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

In the matter of the application of U.S. BANK NATIONAL ASSOCIATION, THE BANK OF NEW YORK MELLON, THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., WILMINGTON TRUST, NATIONAL ASSOCIATION, LAW DEBENTURE TRUST COMPANY OF NEW YORK, WELLS FARGO BANK, NATIONAL ASSOCIATION, HSBC BANK USA, N.A., AND DEUTSCHE BANK NATIONAL TRUST COMPANY (as trustees under various Pooling and Servicing Agreements and indenture trustees under various Indentures), Petitioners, for an order, pursuant to CPLR § 7701, seeking judicial instruction.	Motion Sequence No. 4 Index No. 652382/2014 Assigned to: Friedman, J

THE INSTITUTIONAL INVESTORS' MEMORANDUM OF LAW
<u>ON THE SCOPE OF DISCOVERY</u>

Kenneth E. Warner, Esq.
WARNER PARTNERS, P.C.
950 Third Avenue, 32nd Floor
New York, New York 10022
212-593-8000
kwarner@warnerpc.com

Kathy Patrick, Esq. (*pro hac vice*)
Robert Madden, Esq. (*pro hac vice*)
David Sheeren, Esq. (*pro hac vice*)
GIBBS & BRUNS, LLP
1100 Louisiana, Suite 5300
Houston, Texas 77002
713-650-8805
kpatrick@gibbsbruns.com
rmadden@gibbsbruns.com
dsheeren@gibbsbruns.com

Attorneys for Intervenor-Petitioners, the Institutional Investors

In this Article 77 Proceeding, seven RMBS Trustees seek a single finding: that "their acceptance of the Settlement on behalf of each of the Accepting Trusts comports with all applicable duties under the Governing Agreements and any other applicable law." Petition (Pet.) at ¶ 75. They seek a single form of relief: "that the Certificateholders are barred from asserting claims against any Trustee with respect to such Trustee's evaluation and acceptance of the Settlement in accordance with its terms as memorialized in the Settlement Agreement." *Id.* In deciding whether to grant this relief, the Court must determine a single issue: Were the Trustees' settlement decisions made in good faith and within the bounds of their reasonable discretion?[1] This is a deferential standard under which the Court evaluates the reasonableness of the process, rather than the content,[2] of each Trustee's decision or performance.[3] The Court also may not

[1] *Haynes v. Haynes*, 72 A.D.2d 535, 536 (1st Dep't 2010) ("Where a trustee has discretionary power, its exercise should not be the subject of judicial interference, as long as it is exercised reasonably and in good faith."). RESTATEMENT (SECOND) OF TRUSTS § 187 cmt e (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.").

[2] *In re Clark's Will*, 257 N.Y. 132, 136 (1931) ("In determining whether the acts of a trustee have been prudent, within the meaning of the rule, we must look at the facts as they exist at the time of their occurrence, not aided or enlightened by those which subsequently take [effect]; for it is an obvious truth that a wisdom developed after an event, and having it and its consequences as a source, is a standard no man should be judged by; and it is impossible to say that trustees are wanting in sound discretion 'simply because their judgment turned out wrong. . . . Furthermore, the distinction between negligence and mere error of judgment must be borne in mind. Trustees acting honestly, with ordinary prudence and within the limits of their trust, are not liable for mere errors of judgment.") (citations and quotations omitted). *See also* 106 N.Y. Jur. 2d Trusts § 383 ("A trustee's performance is not judged by success or failure – i.e., right or wrong – and while negligence may result in liability, a mere error in judgment will not.")

[3] RESTATEMENT (THIRD) OF TRUSTS § 77, cmt. a (2007) ("The test of prudence is one of conduct not of performance."). *See also* J. Alan Nelson, Comment, *The Prudent Person Rule: A Shield for the Professional Trustee*, 45 Baylor L. Rev. 933, 938 (1993) ("The court's focus in applying the Prudent Investor standard is conduct, not the end result."); McKinney's EPTL § 11-2.3(b)(1) (Prudent Investor Act) ("The prudent investor rule requires a standard of conduct, not outcome or performance."); and, *In re JPMorgan Chase Bank, N.A.*, --- N.Y.S.2d ----, 2014 WL 5902477, at *3 (4th Dep't 2014) (quotations omitted) ("Thus, it is well settled that a fiduciary's conduct is not judged strictly by the success or failure of the investment ... In short, the test is prudence, not performance, and therefore evidence of losses following the investment decision does not, by itself, establish imprudence.")

substitute its judgment for that of the Trustees unless it finds that the Trustees acted dishonestly[4] or outside the discretion conferred by the PSAs.[5]

The summary nature of this "special proceeding,"[6] the limited nature of the Trustees' requested relief, and the deferential standard of review the Court must apply, set important limits on the scope of the discovery (if any) the Court should permit in this proceeding.[7] Here, the Trustees have engaged in robust pre-settlement disclosures, and have agreed to produce the universe of *relevant* information, so the discovery the Objectors seek is not required.[8]

1. Inquiries Into the Merits of the Settled Claims Are Improper

The Court's role in this Article 77 Proceeding is limited to ensuring that the Trustees have not acted in bad faith or abused of their discretion. It not the Court's task to conduct its own inquiry into whether the Trustees' exercise of discretionary judgment was "right or wrong."[9]

[4] *In re Clark's Will*, 257 N.Y. at 136 ("Trustees acting honestly, with ordinary prudence and within the limits of their trust, are not liabile for mere errors of judgment.").

