D348DEX1

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
----------x

DEXIA SA/NV, et al.,

Plaintiffs,

v. 12 Cv. 4761 (JSR)

BEAR, STEARNS & CO., INC., et al.,

Defendants.

----------x

March 4, 2013
6:00 p.m.

Before:

HON. JED S. RAKOFF

District Judge

APPEARANCES

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP
Attorneys for Plaintiffs
BY: TIMOTHY A. DeLANGE
MAX W. BERGER
JEROEN VAN KWAWEGEN

CRAVATH, SWAINE & MOORE LLP
Attorneys for Defendants
BY: DANIEL SLIFKIN
WES EARNHARDT
MICHAEL A. PASKIN
HECTOR VALDES

(Case called)
THE COURT: Would counsel please identify themselves?
MR. DeLANGE: Good evening, your Honor. Timothy DeLange of Bernstein Litowitz Berger & Grossmann, on behalf of the plaintiffs.
MR. VAN KWAWEGEN: Jeroen Van Kwawegen, Bernstein Litowitz, on behalf of the plaintiffs.
MR. BERGER: Max Berger, Bernstein Litowitz, for the plaintiffs.
MR. SLIFKIN: Daniel Slifkin of Cravath, Swaine & Moore for the defendants.
MR. EARNHARDT: Wes Earnhardt of Cravath Swaine & Moore for the defendants.
MR. PASKIN: Michael Paskin, from Cravath, Swaine & Moore, for the defendants.
MR. VALDES: Hector Valdes of Cravath, Swaine & Moore, for the defendants.
THE COURT: Welcome back.
Now, there has been one devastating development since you were last here. As a result of the sequester, power in this courtroom, and all the courtrooms in this courthouse, will go off at 8 p.m., which only gives you about two hours. I, of course, am devastated at what this will do to my reputation. My wife is even more devastated because it means I might come home early, but notwithstanding that, there we are. So I just

wanted to flag that. In all seriousness, I think we have more than enough time, but at 8:00 we will have to stop.

So we had sort of left everyone in midstream. I guess maybe we should start with moving counsel again. There were a bunch of arguments that he hadn't gotten to. There were some that they were going back and forth. But let's begin with defense counsel.

MR. SLIFKIN: Thank you, your Honor.

So there are essentially points I would like to cover, with the Court's permission, and then we can go in whatever direction your Honor chooses.

Those two subjects are, first, to come back to the reliance issue we were discussing a little over a week ago, and specifically to address some of the assertions made by plaintiffs' counsel at the prior hearing, and then if I may go back to standing, as I noted last time, and to touch again on the equitable subrogation issue your Honor flagged and to talk a little bit more about the equities here.

So let me address a few of the specific documents and other evidence that counsel for the plaintiff directed the Court's attention to at the last hearing. And to set the scene again, where we were in that hearing is we had been through, that's to say we defendants had been through an explanation of why the allegations concerning any representations with compliance with underwriting guidelines could not be said to

have been relied upon by the plaintiffs because either they didn't receive that representation for certain deals, or they conceded, where they did receive it in prospectus supplements, they didn't read them, or if they did get that statement, there is no evidence that they relied upon it.

So we were talking about what we have been referring to as computational data. And the question is: Is there any evidence that this computational data is untrue? We will assume for these purposes that it was at least looked at. The question is, is it untrue?

So counsel gave a few examples, counsel for plaintiffs gave a few examples of the computational data, which he says, and I will quote, on page 27 of the transcript, "Those various allegations in the complaint that we identified and pled." If one looks at the complaint and compares it to Exhibit 72 to the DeLange declaration, Exhibit 72 sets forth all the different types of representations that were received. And if one compares that to the complaint, you will see that there were really four computational issues that were actually complained about: Credit ratings, loan-to-value ratios, owner occupancy status, and FICO scores.

(Continued on next page)

MR. SLIFKIN: You then look at what was actually raised in the hearing, there is really a complete mismatch between those specific issues ratings LTV, owner occupancy and FICO score, and the evidence.

