedies *and* the multi-billion dollar servicing remedies incorporated in the Settlement Agreement. Patrick Dep. at 44:23-45:14 (distinguishing between modifications of predatory loans, which require repurchase, and loss mitigation modifications) and 115:19-25 (settlement negotiations included detailed discussions of predatory loans and obligation to repurchase them before modifying them). The Objectors also fail to explain how the express and highly detailed discussion of loan modifications contained in the Settlement Agreement *could* have come to exist if the Trustee had *not* considered the merits of the "modification" claims Triaxx seeks to resurrect in its Supplemental Objection. To cite just one example, the Settlement Agreement confirms the parties' understanding concerning what the PSAs permitted and required concerning loan modifications:

> When the Master Servicer and/or Subservicer, in implementing a modification and/or other loss mitigation strategy (which may, pursuant to the Governing Agreements, include principal reductions), considers the factors set forth above, and/or acts in accordance with the policies or practices that the Master Servicer is then applying to its or any of its affiliates' 'held for investment' portfolios, the Master Servicer shall be deemed to be in compliance with its obligation to service the Mortgage Loans prudently in keeping with the relevant servicing provisions of the relevant Governing Agreement and the requirements of this Subparagraph 5(e), the modification and/or other loss mitigation strategy so implemented shall be deemed to be permissible under the terms of the applicable Governing Agreement, and the judgments in applying such factors to a particular loan shall not be subject to challenge under the applicable Governing Agreement, this Settlement Agreement, or otherwise.

See Settlement Agrm't. at ¶5(e). The Objectors' failure to inquire further into this issue in discovery should not give rise to any inference that, contrary to fact, the Trustee was either unaware of this issue, or failed to evaluate it, before it entered into the Settlement Agreement.

Triaxx and the FHLBs other complaints – two additional claims of "self-dealing" by the Master Servicer – are equally unsupported. First, they claim that "BofA or Countrywide did not reduce the principal balances of the second lien mortgages they held, even though the principal balances of the first lien mortgages owned by the Trusts were reduced significantly." Supp. Br. at 6. In support of this assertion, they cite three "examples" of mortgages where this practice is claimed to have occurred. However, each of these second liens *were in fact* modified under the HAMP second lien program and, as required by that program, the second liens were modified *proportionally* with the first liens modified under the HAMP program].[26]

Furthermore, Treasury Department guidance *requires* that if there is principal forbearance or forgiveness on the first lien under HAMP, then the second lien must also have proportionate principal forbearance.[27] For this reason as well, there is no basis to suggest that modifying firsts was some effort to "self-deal" on seconds. The second-lien loan is required by law to be reduced proportionally whenever the first-lien loan is reduced pursuant to HAMP.

Finally, Triaxx and the FHLBs claim, without support of any kind, that the Master Servicer may have engaged in a form of self-dealing by retaining the right to receive so-called "balloon payments" in connection with certain loan modifications. Supp. Br. at 7. Specifically, Triaxx and the FHLBs posit that notwithstanding that these modified loans were "written off by the Trusts," the Master Servicer "may retain the right to receive balloon payments on the

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[26] The FHLBs' and Triaxx's February letter claims that "there is no evidence in the data available that indicated any impact to the 2nd lien" loans on the three examples. This is not surprising because the second lien loans were "held for investment" (HFI) by Bank of America, so there is no reason to expect that loan-level modification data would be publicly available. To the extent that Triaxx or the FHLB's attempt to offer evidence of these "examples" at trial, the evidence demonstrating the proportional reduction of the second liens will be offered in response. Irrespective, it was irresponsible, to say the least, for Triaxx and the FHLBs to jump to the false conclusion that Bank of America modified the first liens but not the seconds.

[27] *See* Madden Affidavit, Exhibit 4 (U.S. Treasury Department, Supplemental Directive 09-05 Revised: Update to the Second Lien Modification Program (2MP), at 7 (Mar. 26, 2010) and *id.*, Exh. 5 (U.S. Treasury Department, Supplemental Directive 09-05: Introduction of the Second Lien Modification Program (2MP), at 6 (Aug. 13, 2009)).

modified loans" instead of distributing the payments to the trusts. *Id.* Tellingly, while claiming that Triaxx "discovered instances" of such self-dealing by the Master Servicer, they offer no evidence in the Supplemental Brief in support of this claim. *Id.*

This assertion appears to be predicated on a serious misunderstanding of the operation of principal *forbearance* modifications (which are distinct from principal *forgiveness* modifications). The standard HAMP borrower modification agreements are instructive. *See* BOA_Art77_LM_00033396-401. When a borrower is placed in a principal forbearance modification, the terms of the loan are restructured to reduce the borrower's monthly payment obligation by "forbearing" (*i.e.*, deferring) an amount of the principal due on the loan. Specifically, while the maturity date of the first lien remains the same as it was at the loan's origination (typically 30 years), the monthly payments are reduced by calculating a new payment using an extended amortization schedule (typically 40 years). To account for the difference, the payments due on the portion of the amortization period that extends past the maturity date of the loan are made part of a "balloon payment" that becomes due at the end of the term of the loan. Nothing about such a modification relieves the borrower of the obligation to make the balloon payment or grants the Master Servicer an entitlement to the balloon payment.

Nor does the fact that the loan was "written off" impact the Covered Trusts' entitlement to receive these balloon payments. Supp. Br. at 7. Under the Treasury Department's Supplemental Directive 10-05, forborne principal that is deferred is recorded as a "realized loss" in the month of the loan modification – even though the amount is only deferred, not forgiven.[28] As the Supplement Directive makes clear, "when a mortgage loan within a securitization vehicle

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[28] *See* Madden Affidavit, Exhibit 6 (U.S. Treasury Department, Supplemental Directive 10-05: Home Affordable Modification Program – Modification of Loans with Principal Reduction Alternative — Treatment of Principal Forbearance in HAMP, at 10 (Jun. 3, 2010)).

is modified under HAMP," "the servicer *must report* to the trustee . . . any forborne principal as a realized loss" and, in turn, the trustee "*must allocate* any such reported forborne principal as a realized loss to the trust."[29] Furthermore, the Supplemental Directive specified that when the servicer reports the forborne principal amount as a realized loss it "shall constitute 'standard industry practice' within the meaning of the Servicer Safe Harbor" under HAMP.[30]

What Triaxx and the FHLBs have neglected to address is what happens when the forborne principal is received by the Master Servicer from the borrower — either at maturity, or at the time of a sale or prepayment. Since the loan has been "written off" (*i.e.*, the forborne principal has been reported as a realized loss), upon receipt, the forbearance amount will be *reported* and *distributed* to the Trust under the PSAs as a Subsequent Recovery. Thus, the claim that the Master Servicer would simply retain the forborne principal is meritless.

V. Conclusion

For all the forgoing reasons, and for those stated in the Institutional Investors', and the Trustees', statements in support of the settlement, the Trustee's exercise of discretion in entering into the settlement should be approved.

Dated: New York, New York
May 13, 2013

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[29] *Id.* (emphasis added)

[30] *Id.* at 11 (emphasis added)

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