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

In the matter of the application of

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

Petitioners,

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

Index No. 651786/2011

Assigned to: Kapnick, J.

SUPPLEMENTAL BRIEF IN OPPOSITION TO THE PROPOSED SETTLEMENT

I. INTRODUCTION

Pursuant to the February 26, 2013 Amended Scheduling Order, the Federal Home Loan Banks of Boston, Chicago, and Indianapolis ("FHLBs") and the Triaxx entities ("Triaxx") respectfully submit this supplemental brief in opposition to the proposed settlement. In addition to the Joint Memorandum of Law in Opposition to the Proposed Settlement in which they join in full (*see* Doc. No. 588), the FHLBs and Triaxx object because the proposed settlement ("Settlement") releases two categories of valuable claims without proper investigation or valuation, or *any recovery at all* for the Trusts with regard to the claims.

The first category of improperly released claims relates to the failure of the Master Servicer—Bank of America and Bank of America Home Loans Servicing (collectively "BofA") or Countrywide Financial Corporation and Countrywide Home Loans, Inc. (collectively "Countrywide")—to repurchase modified loans as required by approximately 90% of the applicable Pooling and Servicing Agreements ("PSA"s). The second category concerns self-dealing by the Master Servicer with regard to second liens and balloon payments due on modified loans.

The undersigned raised these specific issues with The Bank of New York Mellon ("BNYN" or "Trustee") in correspondence, and subsequently in a telephonic meeting with the Trustee. On May 2, 2013—notably one day prior to the objection deadline—counsel for the Trustee responded by telephone, and indicated, without explanation, that the Trustee disagreed with the undersigned's interpretation of the PSA provision requiring repurchase of modified loans. Counsel for the Trustee further indicated that the Trustee was still researching the Master Servicer self-dealing allegations – a confusing response in light of the Trustee's release of these claims in the Settlement. Accordingly, because no information was provided that resolved the

concerns raised by the undersigned, and there is no evidence in the record justifying the release of these two categories of valuable claims without investigation, valuation, or recovery, the undersigned submit this supplemental objection to the Settlement.

II. DISCUSSION

A. The Settlement improperly releases claims against the Master Servicer for failing to repurchase Modified Mortgage Loans.

Under the PSAs for approximately 468 of the 530 Covered Trusts subject to the Settlement, the Master Servicer has an express obligation to repurchase Modified Mortgage Loans. *See, e.g.*, §§ 3.11(b) or 3.12(a) of the applicable PSAs.[1] Specifically, § 3.11(b) of some of the PSAs state:

> Countrywide *may agree to a modification of any Mortgage Loan* (the "Modified Mortgage Loan") if (i) the modification is in lieu of a refinancing, (ii) the Mortgage Rate on the Modified Mortgage Loan is approximately a prevailing market rate for newly-originated mortgage loans having similar terms and (iii) *Countrywide purchases the Modified Mortgage Loan from the Trust Fund as described below.*[2]

Meanwhile, § 3.12(a) of other PSAs state:

> The Master Servicer *may agree to a modification of any Mortgage Loan* (the "Modified Mortgage Loan") if (i) CHL [[Countrywide)] *purchases the Modified Mortgage Loan from the Trust Fund immediately following the modification as described below* and (ii) the Stated Principal Balance of such Mortgage Loan, when taken together with the aggregate of the Stated Principal Balance of all other Mortgage Loans in the same Loan Group that have been so modified since the Closing Date at the time of those modifications, does not exceed an amount equal to 5% of the aggregate Certificate Principal Balance of the related Certificates.[3]

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[1] Unless otherwise indicated, capitalized terms used and not defined herein have the meaning ascribed to such terms in PSAs for the pools of residential mortgage-backed securities held by the trusts (the "Trusts") covered by the proposed Settlement between The Bank of New York Mellon (the "Trustee"), Bank of America Corporation ("BofA"), BAC Home Loans Servicing, LP ("BofA Servicing"), Countrywide Financial Corporation ("CFC") and Countrywide Home Loans, Inc. ("CHL").

[2] *See* Affirmation of Derek W. Loeser, Exhibit A (citing to PSA for CWL 2006-9) (emphasis added).

[3] *See* Loeser Affirm., Ex. B (citing to PSA for CWALT 2007-OA4) (emphasis added).