Let me say as an initial point. All the evidence that was presented to your Honor in the hearing last time on this topic concerned JP Morgan. There was no evidence concerning Bear Stearns and there was no evidence concerning Washington Mutual.

And the first two things you were shown, which were Exhibits 103 and 106, from the DeLange affidavit, I'm simply referring to what was shown to you last time, your Honor.

THE COURT: I just want to fish it out. Go ahead.

MR. SLIFKIN: They all concern the due diligence process by which the determination is being made not as to whether or not the data is correct, but as to whether the data shows compliance or non-compliance with underwriting guidelines.

So, your Honor, you'll be familiar with the Flagstar trial which I know you conducted a few weeks ago with the process of rating mortgage loans, EV1, EV2, EV3. EV3 being one that is potentially --

THE COURT: If this case does go to trial, is it a jury trial or a bench trial?

MR. SLIFKIN: It is a jury trial, your Honor.

THE COURT: Oh, thank God. Go ahead.
MR. SLIFKIN: So the EV3s, they are loans that potentially are outside the guidelines. And then there is a process, as your Honor is familiar, between the entity that is selling the mortgage loan to the securitizing entity, in this case JP Morgan, as to whether or not they are going to buy it or not, is it really an EV4, or does it fall within an exception. Is it a EV3 which because of a missing document it is really an EV1.
That's got nothing to do with incorrect data. It's entirely to do with compliance with guidelines. Have nothing to do with falsity.
So, you were referred to the testimony of Joel Readence, R-E-A-D-E-N-C-E, who was one of the due diligence managers at JP Morgan. And he was asked about these documents and this specific pool of mortgages. And if you look at oral argument transcript at page 25 from last time, counsel for plaintiff said, well --
THE COURT: I'm sorry, bear with me one -- for some reason we don't have that. But go ahead, read me the relevant portion.
MR. SLIFKIN: Counsel referred to part of the Readence deposition in which there was a discussion of an entry which says income does not meet guidelines for grade slash doc type and talks about what it means to not meet the guideline. As we

said before, that's about compliance with underwriting guidelines. That's about a representation which was never relied upon because in most cases it wasn't seen and it wasn't read. That is not about falsity.

Similarly, in the same passage there is discussion of the property type being unacceptable under the guidelines. Counsel said to the Court, well, that means an investment property as opposed to owner occupancy. That was actually a mistake by counsel. That's not what it means.

What property type means is, is it a single family home, is it a condominium, I suppose in New York is it a cooperative. But again, the very title property type unacceptable under the guidelines. The question is, is this, does this meet the guidelines or not. There is no suggestion that there is some false statement being made to the investor as to whether this is a condo or a single family home. Does it meet the guidelines or not.

So, that really is the evidence that you were shown at the last hearing. It's limited to one company, and it's all, we submit with respect, it's all concerning a compliance with underwriting guidelines. It does not concern the issue we have now, which is, is there any evidence of falsity with respect to owner occupancy, FICO scores, ratings, and loan to value.

So, we submit, the way the falsity ought to be shown, is that counsel should get up and say, okay, here's 52 deals,

let's take each of them. Here's the deal, here's the representation we actually got, here is some evidence we relied upon, and he showed you some of the deals with little checkmarks. We don't know what this is. But for purposes of summary judgment, if they circled an item in their files, it looks like they were looking at it at least, they may have relied upon it, okay. But most importantly this is false, because. You haven't heard any evidence of why this is false.

Now, I read your decision on the motion to dismiss with some care, your Honor. And I know in that, you said, well, it's possible the pleadings, to plead appropriately, if you can show there is a pervasive error. There is pervasive misconduct. Again, you were talking there in the context of underwriting guidelines.

So, if we go back to data falsity, if there were some evidence and there is not -- of some kind of pervasive error. If the policy was add 50 points to every FICO score whether it's true or not. I suppose that evidence might suffice as well. But there is no such evidence. There is no evidence on the specifics, and there is no evidence on the practice with respect to falsity.