[5] *Haynes*, 72 A.D.2d at 536 (Trustee's exercise of discretionary power should not be disturbed when power is exercised reasonably and in good faith); *accord* RESTATEMENT (SECOND) OF TRUSTS §187.

[6] An Article 77 proceeding is a "special proceeding." CPLR § 7701 ("a special proceeding may be brought to determine a matter relating to any express trust"). "By its nature a special proceeding is an expedited process the hallmarks of which are speed, economy and efficiency." *Ford v. Pulmosan Safety Equip. Corp.*, 13 Misc.3d 1242(A) (Sup. Ct. Queens Cnty 2006). *Accord Council of City of New York*, 6 N.Y.3d 380, (2006) ("a special proceeding . . . is brought on with the speed and economy of a mere motion [and] is designed to facilitate a summary disposition of the issues presented.") (citations and quotations omitted).

[7] Article 77 proceedings are summary in nature and are intended to be resolved with "expedition and economy." *Gregory v. Wlkes*, 26 Misc.2d 641, 642 (Sup Ct. N.Y. Cnty. 1960). Accordingly, discovery is to be limited to the "petitioners acts as trustee insofar as they relate to the validity of the [conduct at issue]." *In re Beeman*, 108 A.D.2d 1010, 1012 (3rd Dep't 1985). And discovery seeking inquiry into matter that "extend[s] beyond the scope of th[e] proceeding" is not permitted. *Id. Accord Andrews v. Trustco Bank, N.A.*, 289 A.D.2d 910, 913 (3rd Dep't 2001) (denying discovery beyond the scope of trustees conduct placed at issue as "too broad, or irrelevant, or both").

[8] Unless otherwise noted, internal citations are omitted and all emphasis is added.

[9] "A trustee's performance is not judged by success or failure – i.e., right or wrong." 106 N.Y. Jur. 2d Trusts § 383 (2014). *Accord In re Clark's Will*, 257 N.Y. at 136 ("it is impossible to say that trustees are wanting in sound discretion simply because their judgment turned out wrong"); *In re Cowles' Will*, 22 A.D.2d 365, 377 (1st Dep't. 1965) ("[F]allibility in matters of business judgment is not a standard of liability. The surcharge here is not justified because the trustee's judgment turned out wrong.")

Thus, the scope of discovery does not include discovery directed to the merits of the underlying claims or the adequacy of the settlement consideration. Equally out of bounds is discovery aimed at whether the settlement is in the best interest of a particular certificateholder. The PSAs require the Trustees to consider the best interest of *all* certificateholders *collectively*, *see* PSA §8.01, so discovery concerning a certificateholder's idiosyncratic interests is not relevant to the Trustee's exercise of settlement discretion.

2. Inquiries Into the Trustees' Pre-Settlement Conduct Are Improper

Certain Objectors have served requests regarding the Trustees' pre-settlement conduct, ostensibly to support their "objection" that the Trustees settled to avoid being sued by the Institutional Investors for failing to pursue Trust Claims. Nothing in the settlement releases the Trustees for *any* pre-settlement conduct that occurred before the Trustees received, evaluated, accepted, and sought to implement the Settlement, so this discovery is not relevant. If granted, this discovery would also plunge the Court (and the thousands of certificateholders who want the settlement to be confirmed swiftly) into a lengthy fishing expedition in which the Objectors seek to litigate by proxy a lawsuit against the Trustees they have not filed (and may never file).

3. Inquiries Into Experts' Analysis, Methodologies, and Conclusions Are Not Relevant

Objections that the Trustees' experts allegedly made a methodological error, and discovery requests aimed at investigating these alleged errors, are equally irrelevant. No part of the Court's inquiry into whether the Trustees acted in good faith or within their reasonable discretion turns on whether the Trustees' experts were "correct" in their conclusions or their analysis.

New York law is clear that the *correctness* of the underlying expert opinion on which a trustee relies in making a discretionary judgment is irrelevant to an assessment of the trustee's

good faith and reasonableness: "Nor is the Trustees' good faith put in question merely by virtue of the fact that the opinion relied upon may have been wrong; to so hold would eviscerate the opinion of counsel defense." *Cruden v. Bank of New York*, 957 F.2d 961, 972 (2d Cir. 1992). *See also In re Clark's Will,* 257 N.Y. 132, 136 (1931) (trustee not liable for breach of trust where trustee relied on advice of experts, notwithstanding that the advice later proved to be wrong). [10]

4. Discovery Concerning Settlement Negotiations is Not Relevant.

Objectors have also served document requests on the Institutional Investors seeking their settlement communications with JPMorgan.