In addition to these plain terms, the Prospectus Supplements related to the Certificates confirm that a Modified Mortgage Loan must be repurchased by the Master Servicer. For example, one prospectus states: "The master servicer may modify any mortgage loan *provided that the master servicer purchases the mortgage loan from the trust fund immediately following the modification*."[4]

Despite this obligation to repurchase Modified Mortgage Loans in the Trusts, there is no indication—from the discovery produced in this litigation or otherwise—to suggest that BofA or Countrywide have done so. Furthermore, 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 Mortgage Loans. And, yet, the Settlement releases all claims related to this issue. *See* Settlement Agreement, ¶ 9(a) (releasing claims related to "the servicing of the Mortgage Loans held by the Covered Trusts . . . including any claim relating to . . . an obligation to take any action or provide any notice towards, or with respect to, the possible repurchase of Mortgage Loans by the Master Servicer, Seller, or any other Person").

As previously shown to the Trustee and to the Court in correspondence dated February 1, 2013, a substantial number of loans have been modified by BofA and Countrywide. There are approximately 134,000 Modified Mortgage Loans in the 468 Trusts containing the repurchase language described above. *See* Doc. No. 518, Ex. A.[5] As a result, these Trusts have claims ("Modified Mortgage Loan Repurchase Claims") worth potentially in excess of $30 billion. *Id.*

[4] *See* Loeser Affirm., Ex. C (citing to Prospectus Supplement for CWALT 2005-86CB) (emphasis added).

[5] *See also* Loeser Affirm., Ex. D.

At the time it agreed to the proposed settlement, the Trustee was aware of the Trusts' Modified Mortgage Loan Repurchase Claims. In 2009, one of the Inside Institutional Investors, Kore Capital L.L.C., Redacted .[6] In addition, in December 2010, Redacted

[7] The Trustee's counsel, Jason Kravitt, also inquired whether there would be " Redacted

[8]

Rather than investigating these claims, notifying Certificateholders of them, or recovering anything for them, the Trustee agreed to release these claims despite the requirement under the PSAs to repurchase Modified Mortgage Loans. Indeed, Richard Stanley—a BNYM senior managing director and chair of the Trust Committee that ultimately made the decision to approve the Settlement—testified that Redacted

[9] And although the Settlement states that it does not amend the PSAs (*see* Settlement Agreement, ¶ 5(g)), in fact, it does just that by allowing modifications *on a going forward basis* without repurchase. *See* Settlement, ¶ 5(e) (loan modifications undertaken pursuant to the Settlement "shall be deemed to be permissible under the terms of the applicable" PSAs). The Trustee has no authority to amend the terms of the PSAs, let alone the authority to do so without notifying Certificateholders or obtaining their consent. Likewise, the Settlement tramples on

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[6] *See* Loeser Affirm., Ex. E (citing to BNYM_CW-00253772-775).

[7] *See* Loeser Affirm., Ex. F (citing to BNYM_CW-00270570-72).

[8] *Id.* at BNYM_CW-00270572.

[9] *See* Loeser Affirm., Ex. G (citing to Deposition of Richard Stanley at 253:19-22).

Certificateholders rights' by absolving BofA and Countrywide of the clear obligation under the PSAs to repurchase Modified Mortgage Loans.

B. The Settlement improperly releases claims against the Master Servicer for self-dealing with regard to Modified Mortgage Loans.

The Master Servicer is required by the PSAs to service the loans prudently. *See, e.g.*, PSA § 3.01 (governing the Master Servicer's prudent servicing obligations). Self-dealing plainly is inconsistent with prudent servicing and is prohibited by the PSAs. *See id.* ("[T]he Master Servicer shall take no action that is inconsistent with or prejudices the interests of the Trustee or the Certificateholders in any Mortgage Loan.").

As set forth in the February 1 letter, Triaxx used sophisticated data mining techniques to evaluate public and proprietary data concerning modifications of loans held by the Trusts. *See* Doc. No. 518. Based on this review, Triaxx discovered self-dealing by the Master Servicer. One type of self-dealing involved first lien loans held by the Trusts where BofA or Countrywide held second lien loans on the same subject properties. The data reviewed by Triaxx demonstrated 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. Thus, in effect, BofA and Countrywide gave priority to the second liens they owned over the first liens owned by the Trusts. This is self-dealing writ-large, and contrary to both black letter law that first liens take priority over second liens, as well as the prudent servicing requirements of the PSAs.