THE COURT: I want to emphasize, although this is implicit in what you've just said, that, obviously, the motion to dismiss opinion did not take account in any way, shape or form of the summary judgment record. It was purely on the

pleadings.
MR. SLIFKIN: We understand and appreciate that, your Honor.
There are a lot of broad allegations in the complaint and there are a lot of broad allegations made with respect to on the summary judgment motion and broad allegations of those kind make for good reading in The New York Times or certainly a juicy article that somebody can write about, but they are not, to quote Gertrude Stein, there is no there, there.
When you actually look at them, you will say, okay, I need to -- not just some broad assertion. I need to, so for this deal where is the representation, was it relied upon, what is the evidence of falsity. Was this loan in fact securitized, in which deal was this securitized. Did this data, if there is any falsity, affect the aggregate data that was presented to the plaintiff. Because the plaintiff did not get individualized loan by loan data. They got aggregated data as we discussed last time. Was that within the 5 to 10 percent tolerance that was specifically identified in the PROSUPP, and we submit discovery is over.
There is no evidence in this regard. And tellingly, there is no expert testimony. Plaintiffs haven't got an expert to look through this and say, okay, I am going to explain why there is falsity. There is nothing like that, your Honor.
There is evidence, because this case is all about

compliance with underwriting guidelines. And on that, we could have a debate as to what the evidence shows. That would not be an appropriate debate on summary judgment. But we haven't moved on those grounds. We've moved entirely on the grounds of lack of reliance. And when we get to the other data they say they did rely upon as we just have tried to demonstrate, there is no evidence of falsity. And then beyond that no evidence of scienter.

THE COURT: I think that's a very helpful reorientation to sort of where we left off. I do want to hear from you because I know I didn't give you an opportunity to talk much last time about standing, equitable subrogation and so forth, but let's hear first from your adversary on the reliance issue.

If I recall correctly, Gertrude Stein, when she was asked what does your poetry mean, said those who love my poetry don't need to be told, and those who hate my poetry won't be satisfied even if I answer the question, so I decline to tell you.

Go ahead.

MR. DeLANGE: Thank you, your Honor. I am going to first address reliance and the specific element of reliance.

As the Court is aware, New York common law fraud claims have different elements. The false statement made with knowledge or recklessness that plaintiff relied on that caused

damages. Reliance is a separate element, that's the element defendants moved on. Counsel just admitted before the Court that for purposes of their argument they are going to assume that plaintiff looked at the computational data and they in fact did and the record is very clear about that.

The testimony from Mr. Hendrickson, which is Exhibit 73 to my declaration, as well as the testimony of Mr. Albus, which is Exhibit 159. Both Mr. Hendrickson and Mr. Albus made very clear what FSAM's investment process was. And I am going to give a brief summary to orient the Court for the reliance element.

FSAM would be contacted by a Wall Street bank, sponsors or underwriters of mortgage backed securities such as defendants. We have a new deal coming out, would you be interested in it. We'll send you a term sheet, we'll send you marketing materials and information about this particular deal. They would then receive the term sheets, they would receive maybe a free writing prospectus, other marketing materials. That material would have deal specific information. And what information in there did FSAM rely on? The testimony is very clear. I'll point you to Exhibit 73 which is Mr. Hendrickson's testimony. He says that LTV was always important. I'm looking at page 28, your Honor.

THE COURT: Hang on just a second.

