

Exhibit 78
to
Affidavit of Daniel M. Reilly
in Support of Joint Memorandum of
Law in Opposition to Proposed Settlement

REDACTED

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)

Petitioner,

for an order pursuant to CPLR § 7701 seeking
judicial instructions and approval of a
proposed settlement.

Index No. 651786/2011

Assigned to: Kapnick, J.

EXPERT REPORT OF PROFESSOR JOHN C. COATES IV

V. Opinions

I was asked by AIG to consider the steps that the Trustee had available to it to evaluate the Settlement, the steps that it did take, and the kinds of information that it could have obtained, whether through litigation or otherwise, that would be relevant to its evaluation of the Settlement. In particular, I was asked to focus on the steps available, steps taken, and information obtainable that was relevant to the position taken by CFC in its discussions with the Trustee, as described by the Trustee at paragraphs 79-81 of its Verified Petition, that “it, standing alone, would be unable to pay a judgment in the amount of the Settlement Amount,” and the position taken by BAC and CFC, as described by the Trustee at paragraphs 82-92 of the Verified Petition, that BAC “would prevail” on any claims “based on theories of successor liability, veil piercing or similar legal theories.” I have not conducted a complete study of the possible Claims, nor have I reached any bottom-line conclusions as to the outcome of such Claims were they to be brought. Nor have I conducted or had conducted for me any valuation of CFC’s assets, or a choice-of-law analysis. However, based on my prior practice experience as an attorney, my research and teaching of law with a focus on M&A, my consulting experience, and my consideration of the documents listed in Exhibit B, I have formed the following opinions:

A. Steps Available but Not Taken

The Trustee had available to it a number of steps that it could have taken to evaluate the Settlement, but has presented no evidence that I have seen that shows that it took these steps, or even considered taking them. These steps fall into six general categories: (a) evaluation of fraudulent conveyance, (b) evaluation of fiduciary duty claims; (c) evaluation of successor liability claims based on the PSAs; (d) evaluation of

direct liability for servicing-related losses; (e) probability weightings; and (f) evaluation of the costs and benefits of obtaining *verified* information relevant to the steps that it did take, such as by negotiating with BAC and/or CFC or *commencing* litigation before reaching a settlement, in order to obtain discovery.

1. Fraudulent conveyance claims

I have seen no evidence that the Trustee ever considered the possibility that CFC or its subsidiaries may have had assets in the form of potential fraudulent conveyance claims related to the merger of CFC into the Red Oak Merger Corporation on July 1, 2008 (the *Red Oak Merger*) or the subsequent series of transactions (the *Asset-Stripping Transactions*, described more fully in Exhibit C) through which BAC caused CFC to sell to BAC and its non-CFC subsidiaries substantially all of the operating assets of CFC and its subsidiaries, as well as transferring substantially of their employees to BAC and its non-CFC subsidiaries. If those transactions resulted in a fraudulent conveyance, the affected CFC entity could have had a basis to increase its assets by pursuing such a claim.

Nothing in the “valuation analysis” filed by Capstone Valuation Services, LLC (*Capstone Report*) considers the possibility that CFC or its subsidiaries could have increased their assets by bringing such a claim. While the possibility that fraudulent “underpayment” is discussed in the report of Professor Robert Daines (*Daines Report*) in his analysis of veil-piercing doctrine in Delaware and New York (at 18-22), the Daines Report does not undertake an analysis of possible fraudulent conveyance claims themselves. Because fraudulent conveyance claims can be premised on the ground of constructive fraud, they do not need to include proof of intent (or meet heightened pleading standards required in cases in which actual fraud is alleged). While constructive fraud claims would require proof that less than adequate consideration was paid in the

relevant transaction, there is no evidence in the record to suggest that the Trustee ever obtained and verified information about the consideration paid to CFC and its subsidiaries in the Asset-Stripping Transactions. The Capstone Report (at 5) expressly assumes (and states that they did not verify) that CFC and its subsidiaries were solvent and received reasonably equivalent value for any transfers in the Red Oak Merger and the Asset-Stripping Transactions. In fact, as discussed more below, even the directors and officers of CFC and its subsidiaries failed to obtain any sort of contemporaneous adequacy opinion, fairness opinion, solvency opinion, or other proof that the Asset-Stripping Transactions did not leave CFC and its subsidiaries insolvent and/or received less than fair value for their operating assets in those transactions, whether from an independent appraiser, investment bank or other party. Without investigating such claims, the Trustee had no way to test the “position” taken by CFC that its assets were less than the Settlement Amount or insufficient to satisfy a judgment or larger settlement amount.

