UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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|---|---|---|
| BANK OF AMERICA, NATIONAL ASSOCIATION, BANC OF AMERICA SECURITIES LLC, and U.S. BANK NATIONAL ASSOCIATION, solely in its capacity as Trustee under the Indenture | : | |
| Plaintiffs, and | : | Civil Action No. 08cv9265 (AJN) |
| BANC OF AMERICA SECURITIES LLC, | : | ECF Case |
| Counter Defendant, | : | |
| - against - | : | |
| BEAR STEARNS ASSET MANAGEMENT INC., RALPH CIOFFI, MATTHEW TANNIN, and RAYMOND McGARRIGAL, | : | |
| Defendants/Counter Claimants | : | |

**PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO**
**DEFENDANTS' MOTION FOR SUMMARY JUDGMENT**

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## INTRODUCTION

Defendants' motion largely previews their jury arguments—but does not come close to meeting the exacting standards for summary judgment. Far from establishing that they are entitled to judgment as a matter of law because of the *absence* of disputed material facts, defendants rely—at every turn—on hotly contested and highly material questions of fact that are the quintessential province of the jury:

"It was the subprime market's fault, not ours."

"It was Bank of America's own fault, not ours."

"If only BofA's CDO-structuring desk had shared our May 23, 2007 letter with BofA's repo-financing desk, at least the repo would have turned out differently."

In the fullness of time, a jury may accept defendants' spin on the record—who knows? The jury *may*, for example, find that plaintiff's losses were caused *entirely* by the collapse of the subprime market, and not even in part by the disclosure of the "concealed information concerning the Funds." Defendants' Amended Memo. of Law ("Memo.") 29. But the jury may instead credit what defendant Matthew Tannin said contemporaneously, in an unguarded moment (Ex. 162):

> The rather straight forward non-sexy story is that our hedge fund ran into very serious problems very quickly when the "market" became very very afraid that the underlying risk in our portfolio was much different (worse) than everyone had been thinking. I could write a book or two about all of the details – but they are just details. We owned a lot of stuff (again I could write about numbers with lots of zeros at the end but none of this is meaningful without a lot more context). The simple answer is that we did not have enough flexibility (the artful term is "liquidity") to reduce the size of our portfolio quickly enough. When the "market" realized that we were going to have to sell a good deal of our portfolio it became very difficult for us to sell anything. Prices then deteriorated very quickly and there was a negative cascading effect that ended up affecting many of the larger banks on Wall Street. The securities we'd been investing in (sub-prime mortgages – again just words without a lot of context) had been in the news for a

> while – and our trouble was sort of the straw that broke the camel's back in the market.
>
> Our problems were not limited simply to the two funds we ran that owned these securities. Bear Stearns, the firm, became involved for all sorts of reasons and the resulting losses on our part have affected things at the "big" Bear considerably. Nothing quite like this had ever happened to Bear before so it was big news all around.

We don't pretend to know which account—on this or any other issue—the jury will ultimately accept. But summary judgment is no substitute for a jury trial. *See, e.g.*, *Gibson v. Am. Broad. Cos.*, 892 F.2d 1128, 1132 (2d Cir. 1989). And as shown below, there is abundant evidence on which a jury can find for plaintiffs on each and every claim:

I. There is ample evidence to support BofA's CDO^2 fraud claim (Count II). Although defendants contend that they had no duty to disclose the massive investor redemptions facing their hedge funds, the proof shows otherwise. First, defendants participated in a pre-closing due-diligence phone call, and were asked, point blank, whether there were any material developments BofA should know of. Yet defendants remained conspicuously silent about the redemptions. Under settled principles, defendants were obligated to tell the whole truth once they spoke at all. Beyond that, the "superior knowledge" doctrine independently imposed a duty to disclose the redemptions. Defendants' quarrel with that doctrine misstates the law and fails to grapple with the record.

II. There is ample evidence to support BofA's repo fraud claim (Count IV). It is undisputed that defendants never said a thing about the redemptions to BofA's repo desk or to its repo-credit officer. And defendants get no credit—much less *judgment*—simply because they made a belated (*after* a "binding agreement") and misdirected (*only* to the CDO-structuring desk) disclosure that only partially (*just* about the EL Fund) revealed the truth.

III. There is ample evidence to support the Trustee's breach-of-fiduciary-duty claim (Count III). Although defendants insist that they owed no fiduciary duties as the Issuer's "Collateral Manager," the Collateral Management Agreement says otherwise. Defendants' contrary view rests on a palpable misreading of the deal documents and a gerrymandered account of the facts.

IV. There is ample evidence of proximate cause on all claims—negating the *only* ground defendants' offer for judgment on the CDO^2 Contract Claim (Count I). Under New York law, a plaintiff must prove that the securities it was wrongfully induced to buy lost their inflated value when the market learned the truth. That is exactly what we will do.

Defendants have demanded a trial by jury, and this Court should give them one.

## BACKGROUND

### A. BofA And BSAM Partnered On A $4 Billion CDO^2

On March 9, 2007, Bear Stearns Asset Management ("BSAM") signed a contract (the "Engagement Letter") retaining Bank of America Securities LLC ("BAS") and its affiliates—including Bank of America National Association ("BANA," and with BAS, "BofA")—to structure, underwrite, and market a $4 billion CDO-squared transaction (or "CDO^2"). Ex. 5.[1] A CDO^2 is a debt instrument that issues securities (such as commercial paper) and is backed chiefly by securities issued by other CDOs. CDOs, in turn, are debt instruments typically backed by still other instruments, such as mortgage-backed securities.

The Engagement Letter established the parameters of the CDO^2 transaction. BSAM agreed to establish the "Issuer"—the entity that would issue securities from the CDO^2—and to

[1] Citations to Exhibits 1–99 refer to the Exhibits to the Declaration of Jason M. Moff, submitted in support of Defendants' Motion for Summary Judgment. Citations to Exhibits 100–204 refer to the Exhibits to the Declaration of Matthew M. Madden, filed contemporaneously with this Memorandum.

serve as the Issuer's "Collateral Manager." Ex. 5 at ¶¶ 1(a), 2(ii), 4. As Collateral Manager, BSAM was "solely responsible" for, and would "independently make," all of the Issuer's investment decisions. *Id.* at ¶ 4.

BAS agreed to be the CDO^2's "sole underwriter" (Ex. 5 at ¶ 1(a))—the guaranteed purchaser of the CDO^2's senior-most (and largest) class of securities, the "Super Senior." BAS could fulfill that role either by directly buying the Super Senior, or by financing those securities in the short-term commercial paper ("CP") market and guaranteeing (via a "2a-7 put") to repay CP investors if there were no buyers for the CP when it matured. *Id.* at ¶ 5(a); *see also* Ex. 179 (Castro Rpt.) ¶ 31. In either case, BofA would be taking on risk to the Super Senior's 81% of the CDO^2's securities. For its part, BSAM agreed to purchase the CDO^2's junior debt securities (the "Mezzanine Tranches") and its equity (or "Preference Shares"). Plaintiffs' Rule 56.1 Counter-Statement ("Counter-Stmt.") ¶ 11.

The CDO^2 was to be collateralized at closing with "Initial Collateral" comprising assets purchased from BSAM's two principal hedge funds—the High Grade Structured Credit Strategies fund ("HG") and the High Grade Structured Credit Strategies Enhanced Leverage fund ("EL," and together the "Funds"). Counter-Stmt. ¶¶ 3, 8. The Funds were the heart of BSAM's "high-grade" business platform managed by Senior Portfolio Managers Ralph Cioffi, Matthew Tannin, and Raymond McGarrigal (the "Individual Defendants"). *Id.* ¶ 3.

BSAM's reputation and management abilities were critical to BofA's willingness to participate in the CDO^2. As defendant Tannin put it, "NO ONE else could" have "secure[d] a facility" like the CDO^2 from BofA during March 2007. Ex. 122. Accordingly, BAS negotiated for and received BSAM's commitment, in Paragraph 4(c) of their Engagement Letter (Ex. 5), to

> notify BAS of the occurrence of any of the following events (each a "Collateral Manager Event") promptly after the Collateral Manager becomes aware of such

> occurrence: (i) a material adverse change, or development that would reasonably be expected to result in a material adverse change, in the business, properties, financial condition or prospects of the Collateral Manager, . . . or (iii) any other adverse financial, organizational or other event or change at the Collateral Manager which would reasonably be expected to impair the ability of BAS in its capacity as Placement Agent to market the Securities issued in connection with the Transaction.

### B. Investor Redemption Demands Flooded The Funds And Imperiled BSAM's CDO Management Business

Unbeknownst to BofA and the public, BSAM investors had started a run on the two BSAM Funds in mid-April 2007. On April 19, a large EL Fund investor told BSAM that it would redeem its entire $56.8 million investment—7% of the EL Fund's investor capital—by June 30.[2] Counter-Stmt. ¶ 101. Three days later, defendant Tannin wrote to defendants Cioffi and McGarrigal using personal e-mail addresses—admittedly to evade review by anyone else at Bear Stearns—to sound the alarm bells. *Id.* ¶¶ 102–03. For "the last few months," Tannin reminded Cioffi and McGarrigal, he had been advocating that BSAM "[c]lose the two HG funds now—or get very very aggressive." Ex. 128. In the wake of the redemption notices, Tannin advised "to close the Funds now." *Id.* Even if BSAM tried to keep the Funds afloat, he emphasized, redemption notices might "force our hand anyway." *Id.* McGarrigal agreed, adding that "the only exit here is to sell [the Funds' assets] via CDO"—including the CDO^2 scheduled to close on May 24. *Id.*

The turmoil soon percolated from BSAM up to its parent company, Bear Stearns. BSAM's Management Committee met on April 23 to address the "[a]dequacy" of the Funds' "liquidity to meet redemptions" Counter-Stmt. ¶ 104. BSAM's risk managers made the first in a

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[2] The Funds' governing documents required investors to provide advance notice to redeem some or all of an investment. *See* Ex. 120 at 45–47. Accordingly, investors generally submitted redemption notices at least five or six weeks before the first-of-the-month on which they wanted their redemption to be honored. Once an investor submitted such a redemption notice, its execution was automatic, unless the investor withdrew the notice. Hardly anyone ever did.

series of presentations about the Funds to senior risk officers at Bear Stearns. *Id.* ¶ 105. Bear Stearns co-president Warren Spector began to receive regular briefings about the Funds' distress. *Id.*

Even so, BSAM maintained a business-as-usual stance with the outside world. To that end, defendant Cioffi told the Funds' investors and lenders on April 25 that he "believe[d] we only have *a couple million* of redemptions for the June 30 date." Ex. 130 at 8 (emphasis added). That was patently false—most obviously (but not only) because one investor had already noticed $56.8 million in redemptions by June 30. See Counter-Stmt. ¶ 101. BofA's credit officer responsible for monitoring BofA's repurchase-agreement ("repo") financing to the Funds listened to a recording of that call, and took "comfort" from Cioffi's disclaimer of any redemptions problem. *Id.* ¶ 107.