MR. DeLANGE: So the question is: What sort of

information was provided typically in the term sheets that you would look at prior to having such communications with the investment bankers?
"A. The LTVs was always important. Okay. The FICO scores was always important, whether it was owner occupied or investor owned."
THE COURT: "Q. What sort of information was provided typically in the term sheets that you would look at prior to having such communications with the investment bankers?
"A. The LTV was always important.
"Q. Okay." Such a question.
"A. The FICO scores were always important, whether it was owner occupied or investor owned, what the percentage of the second liens were things along those lines. Geographic distribution."
Go ahead.
MR. DeLANGE: It continues, your Honor.
Mr. Hendrickson at page 56, I am going to start at line eight, and here Mr. Hendrickson is being questioned about Frank Albus who was an analyst that worked for Mr. Hendrickson. And the question is:
"Q. Okay. He would similarly, as you said, look at the deal, right? What does looking at the deal entail?
"A. Review the term sheet and any of the supporting documents.
"Q. Okay. What sort of supporting documents would they look

at?
"A. For a new issued deal?
"Q. Yeah.
"A. Primarily the deal sheet."
Mr. Hendrickson continues on page 57 and I'm at line 20.
"Q. Okay. And you also said that Mr. Recan" who was another analyst" and that's these other guys would prepare an analysis of the deal. What sort of analysis would they prepare?
"A. They would break out the various collateral components and we would compare it against previous purchases that we had."
Then the question continues on page 58 line 13 in the middle. The question is:
"Q. Would the process that you just described be the same used for the specific investments at issue in this case?
"A. Yes."
That's Mr. Hendrickson very clearly identifying the process at FSAM and what information was relied upon, which is the information that we allege is false and they relied upon in making their investment decisions.
There is additional testimony that I want to highlight for Mr. Hendrickson that they relied on the triple-A ratings, and the triple-A ratings were extremely important in the analysis and the process. And that testimony is at page 90 starting at line 24. Mr. Hendrickson says:

"A. By us staying at the triple-A level we did not believe that credit was a huge component of the trade."

You then turn to Mr. Albus' testimony. Mr. Albus talks about the information he reviewed and he relied on in conducting his analysis for Mr. Hendrickson and in making the decision to invest in these certificates. Mr. Albus, again, his testimony is consistent with Mr. Hendrickson, and he identifies the term sheet, the information that was in the term sheets, the LTV ratios. And he finally indicates --

THE COURT: Where?

MR. DeLANGE: I'm sorry. Let me give you specific references at page 38.

THE COURT: What exhibit?

MR. DeLANGE: I'm sorry. It is Exhibit 159 is Mr. Albus' testimony.

THE COURT: All right.

MR. DeLANGE: At page 48, line 17, he's discussing the term sheets and the receipt of the term sheets and the marketing materials and that's the information he would review. He continues on page 53 when discussing the process, and I'm starting at line 12 on page 53. He's discussing the analysis that FSAM is performing on each of these deals. Mr. Albus testifies: "I think the scenarios that I would run could be best described as trying to analyze the projected cash flow profile of the security.

"Q. In order to analyze the projected cash flow, at least one of the components of that analysis was an assessment of the credit risk associated with the underlying collateral, is that correct?
"A. Credit risk is something that I looked at, yes."
Mr. Albus on page 64 specifically identifies LTV ratios as information he relied on. That's page 64, line seven. He summarizes his testimony in what they reviewed at page 91. He says, starting at line two: "Based on my recollection, the term sheet is composed of multiple pages and multiple pages that go into detail on the collateral underlying the securities. So I would look at all the pages provided and all of those pages and all of the information I got would factor into the analysis that I produced."
The testimony is undisputed from Mr. Hendrickson, from Mr. Albus. FSAM clearly relied on this information in making its investment decisions. They relied on the LTV ratio, they relied on owner occupancy, they relied on the credit ratings.
THE COURT: So your adversary says that the statements that they looked at, which you say they relied upon, were statements of whether or not the guidelines were met, but the representations regarding the guidelines and adherence to the guidelines were not among the representations that you now have adduced evidence of reliance on. So, these cannot be false statements that you relied upon. Or even if they were, they're

false statements about adherence to the guidelines, which are not -- which wouldn't be the subject of reliance unless there had been a representation that you also relied on that the guidelines were complied with. Which, he says, are no longer representations available to you, because of the admissions made during discovery. So what about all that?