2. Fiduciary duty claims

I have seen no evidence that the Trustee considered the possibility that CFC and its subsidiaries may have more assets than reflected in the Capstone report based on their having fiduciary duty claims against BAC or its subsidiaries. As discussed in Exhibit C, there is evidence that CFC and its subsidiaries were or may have been insolvent at the time of the Asset-Stripping Transactions. If they were insolvent, then the directors and officers of CFC and their subsidiaries at the time of those transactions owed a duty not just to the sole shareholder of CFC (i.e., BAC or one of its intermediate subsidiaries), but also to their creditors, including the Trusts. Because the Asset-Stripping Transactions involved BAC and its non-CFC subsidiaries purchasing stock and/or assets from CFC

and its subsidiaries, the interests of BAC and CFC were potentially divergent when it came to setting a price in those transactions. The more BAC had to pay, the more CFC stood to gain for itself (as a stand-alone entity) and for its creditors; the less BAC paid, the less CFC stood to gain, as a stand-alone entity and for its creditors. Therefore, any transaction between CFC and BAC's other subsidiaries, such as the Asset-Stripping Transactions, would have been a conflict-of-interest transaction.

The fiduciaries of CFC in approving such a transaction would ordinarily need to prove the transactions were "entirely fair," which would include not only a fair price – which could be more than the asset-by-asset value of the businesses being acquired, but might also need to include estimates of alternative uses for the assets, among other things – but also a fair process, including adequate notice to the beneficiaries of the fiduciary duties in question (which would include creditors, if CFC was insolvent), and, ordinarily, some effort by those fiduciaries to obtain the best reasonably available deal for CFC (which, again, might mean something more than an asset-by-asset valuation of CFC and its subsidiaries). None of this is even addressed in the evidence I have reviewed in this case. Without evaluating such claims, the Trustee had no basis for validly assessing CFC's assets, or capacity to pay more than the Settlement Amount.

3. Successor liability claims based on the PSAs

I have seen no evidence that the Trustee obtained information or evaluated successor liability claims based on the contract provisions of the PSAs. Specifically, the PSAs imposed obligations on CHLS that CHLS allegedly failed to perform. Liabilities arising from failure to perform those obligations were not subject to the defense that CFC had insufficient assets, for two reasons. First, Section 6.04 of the PSAs, which provides that no resignation of CHLS as Master Servicer under the Trusts would be effective

unless a successor servicer assumed all of CHLS's liabilities under the PSAs. Second, Section 6.02 of the PSAs required that any person into which CHLS may be merged would be that person's successor by operation of law, and CHLS has subsequently merged into a fully solvent subsidiary of BAC (Bank of America, N.A.), and is thus by operation of law successor to CHLS. I have seen no evidence that the Trustee considered these potential Claims or related facts in evaluating the Settlement, and Loretta Lundberg—a Bank of New York Mellon managing director and [REDACTED]

[REDACTED]—admitted that [REDACTED]
[REDACTED]

[REDACTED]¹ Additionally, Professor Daines testified that he [REDACTED]

[REDACTED]²

4. Direct liability for servicing-related losses

Loretta Lundberg also testified that [REDACTED]
[REDACTED]³ and I have seen no evidence that the Trustee evaluated the extent to which BAC and/or its subsidiaries may be liable for losses arising from their own improper servicing-related activities after the Red Oak Merger (in which BAC acquired CFC). Indeed, I understand that the institutional investor group represented by Gibbs & Bruns asserted in court pleadings that BAC servicing was the worst in the industry and identified how BAC's servicing caused harm to the Trusts. Any such claims would not be subject to corporate separateness defenses.

¹ Lundberg Dep. 428-29.

² Daines Dep. 194-95.

³ Lundberg Dep. 332-33.

5. Probability weightings

I have seen no evidence that the Trustee itself developed probability weightings for the various possible Claims, even with respect to those Claims that it did consider, nor that it asked third parties to assist in doing so. In any rational decision analysis, it is important to translate qualitative judgments about likely outcomes of uncertain events into probability weightings, in order to adjust appropriately the related payoffs and reduce the probability-weighted payoffs to an expected value. This is basic to any economic (indeed, any rational) analysis of any uncertain set of events. Neither the Capstone report, nor the Daines Report, nor the Professor Barry Adler's report (*Adler Report*) on [REDACTED] included probability estimates associated with their analyses of the claims they analyzed. Rather, they provided bottom-line estimates that the claims they analyzed were "difficult to win" (Daines Report, at 38) and [REDACTED] (Adler Report, at 13). It is needless to point out that a Claim with "only" (say) a 55% chance of winning still has a 45% chance of losing, and so might be fairly characterized as "difficult to win" or "not ... easily available". At the same time, a Claim with a 0.001% chance of winning could also be characterized as "difficult" or "not ... easily available."