Things then went from bad to worse. Redemption notices flooded the Funds in late April and early May. Counter-Stmt. ¶ 108. By May 7, defendant McGarrigal had modeled a "base case" scenario in which the EL Fund faced 50 percent redemptions. *Id.* ¶ 109. By May 9 there were $226 million in EL Fund redemptions—more than a third of that Fund's capital—plus another $47 million redemptions at the HG Fund. *Id.* ¶ 42. A BSAM risk analyst summed up the prevailing view: Redemptions in the two Funds were "brutal." *Id.*

By now, defendants knew how the story would end. On May 11, Tannin approached BSAM's outside counsel about the Funds' "redemptions issues." Ex. 135. On May 13, Cioffi told Tannin and McGarrigal that he was "somewhat certain" the EL Fund would be "liquidated" "given the redemption activity." Ex. 136. The Funds would have to sell off billions of dollars of assets similar to (and sometimes identical to) the collateral backing the CDO^2 in order to meet their investors' demands. The EL Fund's very "existence" was "threaten[ed]," Cioffi said the

next day, and he was "concern[ed]" that "the closing down and liquidation of [the EL Fund] will negatively impact [the HG Fund] *and other businesses on the HG platform*." Ex. 137 (emphasis added).

With so much at stake, BSAM's senior management met almost daily during the middle of May—often many times a day—to review "liquidation" plans and discuss "terminat[ion]" analyses for Funds. Counter-Stmt. ¶ 115. BSAM pleaded with Bear Stearns to throw the Funds a lifeline, but the parent refused to bail the Funds out. *Id.* ¶ 116. Increasingly panicked, BSAM quietly put its high-grade business platform—*including BSAM's entire CDO-management business*—up for sale. *Id.* ¶ 110. BSAM recognized that any of these rescue measures would have a "very negative impact on BSAM and business platform franchise value"—including its CDO-management business. Ex. 133.

### C. BSAM Purposefully Delayed Any Redemptions Disclosure To BofA Until After It Had Put BofA At Risk

Even as BSAM was frantically—but secretly—trying to unload its business, it continued to pursue the CDO^2 transaction with BofA without hinting at, much less disclosing, the Funds' redemptions until it was too late.

On Friday, May 18, BofA sent defendants Cioffi, Tannin, and McGarrigal a "due diligence" agenda for a May 21 call with BofA and two other banks that would place the CDO^2's CP with investors. BofA's agenda directed BSAM—point blank—to disclose "[a]ny impending material . . . organizational/business developments or announcements" and "[a]ny other . . . material information not yet disclosed." Ex. 28. When defendant Tannin read that agenda on May 18, it immediately "prompted" him to consider whether BSAM should—at long last—disclose the Funds' redemptions. Counter-Stmt. ¶ 45. By then, the EL Fund had received redemption notices totaling $304.5 million—roughly 47% of its capital—and the HG Fund had

received another $75.7 million. *Id.* ¶ 43; Ex. 27. But when the due-diligence call took place on May 21, BSAM didn't say a word about the Funds' redemptions. Counter-Stmt. ¶ 117. Nor did defendants breathe a word about the redemptions to BofA the next day, May 22.

And that made all the difference. On May 22, defendants sold BAS $2.86 billion in CDO collateral from the two BSAM Funds to facilitate the CDO^2's closing two days later. Counter-Stmt. ¶ 36. BofA now owned those assets outright and was at risk if the CDO^2 failed to close and the assets lost value (as defendants secretly knew they would). Neither BSAM nor its Funds had any obligation to take back those assets if something derailed the CDO^2 at the last minute. *Id.* ¶ 119. Still unaware of the turmoil at the Funds, BofA arranged to transfer the Initial Collateral to an escrow account, and executed instructions to release the Initial Collateral to the Issuer automatically when the CDO^2 closed on May 24. *Id.* ¶ 120.

Meanwhile, on May 23, defendants met throughout the day about whether, when, and how to disclose the Funds' redemptions crisis to BofA. Counter-Stmt. ¶ 122. Draft disclosure letters continued to circulate, including to outside counsel. *Id.* ¶ 121. But when the same due-diligence agenda was considered during a May 23 call with prospective CP investors, BSAM again stayed silent. *Id.* ¶ 123. And not only that: The same day, one of the Funds' traders contacted BofA's repo desk, and obtained a "binding agreement" to provide the Funds $696.2 million in repo financing on May 24, to be secured by the CDO^2's Mezzanine Tranches that BSAM had committed to purchase at closing. *Id.* ¶¶ 124–26. Yet again, BSAM failed to disclose the Funds' redemptions. *Id.* ¶ 127.

The evening of May 23—intentionally *after* the Initial Collateral was on BofA's books, the repo was locked in, and the CDO^2's closing was less than 24 hours away—BSAM finally apprised BofA's CDO bankers of *part* of its big secret. BSAM's top portfolio manager,

defendant Cioffi, called BofA's CDO^2 deal manager, Brian Foley, to inform him that a letter about redemptions was on the way. Counter-Stmt. ¶ 47. But he offered no reason for having waited so long—the EL funds' redemption notices had topped 50% of that fund's investor capital since at least May 18. *Id.* ¶ 43. Inded, Cioffi used the call to soften the ground—telling Foley that some of his lawyers believed BSAM's letter was unnecessary, and that he was sending it to BofA only to be a good partner. *Id.* at ¶ 47. Inside BSAM, however, people were acutely aware of the gravity of the moment; BSAM's deal manager characterized BofA's reaction to the last-minute disclosure as a "[m]illion dollar question." *Id.* ¶ 128; Ex. 110.

At 6:31 p.m. on May 23, BSAM e-mailed the letter to BofA. In it, BSAM stated that the EL Fund had "recently" received large redemption notices and that BSAM expected June and July redemptions from the EL Fund totaling $324 million—49.92% of its total equity capital. Ex. 31. BSAM said it was "considering all available options" including "asset sales," gating redemptions, or winding down the fund. *Id.* BSAM tried to assure BofA, however, that "the foregoing redemptions will not materially affect our ability to perform our obligations as collateral manager of High Grade Structured Credit CDO 2007-1" or "have a material adverse effect on our business, properties, financial condition or prospects." *Id.*

BSAM also instructed BofA that the redemptions information in the letter was governed by "the confidentiality provision of our Engagement Letter." *Id.* Among other things, BSAM's instruction prohibited BofA from disclosing the EL redemption levels "in any offering memorandum" for the CDO^2 without BSAM's "consent," and permitted such information to be shared with BAS's affiliates only "for the sole purpose of consummating the [CDO^2] offering." Ex. 5 at ¶ 9(a)–(b).

### D. To Mitigate Its Risk, BofA Elected To Close The CDO^2 On May 24

BofA found BSAM's May 23 letter deeply "disturbing" and the information in it "absolutely critical," "important," and "a big deal." Counter-Stmt. ¶ 129. Overnight and early the next morning, BSAM's partial disclosure circulated to members of BAS's CDO-structuring desk, to legal and compliance officers at the Bank, and to a credit-risk analyst responsible for managing the Bank's risk to the CDO^2 transaction. BofA demanded that BSAM authorize a disclosure about the redemptions in the CDO^2's offering materials. *Id.* ¶ 60. But BSAM never amended the offering materials' "Collateral Manager Information," for which BSAM expressly bore sole responsibility. *Id.*

Having received the May 23 Letter, BofA now faced a Hobson's choice. As of May 22, it owned the $2.86 billion in CDO assets that BSAM had earmarked from the Funds as the CDO^2's Initial Collateral. As defendants well knew, once the market caught wind of the Funds' massive redemptions, it would push prices for those assets sharply downward. So refusing to close the next day, and holding the assets on its books, posed terrible and immediate losses for BofA. Counter-Stmt. ¶¶ 130–32. By closing the deal, however, BofA could at least mitigate its losses by gaining access to CP funding (which it had backstopped with a 2a-7 put) and receive nearly $800 million in equity and mezzanine financing from BSAM for those assets. *Id.* at ¶¶ 11, 59, 131.[3]

### E. When The Market Learned Of The Redemptions In The Funds, BSAM Assets Took A Nosedive In Value

On June 6, a trade publication broke the news that the EL Fund was "preventing investors from pulling out their money" by "halting" their redemption rights. Counter-Stmt. ¶ 133.

[3] When BofA's CDO bankers made the decision to close, they did not know about the repo trade that BSAM had made with BofA's separate repo desk. Counter-Stmt. ¶ 67. The repo effectively transferred the risk associated with the Mezzanine Tranches from BSAM back to BofA.

BSAM's chief risk officer knew that, once this news hit the street, things would "move FAST." *Id.* The suspension of redemptions would trigger "tough questions" from repo "counterparties," who would "mark down their assets, take [additional] margin, [and] not roll their financing." *Id.* And Cioffi observed that this fallout began only "30 minutes" after the news broke. Ex. 160. Repo counterparties marked down the Funds' collateral, recognizing (among other things) that the EL Fund would be selling its assets to meet redemptions. *Id.* ¶¶ 74, 133.