The Trustees do not seek any finding concerning the settlement negotiations or their substance. In fact, (i) the Trustees' Petition makes clear that the Trustees played *no role at all* in the settlement negotiations; Pet. ¶1; and (ii) the Trustees' expert, Prof. Fischel, confirms that he formed his recommendation to the Trustees without any knowledge at all of the settlement negotiations; *See* Fischel Rep't. at 17, 50,82-88. Since the Article 77 Petition seeks no relief

[10] *See also In re Wainwright's Estate*, 55 N.Y.S.2d 303, 307 (Sur. Ct. Queens Cnty 1945) (Trustee "carefully reviewed the problem, consulted with counsel and secured the advice of a qualified person experienced in real estate values, reconditioning and the future economic possibilities of the property....In view of all the circumstances, I find no basis for imposing any liability upon the trustees for pursuing the course taken by them."); *In re Fensterer's Estate*, 79 N.Y.S.2d 427, 431 (Sur. Ct. Bronx Cnty 1948) ("The executor was confronted with a problem which required the services of an accountant and an attorney. He was entitled to rely upon their advice, and in so doing, is protected from charges of bad faith and negligence."); *In re Joost's Estate*, 50 Misc. 78, (Sur. Ct. King Cnty 1906), aff'd 126 A.D. 932 (2nd Dep't 1908) ("The question, therefore, is not whether or not [expert's] advice was correct as a matter of law, but was the executor, who in good faith sought such advice and followed it, discharging his duty by the estate, or was it his duty, upon the receipt of such advice, to disregard it and proceed to endeavor to collect this note? ... where, in the course of the administration of his trust, [an executor] is confronted with any question which requires the advice of a skilled specialist and in good faith seeks such advice, receives the same, and acts thereon, he is not held accountable for the consequences of following it."). *Accord* RESTATEMENT (THIRD) OF TRUSTS § 77, cmt. b (2007) ("As necessary or appropriate to informed decision making, care may also call for obtaining and considering the advice of others on a reasonable basis. It is ordinarily satisfactory that information or advice be obtained from sources on which prudent property owners or managers in the community customarily rely.").

regarding the settlement negotiations, and since the Trustees' settlement decision did not consider those negotiations, they are not relevant to any issue in this proceeding.[11]

5. Holdings Discovery is Relevant.

Under the PSAs, the Trustees' duties run to current certificateholders. The PSAs also preclude individual certificateholders from invoking trust rights to advance their individual interests at the expense of all Certificateholders.[12] Standing and the relevant contract provisions thus require the Court to ascertain that the party lodging an objection: a) actually holds certificates, and b) held them before the settlement offer or its acceptance by the Trustees.

This case concerns the reasonableness of the Trustees' actions once the settlement offer was received, during the period it was being evaluated, and once it was accepted. It is highly relevant, therefore, whether the Objectors were actually holders of certificates at any of these points in time. A certificateholder who bought certificates *after* the settlement offer or its acceptance may be seeking to advance its *own individual interests* through the assertion of an opportunistic objection. Discovery of the Objectors' holdings, and the timing of their purchases relative to these key dates are highly relevant in this proceeding.[13]

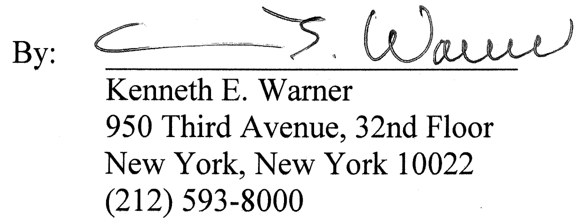
[11] The negotiations also are not discoverable. They occurred in a mediation conducted under California law, before a California-based mediator. California's mediation statute imposes "clear and absolute" prohibitions on the discovery of communications made in a mediation. *Cassel v. The Superior Court of Los Angeles County*, 51 Cal.4th 113, 117, 244 P.3d 1080, 1083 (Cal. 2011). New York law also protects the confidentiality of mediation communications. *Compare Lynbrook Glass & Architectural Metals, Corp. v. Elite Assocs., Inc.*, 656 N.Y.S.2d 291, 292 (2d Dep't. 1997) (denying disclosure of mediation communications).

[12] *See* PSA §10.08.

[13] The Objectors appear to concede the relevance of holdings information as of these dates, as they have served virtually identical discovery requests on the Institutional Investors.

Dated: New York, New York
December 9, 2014

WARNER PARTNERS, P.C.

By: 

Kenneth E. Warner
950 Third Avenue, 32nd Floor
New York, New York 10022
(212) 593-8000

GIBBS & BRUNS LLP
Kathy D. Patrick (*pro hac vice*)
Robert J. Madden (*pro hac vice*)
David Sheeren (*pro hac vice*)
1100 Louisiana, Suite 5300
Houston, Texas 77002
(713) 650-8805

Attorneys for Intervenor-Petitioners, the Institutional Investors