MR. DeLANGE: I will answer that I think in three parts, your Honor. The first is, you are correct, that is my adversary's argument. And in fact that is their only argument they have on reliance. And it is focused specifically on the representations with respect to underwriting guidelines. What they point to is not all 51 offerings, but a certain number of the deals where there were not specific affirmative representations regarding underwriting guidelines prior to FSAM's commitment to invest.

What they disregard and ignore is what they didn't tell FSAM in those other deals. The deals where they provided the term sheet, the deals where they provided other marketing materials that didn't have an affirmative representation on the underwriting guidelines, they omitted material information. And omissions are actionable under New York common law. Defendants do not dispute that. They don't even discuss the cases we cite in our opposition.

It's key what information they're not telling investors like FSAM. They're not telling FSAM when they send

them a term sheet, that they just received a report from a due diligence provider that found 80 percent of the loans they looked at were EV3. Counsel said an EV3 potentially doesn't meet guidelines. That's incorrect. And EV3 is a loan that does not meet guidelines. Period. That's a determination is made by an independent due diligence provider.

They notified defendants 80 percent of these loans don't meet guidelines. Defendants don't reveal that. They don't provide that information to investors. They don't provide that information to the rating agency. That is a material omission. Why is that important? What is underwriting? What is the point of underwriting a home mortgage loan? The point is what we call the three Cs. Credit, collateral, and compliance. Our case is focused on credit and collateral.

You underwrite a loan to guidelines to ensure that the borrower has the credit and the ability to repay a loan. You underwrite a loan to ensure that in the case of default you have adequate collateral to cover your risk. If you're not following guidelines, that is material information. It affects the quality of the underlying borrowers; it affects the quality of the underlying loans.

Those are material omissions, they're actionable under New York common law, and they are actionable for all 51 of the deals here because they did not disclose it.

What they did, what they also did not disclose is they received these report from the due diligence providers and then they spent their time trying to clean up the sample. Trying to find ways and convince the independent due diligence provider instead of 80 percent it should be something less. There are instances where they had 80 percent loans that the independent due diligence provider identified as materially defective. By the time they finalized that deal, they lowered that to 5 percent. They didn't disclose that to investors.

They also didn't disclose to investors the information they received on the sample, and they did nothing with respect to the remaining population of loans within that pool. Investors didn't know that 80 percent of these loans had materially defective issues. Those are omissions. That affects all of the data that is in the term sheet, it affects the representations made to FSAM and other investors.

I submit reliance, we have provided clear and convincing evidence of what FSAM reviewed and relied upon in making its investment decisions. The testimony is undisputed. It is an issue for the jury as to whether or not they reviewed the information and relied on it. The evidence we submit being undisputed will prove to a jury what they relied on.

THE COURT: All right.

MR. DeLANGE: Now I want to address falsity. Because counsel now at today's hearing has essentially conceded

reliance. Rightfully so. The evidence is undisputed and now is focusing the entire argument on falsity. Interestingly, you won't find falsity in their moving papers. You can look through the headings. They moved on four issues. They moved on causation, they moved on reliance, they moved on standing, and they moved on deals where they served as an underwriter only. They did not move on falsity. They could have; they chose not to. Likewise they didn't move on scienter. They could have; they chose not to.

Now they are trying to argue falsity, that we haven't come forward with the evidence demonstrating falsity. At the last hearing I provided the Court with specific examples. Despite the fact they didn't move, we had put some evidence into the record. And I have more examples that I can walk the Court through that will explain to the Court exactly how we are going to try this case to the jury, exactly how we are going to give the information to the jury of what defendants knew, what they didn't disclose to us, what they kept secret, and what they kept private, and how that renders the information. Not only is the data false, when you have EV3s that identify missing property appraisals or property appraisal too high, that's a variable that goes into the LTV calculation. There is no way your LTV calculations that you are sending out in term sheets can be accurate or reliable if you are not following your guidelines.