By Monday, June 11, Cioffi was "fighting the battle of the bulge with [the Funds'] repo lenders" because of their lower prices on the Funds' collateral. Ex. 160. The Funds could not meet the rising margin calls, resulting in what defendant Tannin called a "game of high stakes chicken" between the Funds and their lenders. Counter-Stmt. ¶ 135. Those lenders' default option was the remedy afforded them by their repo agreements: seizing the collateral that backed the repo loans and auctioning it into a newly reeling market. *Id.*; Ex. 161. And indeed, some of the Funds' repo counterparties seized and sold the Funds' assets, sustaining huge losses by selling at prices that were falling in reaction to BSAM's disclosures.

But BofA, as defendant Tannin observed at the time, had "a lot to lose if they are stuck with [the CDO^2] bonds" on repo and had to sell them *en masse*. Ex. 161. It had an incentive to "participate in a solution." *Id.* And so BofA, like other of the Funds' lenders, agreed to a Termination and Purchase Agreement on June 18 that unwound the CDO^2 repos by permanently transferring the Mezzanine Tranches to BofA. Ex. 48. BSAM and the Funds waived any claims they had against BofA arising from the unwound repo agreements, but BofA *did not* waive its tort claims against defendants. *See id.* ¶ 8.

In the subsequent weeks, additional revelations about BSAM's plight continued to drive down the prices of BSAM assets. BSAM announced on June 27 that it would suspend

redemptions in the HG Fund (Ex. 52), and Bear Stearns CEO James Cayne announced on July 17 that the HG and EL Funds would be unwound completely (Ex. 53). This chain of events—foreseen by the Individual Defendants and other BSAM leaders in May (*see supra* pp. 6–7)—had a cataclysmic effect on BSAM's reputation as a CDO collateral manager. It also devalued the CDO assets that BSAM had caused the Issuer to purchase, and BofA to underwrite and finance, on May 24. As defendant Tannin explained in a candid e-mail to a trusted personal friend on July 8, 2007, "the 'market' became very very afraid [about] the underlying risk in our portfolio" and "realized that we were going to have to sell a good deal of our portfolio." Ex. 162. "Prices then deteriorated very quickly and there was a negative cascading effect that ended up affecting many of the larger banks on Wall Street" (*id.*)—especially those, like BofA, with whom the Funds had substantial financing arrangements.

By late-July 2007, the Funds were effectively bankrupt, BSAM's CEO had been forced to resign, and defendant Cioffi had been relieved of his duties atop the high-grade platform. Counter-Stmt. ¶ 137; *see also S.E.C. v. Cioffi*, 868 F. Supp. 2d 65, 68 (E.D.N.Y. 2012) ("In Bear Stearns's case, the collapse" of "the Wall Street investment bank" "was largely attributed to the [Funds]" after their collapse left Bear Stearns "moribund").

The CDO^2 eventually defaulted and liquidated in 2008. Counter-Stmt. ¶¶ 83–84. By then, the Issuer had recovered just over $600 million in principal on collateral for which BSAM had caused it to pay more than $3.2 billion ($2.86 billion at closing and the rest thereafter). *Id.* ¶ 139. BofA, in turn, received no principal repayment whatsoever on account of its ownership of the Mezzanine Tranches and recovered just $589.3 million on the Super Senior tranches for which it had paid close to $2.9 billion. *Id.* Plaintiffs' expert's econometric modeling shows that the Issuer purchased the Initial Collateral for upwards of $466.5 million more than it would have

had its price tag reflected the Funds' undisclosed redemptions and planned liquidation. *Id.* ¶ 140 Defendants' primary economic expert made only minor adjustments to that econometric model, and his results also put BofA's and the Issuer's damages into the hundreds of millions of dollars. *Id.* ¶ 141.[4]

## ARGUMENT

"Summary judgment is proper only if there is no genuine dispute of material fact and the movant is entitled to judgment as a matter of law." *Fortunato v. Liebowitz*, No. 10 Civ. 02681 (AJN), 2012 WL 6628028, at *1 (S.D.N.Y. Dec. 20, 2012) (citing *Ramos v. Baldor Specialty Foods, Inc.*, 687 F.3d 554, 558 (2d Cir. 2012)). "The burden of demonstrating the lack of any genuine unresolved issues of fact rests on the moving party. Uncertainty as to the true state of any material fact defeats the motion." *Gibson*, 892 F.2d at 1132 (citations omitted). "Because granting the motion deprives a party of its day in court and the right to present its cause to a jury, the district court in examining the record must resolve all ambiguities and draw all reasonable inferences in favor of the nonmoving party." *Id.*; *see also Ramos*, 687 F.3d at 558.

### I. SUMMARY JUDGMENT IS UNWARRANTED ON THE CDO^2 FRAUD CLAIM (COUNT II) BECAUSE THERE IS ABUNDANT EVIDENCE THAT DEFENDANTS HAD A DUTY TO DISCLOSE THE FUNDS' REDEMPTIONS

The elements of fraud by omission in New York are (1) a material omission, (2) a duty to disclose, (3) intent to defraud, (4) reasonable reliance, and (5) damages. *See Banque Arabe et Internationale D'Investissement v. Md. Nat'l Bank*, 57 F.3d 146, 153 (2d Cir. 1995). Defendants do not contest that there is sufficient evidence of materiality, intent, and reasonable reliance. *See*

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[4] Defendants Cioffi and Tannin consented to a final judgment in a civil action brought against them by the SEC. Without admitting or denying the SEC's allegations, Cioffi disgorged $700,000, and paid a $100,000 civil penalty; Tannin disgorged $200,000 and paid a $50,000 civil penalty. *Cioffi*, 868 F. Supp. 2d at 68. A jury acquitted Cioffi and Tannin of related criminal-securities-fraud charges in a separate proceeding. See Docs. 267 & 268, *United States v. Cioffi*, 08 Crim. 415 (FB) (E.D.N.Y. Nov. 16, 2009).

Memo. 14–19. They contend, however, that they had no duty to disclose the Funds' massive redemption notices and potential liquidation before BofA bought $2.86 billion in collateral from those very Funds. For at least two independent reasons, that is mistaken.

### A. Having Chosen To Answer BofA's Questions On A Due-Diligence Call, Defendants Were Obligated To Disclose The Full Truth Regarding The Redemptions

Defendants do not even mention the first reason. On May 18, BofA sent BSAM an agenda for a pre-closing, due-diligence call to be held on May 21 with BofA and the other firms that would be marketing the commercial paper on the transaction. Counter-Stmt. ¶ 45; Ex. 28. As defendants well understood, the purpose of that due-diligence call was to apprise the CP dealers of any developments that might adversely affect the transaction in which they were about to participate. Accordingly, in the agenda, BofA called upon BSAM to address any "impending material . . . developments or announcements" and any other undisclosed "material information." Ex. 28. That should have caused defendants to disclose the turmoil at the two Funds (whose assets would collateralize the commercial paper). Indeed, defendant Tannin acknowledged in deposition that BofA's due-diligence agenda did in fact "prompt[]" him—on May 18—to consider whether BSAM should disclose the redemptions in connection with the CDO^2. Counter-Stmt. ¶ 45. When the May 21 call took place, however, defendants said *nothing* about the Funds' redemptions. *Id.* ¶ 117. Yet there is overwhelming evidence that those redemptions *were* material on and before May 21 (*id.* ¶ 43), and defendants do not suggest otherwise.

Having chosen to speak during the due diligence call, BSAM had a duty, enforceable in tort, to tell the full truth, including about the redemptions. *See Brass v. Am. Film Techs., Inc.*, 987 F.2d 142, 150 (2d Cir. 1993); *see also Caiola v. Citibank, N.A., N.Y.*, 295 F.3d 312, 331 (2d Cir. 2002) ("[U]pon choosing to speak, one must speak truthfully about material issues."). BSAM "had a duty to make a statement . . . both truthful insofar as it went, and not misleading in

light of the facts known at that time." *Schlanger v. Four-Phase Sys., Inc.*, 582 F. Supp. 128, 133 (S.D.N.Y. 1984); *see also Atlantic Bank of N.Y. v. Carnegie Hall Corp.*, 268 N.Y.S.2d 941, 946 (1st Dep't 1966) ("Having assumed to respond to [a party's] inquiry, it was [the other party's] duty 'to speak fully and truthfully.'"). For this reason alone, defendants had an unmistakable duty of disclosure—or so a jury could find.

### B. Defendants' Superior Knowledge About The Funds' Redemptions Crisis Also Established Their Duty To Disclose

But there is a second reason as well. Under New York law, a disclosure duty arises where "(1) one party has superior knowledge of certain information; (2) that information is not readily available to the other party; and (3) the first party knows that the second party is acting on the basis of mistaken knowledge." *Banque Arabe*, 57 F.3d at 155; *Brass*, 987 F.2d at 150 (similar); *see also id.* at 151 (observing "a tendency in New York to apply the rule of 'superior knowledge' in an array of contexts in which silence would at one time have escaped criticism").

Defendants undoubtedly had "superior knowledge" about the Funds' redemption notices before BofA purchased the Initial Collateral on May 22. Counter-Stmt. ¶¶ 42–43, 111–17. And those redemptions were non-public, confidential information not "readily available" to BofA. *Id.* ¶ 118. BofA did not have "an opportunity equal to" the defendants' "to obtain information" about the redemptions, was "not required to conduct investigations to unearth" that information, and was entitled to "rely on [defendants] to make full disclosure." *Brass*, 987 F.2d at 151.[5]

Defendants contend, however, that the "superior knowledge" doctrine applies only to concealed facts that go "to the basis, or essence, of the transaction." Memo. 15 (quoting

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[5] Even if BofA had a duty of inquiry, it *asked* BSAM to disclose any material information during the May 21 due-diligence call. *See supra* pp. 7–8, 14. Information that is successfully withheld is not "readily available" to the party who asked for it.