The Trustee could not, without more analysis, which is nowhere reflected in the record that I have seen, translate these vague and qualitative conclusions into anything useful for evaluating the Settlement. One might have thought that the Capstone Report would be a place to look for such quantitative estimates, or ranges, but none there appears. Instead, Capstone expressly disclaims having engaged in this task: "Capstone has not analyzed the probability of a positive outcome for the Trustee in litigating the Claims or attempted to quantify the amount of any potential Judgment." (Capstone

Report at 5.) Nor did internal personnel at the Trustee testify that they engaged in such analysis, but instead stated [REDACTED]

[REDACTED]⁴ Instead, the Trustee seems to have translated “difficult to win” or “not ... easily available” into zero, without reason or basis.

6. Obtaining verified information, through discovery or otherwise

I have seen no evidence to suggest that the Trustee did any analysis – quantitative or qualitative – of the costs and benefits of *commencing* an action so as to obtain through the discovery process information about the facts relevant to the Claims, as opposed to litigating the case all the way to trial. The Verified Petition makes reference to the costs of full-blown litigation, which of course would be significant for any multi-billion dollar claim against a well-funded organization like BAC. But there is nothing in the Petition to suggest that the Trustee attempted to estimate the costs of initiating litigation, and pursuing discovery, and Robert Griffin – a Bank of New York Mellon managing director – admitted that [REDACTED]

[REDACTED]⁵ Even though those steps would likely generate some non-trivial costs, the likely increase in the ability of the Trustee to make better estimates of the likely outcomes of any fully litigated Claim would have been enormously benefited by incurring those costs.

Even without commencing litigation, moreover, the Trustee had at least some ability to obtain information from CFC and BAC through whatever leverage it had in the

⁴ See, e.g., Lundberg Dep. 143, 241-42, 332, 427, 452-54 and 469-74 [REDACTED]
[REDACTED]
Griffin Dep. 282 [REDACTED]
[REDACTED] Bailey Dep. 200 [REDACTED]
[REDACTED]

⁵ Griffin Dep. 219-20.

negotiations. Even a highly limited but specific request – focused, for example, on just the terms of the Asset-Stripping Transactions, or the degree to which those transactions might have resulted in a de facto merger of CFC into BAC – would have produced significant improvements in the ability of the Trustee or its expert advisors to probability-weight the likely outcomes of potential Claims, to negotiate with BAC and CFC to obtain sworn statements from knowledgeable participants in transactions relevant to those Claims, or otherwise to test and verify the formal and informal representations made by the potential defendants to the Claims, who had every incentive (as the potentially liable party) to omit relevant information or deflect the Trustee’s inquiries and prevent the Trustee from obtaining a materially true and complete understanding of the facts relevant to the Claims.

Finally, if BAC and CFC’s claims were in fact valid, then BAC and CFC, too, would have had an interest in allowing the Trustee to do more genuine factual investigation than the record suggests the Trustee did. The Trustee does not seem to have considered requesting sworn statements from percipient fact witnesses, from either CFC or BAC, as to the basis for BAC’s and CFC’s defenses. Had the Trustee obtained such statements and/or specific representations as to elements of the Asset-Stripping Transactions that were relevant to the likelihood of success on the fraudulent conveyance, fiduciary duty, contract, or direct and successor liability claims, the Trustee would have been able to make an informed judgment about the positions that BAC and CFC were taking in the Settlement discussions. Instead, the Trustee apparently decided to [REDACTED], BAC only represented in Section 13(b) of the Settlement Agreement that its representations were “not materially false or materially inaccurate,” as opposed to “materially true and complete” or the

[REDACTED]

[REDACTED]

[REDACTED]

3. Choice of Law Analysis

I have seen no evidence that the Trustee ever obtained a detailed and adequate choice-of-law analysis from a qualified expert who specializes in choice of law. Such an analysis is important in assessing the likelihood that a successor liability claim could successfully be brought against BAC. The reason such an analysis is important is demonstrated by the Daines Report, which correctly notes that there are different tests for successor liability in different jurisdictions.

While the Daines Report includes an appendix discussing choice of law, the Daines Report does not provide a detailed and adequate choice-of-law analysis that is consistent with the bottom-line of the report, including (for example) the fact that the Trustee (as plaintiff) would have had discretion as to where to bring a claim, including claims based on the PSAs, which would be governed by the choice of law clauses in the PSAs. Professor Daines even candidly stated at his deposition that he was [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Thus, the record evidence that I have reviewed suggests that the Trustee had no choice of law analysis or information for other claims.