The undersigned provided the Trustee with three examples of this specific type of self-dealing. *See* Doc. No. 518, Ex. A. The Trustee was also informed BofA held a substantial amount of second lien mortgages. In fact, publicly available information reveals that at the end

of 3Q 2012, BofA held more than $116 billion in these mortgages.[10] Hence, the Trustee is aware that BofA stands to reap enormous financial benefit from second lien self-dealing.

Another form of self-dealing brought to the Trustee's attention concerns balloon payments at the end of the loan period from a borrower on modified loans. Triaxx discovered instances in which investors were informed that modified loans were written off by the Trusts, and, yet, BofA may retain the right to receive balloon payments on the modified loans. There is no justification for BofA not to distribute balloon payments on loans owned by the Trusts *to the Trusts*. Such payments should offset or mitigate the Trusts' losses; instead, it appears that BofA may retain the payments.

In a call among counsel for the Trustee, the Triaxx entities and the FHLBs, counsel for the Trustee initially refused to answer any questions regarding the Master Servicer's self-dealing. In a subsequent call on May 2, 2013, counsel for the Trustee indicated that he believed the Trusts would forward balloon payments, but could not identify a document requiring the same. Counsel further indicated that the Trustee was doing more research on the second-lien issues. However, the Trustee already agreed to release *all* servicing-related claims for servicing abuses "in all cases prior to or after the Approval Date." Settlement Agreement, ¶ 9(a). While it is welcome news that the Trustee is now researching these issues, the fact that it is doing so *after* agreeing to release the claims is deeply troubling. The Trustee has not and cannot provide any legitimate rationale for releasing claims without first investigating them. Nevertheless, the broad release of all abuses by the Master Servicer does just that.

[10] http://www.nytimes.com/2013/02/04/business/new-questions-raised-over-a-bank-of-america-settlement.html?_r=0 (last visited on May 3, 2013).

C. The Trustee cannot satisfy its burden of establishing that the release of Modified Mortgage Loans and self-dealing claims is reasonable and in the best interests of the Trusts.

This Court has previously held that the Trustee, at a minimum, owes a fiduciary obligation to "act with a singleness of purpose and to have a duty of loyalty to the Certificateholders." *See* Tr. 159:16-160:11 Aug. 2, 2012. To the extent an Event of Default occurred, consistent with the PSAs and well-established New York law, the Trustee also owes a duty to "use the same degree of care and skill in their exercise as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs." *See* PSA § 8.01; *see also Beck v. Mfrs. Hanover Trust Co.*, 218 A.D.2d 1, 12-13 (1st Dep't 1995).

The Trustee's release of Modified Mortgage Loan and Master Servicer self-dealing claims without proper investigation, or evaluation, and without any redress at all to the Trusts, violates these duties owed by the Trustee to the Trusts. Simply put, valuable claims that have not been fully investigated or evaluated should not have been given away for free. Furthermore, the Trustee's conduct cannot be squared with the broad relief sought by the Trustee in the PFOJ, including findings by the Court that: (1) the Trustee "appropriately evaluated . . . the strengths and weaknesses of the claims being settled"; (2) "the Trustee's deliberations appropriately focused on the strengths and weaknesses of the Trust Released Claims, the alternatives available or potentially available to pursue remedies for the benefit of the Trust Beneficiaries"; and (3) "[t]he Trustee acted in good faith, within its discretion, and within the bounds of reasonableness in determining that the Settlement Agreement was in the best interests of the Covered Trusts." *See* PFOJ, ¶¶ (i), (j), and (k). Finally, the Trustee has done nothing to carry its burden of proving that the release of these claims was an appropriate exercise of the Trustee's discretion or

consistent with its duties under the PSAs and New York law. Accordingly, the undersigned object to the Settlement and the relief sought by the Trustee in connection with the Settlement.

III. CONCLUSION

For the reasons set forth herein and in the Joint Memorandum of Law in Opposition to the Proposed Settlement, the FHLBs and Triaxx respectfully submit that the Settlement should not be approved by the Court.

DATED: May 3, 2013.

RESPECTFULLY SUBMITTED,

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