Restatement (Second) of Torts § 551(2)(e)). But the *Brass* case—on which defendants rely—held no such thing; defendants' block-quoted language does not even appear in the decision. *See* 987 F.2d at 150–52. What matters, according to *Brass*, is that one party knows that its counterparty "is acting on the basis of mistaken knowledge." *Id.* at 150.

But even if the Second Circuit *had* embraced the "essence of the transaction" standard, there is abundant evidence—overwhelming, in fact—that the redemptions were "essential" to the CDO^2 transaction. As defendant Tannin explained, BSAM was able to persuade BofA to do the deal precisely because the two Funds "were sufficiently large and we were sufficiently well-respected by the dealer community." Counter-Stmt. ¶ 100. The CDO^2 was to be managed on the same platform as the Funds, by the same portfolio managers, and most of the CDO^2's collateral was to come from the Funds. *Id.* ¶¶ 3, 8. A jury can easily find that BofA would not have proceeded with a BSAM-managed CDO^2 had it known that BSAM's reputation was about to implode on account of problems at those Funds. Indeed, multiple BofA witnesses have stated that, had defendants told BofA the truth about the redemptions, the Bank would either have declined to do the deal, or would have done so only on materially different terms. *Id.* ¶ 132.

Defendants themselves knew that when the truth about the Funds emerged—when the redemption notices became public—there would be a "very negative impact" on the entire "BSAM franchise and high grade business platform franchise." Ex. 133. By mid-May, BSAM had put its high-grade business platform up for sale—*including the very CDO-management business that was supposed to manage the CDO^2*. Counter-Stmt. ¶ 110.[6] Defendants also

[6] Plaintiffs' CDO-industry expert, Daniel Castro, will testify that experienced market participants like the defendants would have understood that a reasonable CDO^2 underwriter would not proceed with a large transaction knowing that the collateral manager's business platform was besieged by investor redemption notices, on the auction block, seeking a bailout, and on the precipice of offloading the very assets about to be re-securitized. See Ex. 179 (Castro Report) ¶¶ 34–51.

understood that their disclosure of the EL Fund's redemption notices would be a substantial blow to BofA. They waited with bated breath for BofA's reaction to their eve-of-closing disclosure—referring to it as *the "[m]illion dollar question*." Ex. 110 (emphasis added); *see also* Counter-Stmt. ¶ 128.[7] Indeed, at this stage of the litigation, plaintiffs are entitled to the inference from this evidence that defendants delayed their disclosure to BofA *precisely because* timely disclosure would have torpedoed the deal.

Defendants do not address any of this evidence. Instead, they mine the record for competing inferences, and ask for judgment on that basis. Of course, that would be improper on a Rule 56 motion, even if the record were friendlier to defendants. But it isn't. Defendants contend, for example, that the mounting redemptions could not have been "essential" to the deal because no one amended the CDO^2's offering documents to reflect the May 23 disclosure of the EL Fund's redemptions. Memo. 17–18. That is a remarkable assertion. For one thing, BSAM's May 23 Letter ordered BofA to treat the disclosure as confidential information under the parties' Engagement Letter (Ex. 31), which required BSAM's consent to *any* offering-document disclosure of its confidential information (Counter-Stmt. ¶ 60). What is more, under the Offering Circular's express terms, disclosures about the collateral manager were BSAM's sole purview, and BofA was not responsible for the content of those disclosures. *Id.* And shortly after BofA received the May 23 Letter, it in fact demanded that BSAM make a disclosure about the EL Fund's redemptions to CDO^2 investors, *and BSAM didn't do it*. *Id.* BofA thereupon stopped marketing the CDO^2's long-term, unguaranteed bonds to outside investors (*id.* ¶ 59),

[7] When confronted with this e-mail at their respective depositions, both its author (Patrick Fleming) and its recipient (defendant Tannin) turned cartwheels, explaining that, by "million dollar question," they meant only that the question regarding BofA's reaction was as yet "unanswered." Ex. 183 (Fleming Tr.) at 226–30; Ex. 204 (Tannin Tr.) at 374–77.

even though that meant giving up $5 million in commissions that it expected to earn selling those bonds (*id.* ¶ 12).[8] Far from shrugging its shoulders at BSAM's last-minute revelation, BofA's recognized that the news was a significant blow to the success of the CDO^2.

Defendants likewise contend (at 16–17) that "the Funds' performance" was not identified as a material issue in BofA's internal deal-approval documents, the deal's term sheet, or in any specific inquiries from BofA's deal team. Not so. The deal-approval documents, for example, touted BSAM's successful management of "$25B in structured credit assets"—including those held by the Funds—and the "experience" of the portfolio managers responsible for both the Funds and the CDO^2. Counter-Stmt. ¶ 51(a), (c). The term sheet—a brief factsheet about the transaction—likewise emphasized that BSAM was the collateral manager. *Id.* ¶ 51(d). And as we noted above, BofA convened a due-diligence call precisely to elicit whether there were any "impending" threats to BSAM's CDO-management platform (*see supra* pp. 7, 14–15).

In short, BSAM's mounting redemptions, and the incipient collapse of the two Funds, were "essential" to the CDO^2 deal. Or so, on this record, a reasonable jury could find.

## II. SUMMARY JUDGMENT IS UNWARRANTED ON THE REPO-FRAUD CLAIM (COUNT IV) BECAUSE THERE IS ABUNDANT EVIDENCE THAT DEFENDANTS FRAUDULENTLY INDUCED THE REPO FINANCING AND CAUSED DAMAGES THAT WERE NOT SETTLED BY THE TERMINATION AND PURCHASE AGREEMENT

Defendants seek judgment on Count IV—alleging fraud in connection with the $696.2 million Repo Agreement—on two grounds: first, that by the time the Repo Agreement was consummated, BSAM had already made the May 23 disclosure, and thus could not have

[8] BofA continued to fund its own Super-Senior underwriting commitment to the CDO^2 in the short-term commercial paper market. Those investments, unlike any in the CDO^2's long-term Mezzanine Tranches, were effectively guaranteed by a 2a-7 put to BofA. Not one third-party CP investor lost a penny when, as matters turned out, BofA purchased their CP at maturity consistent with its put obligation.

fraudulently induced the repo transaction; second, that the parties' June 18 Termination and Purchase Agreement resolved all damages claims for the repo fraud. Both contentions are mistaken.

**A. The May 23 Letter Was Too Little, And Too Late**

1. The May 23 Letter was sent too late to do any good on the repo transaction. Although defendants do not mention this, BofA made a "binding agreement" to extend the repo loans to BSAM *before* BSAM sent the May 23 Letter to *anyone* at BofA. Counter-Stmt. ¶ 126. Earlier on May 23, BSAM's repo trader, Joanmarie Pusateri, had contacted her counterpart on BofA's repo desk, David Frisina. *Id.* ¶ 124. She proposed that BofA extend financing to both Funds, beginning on May 24 and through September 5, secured by a repo of the CDO^2's Mezzanine Tranches. *Id.* In response, Frisina sought the necessary internal authorizations. He received approval and the standard "haircuts" from Jeffrey Malo (*id.* ¶ 125), the credit officer at BofA who was responsible for monitoring the Bank's financing to the Funds and who had listened to the Funds' misleading April 25 conference call (*id.* ¶ 106–07). Frisina also received "rates" for the financing from a trader on the repo desk. *Id.*[9] Pusateri and Frisina subsequently confirmed what Pusateri called their "binding agreement" on May 23 to settle those repo trades the next day.[10] *Id.* ¶ 126. Plainly enough, a letter BSAM sent only *after* BofA had already agreed to

[9] Contrary to defendants' explanation (at 5–6), a repo "haircut" is the difference between the value of the collateral and the amount financed. (A 10% haircut on $100 of collateral results in a $90 loan.) A repo agreement's "rate" is what is reflected by "[t]he difference between the loan amount and the repurchase price." Memo. 5. (In a simplified example, a 10% rate on that $90 loan results in a repurchase price of $99 at the conclusion of the loan's term.)

[10] In reaching this "binding agreement," Pusateri and Frisina agreed to "go over loan values and rates in the morning." Ex. 199 (Pusateri Tr.) at 247. But both traders explained that those outstanding issues were insignificant. The agreed-on "rate" would be "set in the morning based on where the LIBOR levels are," or on some other benchmark. *Id.* at 248. And calculating "loan values" was just a matter of "do[ing] the math." Ex. 185 (Frisina Tr.) at 217. *See also* Counter-Stmt. ¶ 126.

extend repo financing to the Funds cannot absolve defendants of material misrepresentations and omissions that induced that financing in the first place.

To make matters worse, when defendants finally *did* send the May 23 letter, they failed to send it to anyone at BofA who was actually responsible for—or who even knew about—the pending repo loans. Counter-Stmt. ¶ 127. It is undisputed that no one involved in the repo financing knew about the May 23 letter prior to the settlement of the repo trades on May 24. *Id.* ¶¶ 67, 127. Yet defendants knew full well who they should have contacted at the BofA repo desk to disclose information relevant to a repo agreement. Pusateri routinely dealt with Frisina on all manner of issues relating to repo loans (Ex. 185 (Frisina Tr.) 53); Malo had met with defendants at BSAM's office on more than one occasion, and had corresponded by e-mail with defendant Tannin about the Funds' financing arrangements with BofA (Ex. 194 (Malo Tr.) 107–15). If defendants had wanted the BofA employees responsible for the repo loans to know about the EL Fund's (or HG Fund's) redemptions, they would have told them. They didn't.