The Daines Report does note that the Trustee would have had a choice as to where to bring an action, on whatever basis, and thus could have brought Claims in New York courts. The Daines Report also provides a partial summary of the law governing

⁹ Daines Dep. 271.

in the New York choice of law cases. Even there, the conclusion in the choice-of-law appendix to the Daines Report (at 41, “I do not expect” that New York courts would apply Delaware law) is stated rather differently than the conclusion to the report itself (at 38, “New York law may not ... apply”).

In combination, these factors should have at least alerted the Trustee to the need for a more careful analysis from a person who spends their time analyzing choice of law cases generally, and not just those involving corporate law disputes. The Trustee should also have considered the choice of law analysis more carefully, by getting some more detailed sense of how often and when cases involving *creditors* led courts to use interest analysis rather than the internal affairs doctrine. Finally, the Trustee should also have, as discussed above, considered putting some probability estimate on the outcome of such a choice of law analysis. A 50% or even 30% weighting of New York as the outcome of the choice of law analysis would have resulted in a significantly different bottom-line to the successor liability analysis overall, particularly once the facts that were available to the Trustee to obtain – discussed next – are considered.

C. Information Obtainable but not Obtained

Had the Trustee obtained a materially complete and accurate understanding of the facts relevant to the Claims, it would have learned a variety of things relevant to the Claims, as other plaintiffs have learned through the customary discovery process in other proceedings in which CFC has taken the position that it lacks assets to pay its liabilities (i.e., that it is or may be insolvent) and/or in which BAC has taken the position that neither it nor its non-CFC subsidiaries are successors to, or are otherwise liable for, the liabilities of CFC and its subsidiaries. Such information includes evidence falling into at least three categories of evidence showing that: (a) the Red Oak Merger and the Asset-

Stripping Transactions were inconsistent with M&A customs; (b) the Asset-Stripping Transactions had economic effects equivalent to those of a *de jure* merger of CFC into BAC; and (c) those transactions were approved in non-customary means for transactions involving a potential conflict of interest for the relevant fiduciaries and companies that were or may well have been insolvent. Each of these sets of information is discussed at length in the public version of a report I prepared for a separate litigation involving BAC and CFC, attached as Exhibit C.

Exhibit C shows, among other things, that the Asset-Stripping Transactions are not consistent with efforts to continue the operation of two separate businesses. What BAC accomplished through the Asset-Stripping Transactions—the integration of all of CFC’s lines of business into BAC’s lines of business—could have been accomplished thru a *de jure* merger. However, in that scenario, BAC and its non-CFC subsidiaries would have formally assumed all of CFC’s and CHL’s legal liabilities. The Asset-Stripping Transactions, on the other hand, are consistent with an effort to achieve the same integration of operations and business that would typically be accomplished through a *de jure* merger while also attempting to leave contingent liabilities behind in shell entities – in this case, CFC and its subsidiaries.

CFC and its subsidiaries had the same owners as if *de jure* merged into BAC rather than engaging in the Asset-Stripping Transactions, and BAC transferred to its non-CFC subsidiaries substantially all of the operating assets, employees, physical plant, goodwill, customer lists, and funding capacity, leaving CFC and its subsidiaries without business operations, solely devoted to disputing and/or paying contingent liability claims. BAC continues to operate the businesses that it transferred through the Asset-Stripping Transactions, and the revenues associated with those operations inure to the benefit of

BAC, not CFC or CHL. Before and after the November Transactions, the directors and officers of each of CFC, CHL and the Other Subs reported to and were directed by management of BAC. BAC has chosen to inject sufficient capital into CFC to allow it and its subsidiaries and then caused them to pay some, but not all, of their liabilities.

These facts are all relevant to any fair evaluation of the successor liability components of the Claims. Further facts analyzed in Exhibit C show the conflict-of-interest nature of the Asset-Stripping Transactions, and many facts relevant to fiduciary duty Claims arising out of those transactions, including the fact that the Asset-Stripping Transactions were approved with a cursory process that did not adhere to customs and practices for such transactions. Exhibit C also reflects evidence tending to show that CFC was or may have been insolvent at the time of the Asset-Stripping Transactions, raising the possibility that the Asset-Stripping Transactions were or included fraudulent conveyances. The Trustee does not appear to have reviewed any of these facts in detail, and while the Daines Report and the Capstone Report do contain a general description of some of these facts, considerably more detail even as to those would have been available had the Trustee attempted to verify information supplied by BAC that was relevant to the Claims.

VI. Conclusion

In conclusion, it is my opinion, based on my experience, research, consulting, and teaching, that the Trustee had available to it many steps that would have enabled it to engage in an adequate evaluation of the Claims, many of which it did not take at all, and some of which it did take but in such a constrained and limited fashion as to undermine significantly their value for arriving at an objective understanding of the potential value of the Claims, and thus for an objective evaluation of the Settlement. Had the Trustee