Defendants nonetheless contend (at 20) that it is "BOA's own fault" that the information in the May 23 Letter did not travel across the institution, from one business unit to another, during the fewer than 24 hours between its receipt on May 23 and when the repo loans settled on May 24. There is every reason to believe that the jury will disagree. For one thing, when BofA's CDO-structuring desk received the May 23 Letter, no one on that desk had any idea that BSAM had arranged for repo financing earlier that day with BofA's separate repo desk. Counter-Stmt. ¶ 67.[11] And without knowledge of any reason to share the May 23 Letter with

[11] During discovery, defense counsel pointed to one sentence in a March 2007 e-mail from defendant Cioffi about a different subject (pre-closing financing for the Initial Collateral), as suggesting that BSAM might eventually seek repo financing from BofA for the CDO^2's Mezzanine Tranches. See Ex. 164. A jury is entitled to conclude that BofA's CDO bankers quite reasonably did not think back to that fleeting, hypothetical remark—buried among the hundreds of e-mails between the parties—during the few,

BofA's repo desk and the relevant credit officers, BofA's CDO-structuring desk was *prohibited* from doing so by strict, need-to-know policies that govern how material, non-public information is shared within the Bank. Ex. 193 (Maddox Tr.) 38–41, 91–93. Indeed, even within the CDO-structuring desk, the information in the May 23 Letter was restricted only to those employees working on the CDO^2 transaction. Ex. 202 (Solomon Tr.) at 73–75. What is more, an information wall separated "private side" employees like CDO bankers and "public side" employees like repo traders. Ex 165.

Even had that not been the case, BSAM insisted that its May 23 Letter be kept strictly "confidential" under the parties' Engagement Letter. Ex. 31. The confidentiality clause prohibited BofA's CDO-structuring desk from "shar[ing]" the redemptions information with any of its "agents or representatives" other than for "the *sole purpose* of consummating the [CDO^2] Offering." Ex. 5 ¶ 9(a), (b) (emphasis added). As a result, the CDO-structuring desk was forbidden from "us[ing]" BSAM's confidential disclosure for any purpose not described in the Engagement Letter, which did not address repo financing transactions. Ex. 5 ¶ 9; *see also* Memo. 11 (the repo financing "was not required by, or even addressed in, the Engagement Letter"); Counter-Stmt. ¶ 66 (same). A jury is entitled to reject the contention that BofA should have disseminated the May 23 Letter more widely, notwithstanding defendants' insistence that the letter be kept under wraps.[12]

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overnight hours available to them following BSAM's thirteenth-hour disclosure more than two months later.

[12]

2. The May 23 Letter was also too little. Even if it had gone to the right people at the right time, the letter said *nothing* about the substantial and rapidly mounting redemption notices facing the HG Fund. The HG Fund received $244 million of BofA's repo financing, and it, too, was in peril. Counter-Stmt ¶ 134. Defendants acknowledge, in a footnote (at 19 n.3), that the HG Fund faced redemptions of "about 15%" of its investors' capital on May 23—a whopping $151 million in capital outflows that put substantial pressure on that Fund and the high-grade platform. Counter-Stmt. ¶ 44. Mr. Malo, who approved the repo loans from a credit perspective, stated that red flags fly when a hedge fund's redemptions-to-capital percentage hits "double digits." *Id.* ¶ 127; *see also* Ex. 179 (Castro Rpt.) ¶ 46 (redemptions over a *de minimus* level—around 5%—are significant). And unbeknownst to BofA, the HG Fund—like the EL Fund—was very much part of BSAM's plans to liquidate assets (Counter-Stmt. ¶ 115), sell the business platform to an outside "angel investor" (*id.* ¶ 110), and obtain a bailout from Bear Stearns (*id.* ¶ 116). *But see* Memo. 19 n.3 (claiming "no evidence" that the HG Fund's liquidation was a possibility on May 23). Defendants' material omission of the HG Fund's plight when it secured repo financing for that Fund is, by itself, sufficient to establish BofA's Repo Fraud Claim.

**B. The TPA Does Not Get Defendants Off The Hook**

BofA's June 18 Termination and Purchase Agreement (TPA) with BSAM and the Funds, which unwound the repo loans when the Funds defaulted, did not "compensate" BofA for its losses on the repo fraud. Here are the pertinent facts: On Thursday, June 7, BSAM publicly announced the EL Fund's suspension of massive investor redemption requests. Ex. 44. The next day, BofA's trading desk re-examined valuations of the Mezzanine Tranches securing BSAM's repo loans, and determined that they were now worth less than their May 24 market value. Counter-Stmt. ¶ 134. In the early morning of Monday, June 11, BofA sent its new valuations to BSAM, and asked the Funds to cover the drop in value by providing additional "margin." *Id.*

¶ 74. When the Funds failed to comply by the end of the day, the repo loans were in default under the terms of the governing Master Repurchase Agreements (MRAs). *Id.* BofA so notified the Funds the next day. *Id.* BSAM and BofA worked out a deal that temporarily delayed BofA's declaring an event of default (*id.*), but by June 14 it was clear that the Funds were not going to honor their repo agreements with BofA.

At that point, BofA could have seized the Mezzanine Tranches and auctioned them off *en masse* to obtain whatever recovery on the defaulted repo loans it could obtain from the market. But buyers were newly wary of assets coming from the beleaguered Funds, and the Funds' repo counterparties who *did* seize and auction the Funds' collateral suffered significant losses. *See* Ex. 174 (Bajaj Rpt.) ¶ 44 & nn.64–65 (describing Merrill Lynch's mid-June auction of the Funds' collateral). Defendants recognized that repo counterparties like BofA would want to stave off such] massive asset sales (Ex. 204 (Tannin Tr.) at 411–12, and so BSAM and the Funds engaged them in what defendant Tannin called "a game of high stakes chicken" (Ex. 161). The Funds would allow their lenders effectively to seize their collateral, but without requiring the immediate auctions and other remedies mandated under the MRAs. In exchange, the lenders would cancel margin calls and unwind the repos at prices higher than they expected to obtain in auctions. Defendants recognized that BofA was a prime target for such a deal—Tannin understood that BofA had "a lot to lose if they are stuck with [the Mezzanine Tranches]" *on repo*. *Id.*; *see also* Counter-Stmt. ¶ 135.

The June 18 TPA was the result. *See* Ex. 50 at 3 (both sides' intent was "to avoid an Event of Default on the Repo"). BofA and the Funds unwound their repos at prices set "as of June 14." Ex. 48 at 5 (¶ 1(b)(i)). Those prices reflected a loss to BofA, but it agreed to net that loss against the Funds' gains on unrelated derivatives trades. As a result, the Funds received

desperately needed cash from BofA. *See* Ex. 48. The TPA included a one-way release; BSAM relinquished any repo-related tort claims it had against BofA, but BofA *retained* whatever tort claims it had against BSAM arising out of the unwound repos. *Id.* ¶ 8.

Defendants cannot establish—much less conclusively—that the $105 million "discount" priced into the June 18 Agreement compensated BofA for its losses on the repo fraud. For one thing, plaintiffs intend to demonstrate, based on reliable economic evidence, that the Initial Collateral experienced significant losses (and was therefore overvalued when BofA bought it) on account of BSAM's disclosures *after* June 18. Specifically, the effects of BSAM's June 27 announcement of the HG Fund's substantial investor redemptions, and its July 17 announcement that both Funds would be liquidated entirely, caused losses to the Mezzanine Tranches that were not reflected in prices determined as of June 14.[13]

What is more, the $105 million price negotiated as of June 14 does not even account for all of the losses BofA sustained as of that date. This hasty transaction—consummated with a defaulting counterparty—was based only on the limited information available to BofA in the

[13] Defendants claim that all of that future bad news (and associated price drops) could have been predicted as of June 14, and thus the June 18 Agreement must be taken as a proxy for all of plaintiffs' repo fraud damages. But the evidence mustered in support of this contention is wafer thin. For one thing, defendants rely on the false factual assertion that the June 18 Agreement used valuations "determined . . . as of that date." Memo. 21. The June 18 Agreement in fact specified that the parties used valuations reached on June 14. Ex. 48 at 5. The four day difference matters, because it renders meaningless defendants' reliance on a June 15 proposal and a June 16 Wall Street Journal article. *See* Memo. 21 (citing Exs. 71, 72). Defendants' remaining evidence is no better. A June 14 BSAM presentation slide stating that BSAM had stopped accepting new investments into the HG Funds because of the *possibility* of redemptions in that Fund (Ex. 46 at 2) is hardly conclusive proof that BofA knew that the HG Fund *had already received* crippling redemptions and was two weeks away from disclosing them to the market. Nor did the presentation's statement that both Funds were "selling assets" put BofA on notice of those Funds' wholesale liquidation, particularly in light of defendants' insistence that the Funds' asset sales were orderly. See Ex. 174 (Bajaj Rpt.) ¶¶ 45, 48–49 (citing evidence defendants' contemporaneous descriptions of the Funds' asset sales as "orderly"); Ex. 204 (Tannin Tr.) at 407 (denying that the Funds were "forced sellers"); Ex. 187 (Geissinger Tr.) at 139–40 (stating that BSAM was "never contemplating a fire sale process at any point in time"). Likewise, the June 14 Wall Street Journal article cited by defendants emphasized the relative security of the HG Fund. Ex. 73.

immediate aftermath of BSAM's devastating news. Ex. 202 (Skardon Tr.) at 132–33. Unlike BofA's economic expert, for example, BofA did not have access to data on the Funds' contemporaneous trades. *Cf.* Ex. 174 (Bajaj Rpt.) ¶ 55 & n.83. What is more, plaintiffs' economic expert reasonably examined market activity through June 20 in order to gauge price reaction to BSAM's announcement of the EL Fund's suspension of redemptions. *See id.* App. 5. Plaintiffs, quite obviously, did not have that luxury on June 14.

## III. SUMMARY JUDGMENT IS UNWARRANTED ON THE TRUSTEE'S FIDUCIARY-DUTY CLAIM (COUNT III) BECAUSE THERE IS ABUNDANT EVIDENCE THAT BSAM OWED THE ISSUER FIDUCIARY DUTIES WHEN IT CAUSED THE ISSUER TO PURCHASE THE INITIAL COLLATERAL

There is more than sufficient evidence that BSAM owed a fiduciary duty to the Issuer of the CDO^2 securities.[14] Whether one party owes a fiduciary duty to another under their agreements is a quintessential issue of fact, on which summary judgment is rarely granted. *See, e.g.*, *Kwiatkowski v. Bear, Stearns & Co., Inc.*, No. 96 Civ. 4798 (JGK), 1999 WL 1277245, at *12–13 (S.D.N.Y. Nov. 29, 1999). Nevertheless, defendants assert (at 22–28) that, as a matter of law, BSAM owed no such duty to the Issuer.[15]

1. Defendants' contention founders, first and foremost, on the plain language of the Collateral Management Agreement ("CMA"). Because the Issuer—like almost all such CDO issuers—lacked the expertise to make its own investment decisions for the CDO^2, it appointed BSAM "as its investment adviser and manager with respect to the Collateral," pursuant to the CMA. Ex. 6 ¶ 2(a). The CMA spelled out the obligations that BSAM had assumed months

[14] The Trustee is a plaintiff in connection with Count III against all defendants, and it joins this memorandum in opposition to defendants' motion for summary judgment solely in that capacity.

[15] The Trustee also claims that the Individual Defendants aided and abetted BSAM's breach. *See* 2d Am. Compl. (Doc. 93) at p.36 & ¶¶ 139–148. Those defendants seek summary judgment only on the basis that BSAM did not commit a primary violation. See Memo. 40 n.19.

earlier in the Engagement Letter, in which it agreed to "act as collateral manager for the Issuer and will be *solely responsible for*, and *independently make*, all [of its] investment, credit, purchase and trading decisions." Ex. 5 ¶ 4(a) (emphasis added). The CMA likewise authorized BSAM to perform various duties "on behalf of the Issuer" (Ex. 6 at 1), including "effect[ing] the [Issuer's] acquisition" of collateral and "caus[ing]" the Issuer's trustee "to acquire" such collateral. Ex. 6 at 3–4. BSAM's collateral-management decisions were discretionary, limited only by the selection criteria set out by the CDO^2's Indenture. *E.g.*, Ex. 179 (Castro Rpt.) ¶ 30. BSAM pledged to execute its responsibilities on the Issuer's behalf—including the acquisition of its collateral—by "exercising a degree of skill and attention no less than that generally exercised by institutional managers of national standing for clients in substantially similar transactions." Ex. 6 at 3.

That broad delegation of authority to act as the Issuer's Collateral Manager was easily sufficient to have conferred fiduciary duties on BSAM. Nor is there any question that such duties extended to BSAM's placement of the Initial Collateral with the Issuer. By its terms, the CMA made BSAM responsible for the Issuer's purchase of all of its "Collateral Debt Securities." Ex. 6 ¶ 2(a)(ii). That term took its definition from the CDO^2's Indenture (*see* Ex. 6 at 2), where it was defined to include the Initial Collateral (Ex. 166 at 15–16). *See also* Ex. 16 at 3 (discussing "[t]he Collateral Debt Securities that will be purchased . . . on the Closing Date").

To be sure, the CMA does not use the magic words "fiduciary duty" to describe BSAM's role. In that sense—but only in that sense—defendants are correct when they assert that the CMA "has no express language creating a fiduciary duty." Memo. 28 n.10. But the CMA *does* have a wealth of "express language" assigning to BSAM the responsibilities and discretion of a collateral manager. That is all the "express language" needed to carry the day.

Indeed, a fiduciary duty may arise without any words at all—simply through the relationship of the parties. *See Sergeants Benevolent Ass'n Annuity Fund v. Renck*, 796 N.Y.S.2d 77, 79 (1st Dep't 2005) (quoting Restatement (Second) of Torts § 874, cmt. b); *cf.* Memo. 25 ("[A] fiduciary duty can arise even outside of a contractual relationship creating one." (citing July 6, 2012 Order (Doc. 91) at 2 n.1)). To borrow from a leading Second Circuit decision, BSAM's "de facto control and dominance" over the Issuer's $2.86 billion investment in the Initial Collateral, and the Issuer's corresponding reliance on BSAM to act in its best interests in directing that purchase, is "the heart of the fiduciary relationship." *United States v. Chestman*, 947 F.2d 551, 568 (2d Cir. 1991) (quotation marks omitted). Under well-settled principles, therefore, BSAM had a fiduciary duty to the Issuer whose collateral it managed. *See Oddo Asset Mgmt. v. Barclays Bank PLC*, 19 N.Y.3d 584, 593 (2012) (recognizing that collateral managers may be fiduciaries to CDO issuers); *MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, No. 09 Civ. 3255 (RWS), 2012 WL 2568972, at *10 (S.D.N.Y. July 3, 2012) (acknowledging a CDO collateral manager's fiduciary duties to an issuer when selecting its collateral).

BSAM cannot avoid either the plain language of the CMA, or the significance of its relationship to the Issuer, by foisting its responsibilities as Collateral Manager on to BofA. Although defendants concede (at 27) that one of BSAM's roles was the selection of the Initial Collateral, they contend (*id.*) that BofA's "review and approval" of that selection acted as "a check on BSAM's discretion." But defendants' *own* industry expert has testified that even when an underwriter provides the kind of input that BofA gave here, "the collateral manager has the *final decision* over which assets the CDO purchases." Ex. 192 (Kesselman *Ramius* Rpt.) at 14 (emphasis added). A jury therefore could easily find that BSAM (and only BSAM) had the authority to finally determine the composition and price of the Initial Collateral. In any event,

there is no doubt that, under the CMA, BSAM (and only BSAM) had the power to *direct* the Issuer to buy that collateral.

2. Nor is it true (Memo. 22–23) that Paragraph 5(c) of the CMA absolved BSAM of its fiduciary duty. Paragraph 5(c) authorized BSAM to acquire collateral on the Issuer's behalf from BSAM's own accounts or those of its affiliates (including the Funds). There were, however, three conditions: (1) the Issuer's Board of Directors had to be notified, (2) the price the Issuer paid had to be no greater than the lower of two bids from unaffiliated dealers or, in certain circumstances, no greater than the BSAM affiliate's original purchase price (with other purchase terms approximating an arm's-length trade), and (3) the related-party purchase had to comply with a particular federal statute. Paragraph 5(c) further stated the Issuer's agreement that those conditions had been met with regard to the Initial Collateral.

Nothing in that Paragraph purported to relieve BSAM of its fiduciary duties to the Issuer when causing the Issuer to make purchases from the Funds and other BSAM portfolios. To the contrary, the CMA expressly stated "that *nothing* in [Paragraph] 5 shall be construed as altering the duties or liabilities of the Collateral Manager as expressly set forth herein." Ex. 6 ¶ 5(b) (emphasis added). And Paragraph 5(c)'s conditions did not purport to regulate BSAM's relationship *with the Issuer*; it regulated how BSAM transacted *with itself*. Those conditions ensured only that when BSAM sold collateral to the Issuer from its own supply, BSAM would charge the Issuer prices that matched what the Issuer would have paid in an arm's-length market transaction.

The "summary" of Paragraph 5(c) in the Offering Circular—on which defendants rely to the total exclusion of the CMA's actual text (*see* Memo. 22–23; *cf.* Counter-Stmt. ¶ 40)—says nothing more than that: BSAM was required to make *all* purchases for the CDO^2 at arm's

length, and the Initial Collateral "shall be deemed to be purchased on an 'arm's-length' basis." Ex. 16 at 144. Such a designation, however, cannot possibly be read to disavow BSAM's fiduciary duties to the Issuer in directing the Issuer to make those purchases. The essence of the Trustee's claim isn't that BSAM failed to secure *then-prevailing* market prices for collateral bought from the Funds, but rather that BSAM caused those purchases to go forward despite knowing that the Funds' redemptions were about to cause those prices to tumble. Paragraph 5(c) is not a get-out-of-jail-free card for such egregious self-dealing.

3. Finally, Defendants invoke what they call the "April 30 Pricing Agreement." Memo. 23–24. Relying on another statement in the Offering Circular (Ex. 16 at 46–47), defendants contend that everyone "agreed" that BSAM would price the Initial Collateral using the Funds' valuations "as of April 30."[16] In defendants' view, because everyone had supposedly agreed to a sale at those April 30 prices, BSAM could not have breached any fiduciary duty when it sold at those prices—even though defendants secretly knew those valuations were about to implode. A jury may well disagree.

First of all, the Offering Circular's disclosure about how BSAM had "determined" the Initial Collateral's prices is not an "Agreement" by anyone to anything. *See* Ex. 16 at 46–47. Nothing prevented BSAM, in its sole discretion as Collateral Manager, from changing that "pricing protocol" (Memo. 24) once it knew that its internal turmoil, when publicized, would cause those prices to plummet. Counter-Stmt. ¶ 35. Defendants' own industry expert, Todd Kesselman, testified that BSAM was not *bound* to sell the Initial Collateral to the Issuer at its "as

[16] Like most hedge funds, BSAM performed its valuations for each month at the beginning of the following month. And so its valuations "as of April 30" were, in fact, calculated in early May. Discovery has revealed that BSAM *falsely* represented that it had determined prices for the Initial Collateral equal to those used to determine the Funds' April 30 net asset values. Internal BSAM documents demonstrate that the Funds actually caused the Issuer to buy the Initial Collateral at prices *at least $16 million higher* than the prices used for calculating the Funds' April 30 NAV. *E.g.*, Ex. 181 (Cioffi Tr.) 573–75.

of April 30" prices—BSAM could have made any adjustments before closing that didn't "fundamentally change" the CDO^2 transaction. Ex. 191 (Kesselman Tr.) at 336–37; *see also* Ex. 192 (Kesselman *Ramius* Rpt.) at 14 ("The collateral manager is responsible for deciding which assets the CDO warehouse should purchase <u>and</u> what price the CDO warehouse should pay for each asset.").

But even if, contrary to the evidence, BSAM's "as of April 30" prices *were* set in stone, the Issuer's breach-of-fiduciary-duty claim is still every bit as viable. BSAM's duty was to deal honestly with the Issuer when it came time to transfer the Initial Collateral into the CDO^2. By the time BSAM caused that transfer to take place, defendants (and *only* defendants) knew that the prices BSAM had set for those assets were about to plummet. BSAM, now charged by the CMA with all the duties and responsibilities of a fiduciary collateral manager, was not free to fob off tainted assets merely because it had decided to set the prices of those assets "as of" some earlier date. Indeed, nothing required BSAM to cause the Issuer to purchase the Initial Collateral *at all* once BSAM realized that the values were about to drop. Defendants made *that* decision on their own—the fictitious "April 30 Pricing Agreement" did not force their hand.

* * * * *

In the end, Defendants' description of the "paradigmatic" fiduciary relationship under New York law hits the bull's eye: "[W]here a client [*the Issuer*] entrusts an adviser [*BSAM*] with capital [*$2.86 billion*] and relies on the adviser and its expertise [*CDO collateral management*] to exercise discretion [*"sole[] responsibil[ity]"*] to invest [*purchase the Initial Collateral*] and manage the assets on a going-forward basis." Memo. 27.[17] BSAM had—and breached—

[17] This Court quoted from a similar statement by BSAM of the "uncontested" legal rule: "'[W]hen an investor or investors give money over to someone who is operating as their financial advisor, and in so doing choosing assets, what to buy, what to sell, when to buy and sell, there is a fiduciary duty.'" July 6,

precisely those duties when it caused the Issuer to purchase overvalued Initial Collateral earmarked from its own beleaguered Funds.

## IV. SUMMARY JUDGMENT IS UNWARRANTED ON CAUSATION GROUNDS BECAUSE THERE IS ABUNDANT EVIDENCE THAT DEFENDANTS' MISCONDUCT PROXIMATELY CAUSED PLAINTIFFS' DAMAGES

The evidence shows that, when defendants publicly disclosed the news they had concealed from BofA, prices for the Funds' assets—including the collateral backing the CDO^2—took a nosedive, just as defendants had expected at the time. That precipitous drop in price is the measure of how much the BSAM collateral was inflated on May 22, when defendants fraudulently induced BofA to buy it, and on May 24, when defendants wrongfully caused the Issuer to accept it. It is that over-valuation of the collateral—resulting from defendants' fraudulent conduct—that is the measure of our damages. Although plaintiffs' total losses on the transaction exceeded $2.9 billion, we are seeking only the portion proximately caused by defendants' wrongful conduct.

We reiterate that causation theory because defendants refuse to engage it on the merits. In the very first paragraph of their proximate cause argument, they chastise us for (supposedly) failing to prove things that we are not seeking to prove at all. Defendants claim, for example, that we have failed to show that the disclosure of the concealed information "caused a *market-wide* decline in CDO asset values"; that defendants caused the *entire* decline in "the value of the CDO^2 notes"; or that defendants' misconduct was the *sole* cause of the "failure of the CDO^2." Memo. 28–29.

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2012 Order at 2 (Doc. 91) (citing *Palmetto Partner, L.P. v. AJW Qualified Partners, LLC*, 921 N.Y.S.2d 260, 265 (2d Dep't 2011); *Bullmore v. Ernst & Young Cayman Islands*, 846 N.Y.S.2d 145, 148 (1st Dep't 2007)).

This is utter misdirection. To the contrary, we are measuring only the particular hit to *BSAM securities* (and thus the collateral BofA and the Issuer purchased). We do not disclaim the possibility—even likelihood—that *other* factors caused *other* losses to "the value of the CDO^2 notes" and contributed to their "failure." Instead, we are seeking to recover only that *portion* of plaintiffs' losses for which defendants' wrongdoing was responsible.

Once their parade of irrelevancies has passed the reviewing stand, defendants have little, if anything, to say. And small wonder: The damages we have measured are deeply rooted in overwhelming evidence. Defendants' proximate-cause challenge—which is the only ground on which they seek summary judgment on our Contract Claim (Count I)—fails in all respects.[18]

### A. To Satisfy The Proximate Cause Standard Under New York Law, Plaintiffs Must Show That The Collateral They Purchased From Defendants Was Over-Valued As A Result Of Defendants' Wrongful Conduct, And Lost That Value When The Truth Was Disclosed

"Under New York law, an 'injury is proximately caused if it is the natural and probable consequence of the [defendants'] misrepresentation or if the [defendants] ought reasonably to have foreseen that the injury was a probable consequence of [their] fraud." *Citibank, N.A. v. K-H Corp.*, 968 F.2d 1489, 1496 (2d Cir. 1992); *see also MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 928 N.Y.S.2d 229, 235 (1st Dep't 2011) (citing cases); *cf. Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 172 (2d Cir. 2005) ("'[T]he damages suffered by plaintiff must be a foreseeable consequence of any misrepresentation or material omission.'").

[18] Defendants scold us (Memo. 32–33) for ostensibly abandoning our effort to prove that the Funds' collapse damaged the entire CDO market, and moving to a more conservative theory as a "Plan B fallback." That is both false and irrelevant. It is false because the collateral-overvaluation theory has been at the heart of the case from the get-go—as defense counsel belatedly conceded at oral argument on the fiduciary-duty claim. Ex. 167 (7/2/12 Hearing Tr.) at 21–22. But the point is irrelevant in any event, since a causation theory supported by the record goes to the jury, regardless of whether it is Plan A or Plan B.

In cases like this one—where a plaintiff alleges that it was defrauded in the purchase of securities—federal law and New York common law ask the same question: Did the alleged misstatement or omission "conceal[] something from the market that, when disclosed, negatively affected the value of the security." *Lentell*, 396 F.3d at 173. The Second Circuit recently reiterated that standard in *Acticon AG v. China N. E. Petroleum Holdings Ltd.*, 692 F.3d 34 (2d Cir. 2012), holding that in Section 10(b)(5) cases, securities-fraud "damages 'consist of the difference between the price paid and the "value" of the stock when bought,'" *id.* at 38. Thus, "a securities fraud action attempts to make a plaintiff whole by allowing him to recover his out-of pocket damages, that is, *the difference between what he paid for a security and the uninflated price*." *Id.* at 41 (emphasis added)).

New York tort law is the same. As the Second Circuit explained in *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, New York "follows the well-established common-law rule that fraud damages represent the difference between the purchase price of the asset and its true value, plus interest, generally measured as of the date of sale." 500 F.3d 171, 183 (2d Cir. 2007) (citing cases). A plaintiff may therefore establish proximate cause by showing that the "purchase price overstated [an asset's] value on the date of sale as a result of [defendants'] misrepresentations and omissions." *Id.* "[L]oss," according to the New York Court of Appeals, "is computed by ascertaining the 'difference between the value of the bargain which a plaintiff was induced by fraud to make and the amount or value of the consideration exacted as the price of the bargain.'" *Lama Holding Co. v. Smith Barney Inc.*, 88 N.Y.2d 413, 421 (1996); *see also Hotaling v. A.B. Leach & Co.*, 247 N.Y. 84, 87–88 (1928); *Reno v. Bull*, 226 N.Y. 546, 553 (1919); accord Restatement (Second) of Torts § 549 (1977) (a fraud plaintiff is entitled to recover "the difference between the value of what he has received in the transaction and its purchase price or

other value given for it.”). Where “the claim is based on a transaction involving a particular quantity of the security at a particular time, . . . to determine damages, *the factfinder need determine only the effect of an accurate disclosure on the price of the security at the particular time the transaction actually occurred*.” *Starr Found. v. Am. Int’l Grp., Inc.*, 901 N.Y.S.2d 246, 250 (1st Dep’t 2010) (emphasis added).

**B. The Evidence Amply Shows That A Portion Of Plaintiffs’ Losses Was Proximately Caused By Defendants’ Misconduct**

Plaintiffs offer overwhelming evidence that they suffered economic losses that were the natural and probable consequence of defendants’ misconduct. Put simply, plaintiffs were hoodwinked into purchasing, underwriting, and financing the CDO^2’s Initial Collateral at market prices that defendants knew were about to fall as a result of undisclosed problems at the Funds. When those problems were finally disclosed to the market, defendants themselves acknowledged the immediate and adverse effects on prices. Plaintiffs’ economic evidence measures—carefully, conservatively, and with reasonable certainty—the extent to which those disclosures “negatively affected the value” of the Initial Collateral. *Lentell*, 396 F.3d at 173.

1. When the Funds’ redemptions levels spiked in early May 2007, defendants recognized that meeting those redemptions posed a threat to the fair market value of the Funds’ assets. Defendant Cioffi fretted that selling assets to meet redemptions in the EL Fund would “exacerbate negative returns” by decreasing prices in a thinly traded market. Ex. 139. And the price hits, Cioffi warned, would extend not only to the EL Fund’s assets, but would also “negatively impact” the HG Fund and the “other businesses on the HG platform” that held similar assets. Ex. 137; *see also* Ex. 168 (Cioffi explaining, on May 22, that “selling things” from EL “in a liquidation scenario” would “impact [HG] returns”).

Defendant McGarrigal concurred. He recognized that, once the Funds' redemption levels were revealed, any entity holding assets that overlapped with the Funds—like the Issuer, whose Initial Collateral was populated entirely from the Funds' portfolios—would face lower market prices. Ex. 196 (McGarrigal Tr.) at 223; *see also id.* at 153–54 (explaining his concern that counterparties would "decreas[e] the price" on the Funds' assets in response to the Funds' redemptions and liquidation). He also believed that the liquidation of the EL Fund would cause—*and in fact did cause*—similar spillover effects on the value of assets held by the HG Fund and other vehicles (like the CDO^2) that held substantially similar assets. *Id.* at 223, 228.

Defendants knew all of this in April and May 2007, and recognized that they had to act fast if the Funds were going to get top dollar for their assets before the market caught on to their problems. In late-April 2007, defendant McGarrigal told his colleagues that the "only exit" from a market they were about to push over the edge was to "sell [the Funds' assets] via CDO." Ex. 126. The sale of $2.86 billion in collateral to the Issuer—for underwriting by BofA—was their prime "exit" opportunity.

2. They barely made it. Circumstances finally forced BSAM's hand on June 7—just two weeks after closing the CDO^2—as defendants belatedly began to disclose the Funds' problems to traders and counterparties. The negative effect on the market was immediate. BSAM's Chief Risk Officer recognized that BSAM's announcement of the EL Fund's redemptions might cause counterparties to act "FAST" by, among other things, "mark[ing] down [the Funds'] assets." Counter-Stmt. ¶ 165. And defendant Cioffi reported that it took "all of 30 minutes" for that to start "happening" once the Funds' news hit the market. *Id.* The Funds' repo counterparties quickly demanded more "margin," which defendant Tannin (and others) explained as their automatic reaction to a "*fall in value*" of the Funds' securities that served as collateral for

those repo loans. *Id.* ¶ 74 (emphasis added). In fact, Tannin admitted that BSAM's disclosure of the Funds' redemptions was a "factor . . . that led to falling prices." *Id.*

That isn't all that Tannin said about causation. This case has rare evidence: the contemporaneous causation analysis of a defendant. On July 8, 2007—after BSAM suspended redemptions in the EL and HG Funds, and just days before it announced the Funds' liquidation—Tannin described the unfolding effects of the Funds' shocking disclosures. In a personal e-mail to a close friend, Tannin explained that "the 'market'" had become "afraid," "very quickly," that the Funds' "risk . . . was much different (worse) than everyone had been thinking." Ex. 162. And so "[w]hen the 'market' realized that [the Funds] were going to have to sell a good deal of [their] portfolio it became very difficult for us to sell anything. Prices then deteriorated very quickly and there was a negative cascading effect that ended up affecting many of the larger banks on Wall Street." *Id.* According to Tannin, the Funds' "trouble was sort of the straw that broke the camel's back in the market." *Id.* Tannin's in-the-moment soliloquy on causation is conspicuously absent from defendants' summary-judgment brief and their Rule 56.1 Statement of the "material" facts. That is no oversight—Tannin's frank e-mail is devastating to defendants' argument that plaintiffs cannot prove proximate causation to a jury.

3. Plaintiffs retained an experienced economist to determine *the amount* by which the "[p]rices" of the Initial Collateral "deteriorated very quickly" after BSAM's corrective disclosures of the Funds' redemptions and liquidation. The expert testimony will show that, when the market learned the full truth about the Funds' redemptions and liquidation in June and July 2007, it caused a drop in the fair market value of the Initial Collateral that is not attributable to any unrelated events in the market.

Dr. Mukesh Bajaj employed a widely-accepted "event study" methodology to measure the amount by which the Initial Collateral's market prices dropped in response to each of three announcements disclosing the concealed information about the Funds. As is typical in economic event studies, Dr. Bajaj made sure that his model's results *did not* include any price effects unrelated to defendants' omissions. Dr. Bajaj concluded that after all the bad news was fully revealed, the Initial Collateral had lost nearly $500 million as a result.

Despite all of this evidence, defendants assert that there is "no evidence" that the Funds' redemptions "had anything to do with" "the declining value of [the CDO^2's] collateral." Memo. 3. Respectfully, we have no idea what they are talking about. Indeed, to read defendants' summary-judgment brief (and their *Daubert* motion, for that matter), one would never know that defendants' own economic expert, Harvard economist Robert Barro, called plaintiffs' analysis a "clever" method of estimating plaintiffs' damages (Ex. 177 (Barro Tr.) at 27), and arrived at similar calculations of those damages when he tried to "improve[]" on Dr. Bajaj's econometric models (Counter-Stmt. ¶¶ 140–41).

Defendants also contend that all we have proven is "but for" causation, not proximate cause. That is just not so. The evidence shows exactly what it is supposed to: that defendants' "misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the [Initial Collateral]." *Lentell*, 396 F.3d at 173; *see also Acticon*, 692 F.3d at 40 (distinguishing the mere purchase of securities "at an inflated price" from proof that "the price of [the securities] dropped after the alleged fraud became known"). That is all that proximate-causation principles require. Plaintiffs do not need to prove that defendants' misconduct caused the entire CDO^2 to be a "failed venture" (Memo. 38) or that it resulted in "the ultimate failure" of the CDO^2 (*id.* at 37). Our burden, instead, is to show that

defendants' misconduct proximately caused a portion of plaintiffs' losses—in particular, the degree to which plaintiffs overpaid for the Initial Collateral due to the concealed information. We will do that in spades.

### C. In This Case, Defendants' Causation Theories Are, At Best, Competing Theories

Defendants contend, finally, that their causation theories are better than ours, so they should get summary judgment. Memo. 33–37.

1. They contend, first (at 33–35), that BofA's internal accounting valuations of the CDO^2 assets should trump plaintiffs' proof—and thus foreclose damages. But the record says otherwise. As the central BofA witness explained, prevailing public accounting standards required BofA to "assume[] the 'highest and best use' of [each] asset" of the CDO^2's collateral. Stmt. Of Financial Accounting Standards (FAS) No. 157, ¶ 12; Ex. 83; Ex. 178 (Carp. Tr.) 157. Those accounting standards therefore prevented BofA from using the well-accepted measure of damages under this Court's precedents: the effect on market prices for each piece of the CDO^2's Initial Collateral immediately following defendants' corrective disclosures. Instead, those accounting standards required BofA to use models that *hypothesized* what conditions might be in the "most advantageous market" if "market conditions . . . improve[d]" before BofA sold any of the CDO^2 securities to investors. Ex. 178 (Carp. Tr.) 29; Ex. 83.[19]

But that, of course, was a world that never came. And so not surprisingly, contemporaneous accounting valuations do not necessarily foreclose competing evidence

[19] Even in these internal accounting documents, BofA expressly recognized the effect on "market conditions" and prices caused by revelations about the Funds. By the end of July 2007, BofA's traders had already marked down prices for the CDO^2's Initial Collateral *by hundreds of millions of dollars*. See Ex. 83 (stating that prices for the CDO^2's portfolio had declined by 15.8% between May 24 and July 31). But the relevant accounting standards did not permit these markdowns to control BofA's valuation for purposes of its financial reporting.

premised on actual market activity that those accounting valuations did not reflect. *See, e.g.*, *CDO Plus Master Fund Ltd. v. Wachovia Bank, N.A.*, 07 Civ. 11078 (LTS) (AJP), 2010 WL 3239416, at *5 (S.D.N.Y. Aug. 16, 2010) (distinguishing the "relevant" "market-price standard" from a "CDO's internal valuation"). On this record, defendants' competing approach to valuation is not dispositive and is little more than grist for trial.

2. Defendants next contend that there cannot be any recoverable damages in this case simply because plaintiffs' losses "coincide[d] with a marketwide phenomenon causing comparable losses to other investors." Memo. 37 (quoting *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 772 (2d Cir. 1994)); *see also id.* at 35–37. That is not the law.

Defendants refer (at 35) to the Court's recognition of the mid-2007 mortgage-market downturn in *King County, Wash. v. IKB Deutsche Industriebank AG*, 708 F. Supp. 2d 334, 344 (S.D.N.Y. 2010). But they overlook Judge Scheindlin's *analysis* of the causation questions in that case. After acknowledging the overall "credit crisis," the Court proceeded to explain that this Circuit's cases *do not* hold "that the existence of a market-wide phenomenon necessarily *eliminates* a plausible causal connection between plaintiffs' losses and defendants' alleged fraud." 708 F. Supp. 2d at 343. Where a plaintiff can demonstrate such a connection, the court concluded, it would place "too much weight on one single factor," to dismiss a claim simply because it asserts losses that "occurred contemporaneously" with other market events. *Id.* at 343; *see also Gelt Funding Corp.*, 27 F.3d at 772 (the coincidence of losses and marketwide phenomena does not mean that "that in all cases" a defendant cannot have caused some or all of the plaintiff's losses).

So, too, here. Plaintiffs' economic evidence—which the jury is entitled to credit—carefully separates the wheat from the chaff by *excluding* any effect on the price of the Initial

Collateral attributable to any "marketwide phenomena" *other than* defendants' disclosures about the Funds. Defendants concede as much; they admit (elsewhere in their brief) that plaintiffs seek only "the portion of their roughly $3 billion in losses that is attributable *specifically* to the collapse of the Funds and *not* to other market-wide developments." Memo. 14 (emphasis added). We could hardly have put it better. This is, in short, *not* a case in which plaintiffs have failed to allege—or will be unable to prove—a causal connection between defendants' misconduct and their economic losses. *See, e.g.*, *Lentell*, 396 F.3d at 173. Defendants' motion to dismiss on this ground was unsuccessful, and their argument is even more untenable now that plaintiffs have come forward with specific and reliable economic evidence showing the portion of losses directly attributable to defendants' misconduct.[20]

## CONCLUSION

The Court should deny defendants' motion for summary judgment in its entirety.

[20] In the same connection, defendants highlight (at 36) excerpts from their economic expert's report. There, Dr. Barro opined that BofA's losses stemmed from a "perfect storm of adverse economic conditions" and "cannot reasonably be attributed to the Bear Stearns Funds." He is free to say so at trial. But Dr. Bajaj's careful econometric analysis isolates the portion of plaintiffs' losses that were distinct from any losses caused by the storm swirling around them. The jury is the arbiter of such disagreements, not defendants.

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Washington, D.C.

ROBBINS, RUSSELL, ENGLERT, ORSECK,
UNTEREINER & SAUBER LLP

By: /s/ Lawrence S. Robbins

Lawrence S. Robbins
Kathryn S. Zecca
Michael L. Waldman
Matthew M. Madden
Alex Potapov

1801 K Street, N.W.
Washington, D.C. 20006
Tel: (202) 775-4500
Fax: (202) 775-4510
lrobbins@robbinsrussell.com

*Attorneys for Plaintiffs*