I am happy to walk the Court through additional examples as I did at the last hearing if the Court will be interested.

THE COURT: Why don't you give me at least a couple.

MR. DeLANGE: I'm going to start with Exhibit 126. This is a Bear Stearns --

THE COURT: I'm sorry, I have to get that.

MR. DeLANGE: We have extra copies if that will be helpful.

THE COURT: No, we have them all right next to our copies of the Encyclopedia Britannica.

MR. DeLANGE: Which is larger, your Honor?

THE COURT: Well, that's an open question. 126?

MR. DeLANGE: Yes, your Honor. This is an underwriter production report. This is a report from the due diligence provider that was sent to Bear Stearns on October 16, 2006. This relates to Sun Trust loans that were securitized in the BSABS2006-HE8 deal that FSAM invested in.

In this report, it shows the number of loans that the independent due diligence provider had identified as EV3 loans. These are loans that do not meet guidelines. Period.

If the Court flips to the very last page of this report, it will show a summary of the number of loans that had material issues. That's last page, it's numbered 15 in the bottom-right-hand corner.

THE COURT: I'm sorry. Maybe I'm looking at the wrong thing. Why don't you give me the Bates number.
MR. DeLANGE: The Bates number is JPMC underscore DEX underscore 002442895.
THE COURT: Okay. I don't see that.
MR. DeLANGE: Exhibit 126.
THE COURT: Right.
MR. DeLANGE: Is that not in the exhibit that your Honor has?
THE COURT: What I have in Exhibit 126 begins with Bates stamp number DEX underscore JPM underscore 00418179, and continues consecutively from there to 00418242.
MR. DeLANGE: That's different than the Exhibit 126 I have in front of me, your Honor.
THE COURT: Let's see where if we can figure that out.
MR. DeLANGE: I have extra copies.
THE COURT: Ah, wait a minute. It's a different 126.
MR. DeLANGE: It is to my declaration.
THE COURT: Yes. This was the 126 to the declaration of Mr. Valdes. So, we want your declaration. So let me get that out. A natural confusion of parties. All right. Now, I got it and it's page 15? Okay, I'm with you. Go ahead.
MR. DeLANGE: It is the very last page of that exhibit.
THE COURT: I'm there.

MR. DeLANGE: You'll notice under credit event, three. Potential reject. Again 3s are materially defective loans. 501 loans or 84 percent of that pool is an EV3. That information was not disclosed to investors. Your Honor, to put in context what those EV3s mean, I have a document that I am going to hand up.

THE COURT: Just I'm not quite sure I follow how this chart works. In that same line, potential rejects, 501 or 84.1 percent, and then it says dollar sign, dollar percentage, 100 percent. How can it be 100 percent if there are, as you go down within the guidelines, 91 or 15.3 percent?

MR. DeLANGE: Your Honor, I cannot explain the representations regarding the dollar signs. I do know that the dollar amount is the same both for the rejects which is number 501, and it is the same for the total of the sample, which was 596.

THE COURT: So, then under compliance event, material issues where it's 24.5 and there are dollar terms 15.9 percent that I understand. I don't understand the first chart you were talking about.

(Continued on next page)

MR. DeLANGE: And the key point there is that the independent due diligence provider is notifying Bear Stearns for a pool of loans that went into this deal that 84 percent of what they sampled were materially defective.

I have a document, your Honor, that puts this into context, and again, because defendants didn't move on falsity, we didn't submit all the evidence that we have. And this is a material exceptions summary report, and I can hand a copy of this up to the Court.

THE COURT: All right.

MR. DeLANGE: Your Honor, this is the same Sun Trust pool of loans where 84 percent were identified as materially deficient.

This document that I have handed the Court identifies the description of some of those material deficiencies. And you will notice some of the descriptions. The eighth description down, missing appraisal. The next entry, appraisal not signed. The next entry, quality of appraisal report unacceptable.

THE COURT: Well, it appears that the great bulk, at least on this first page, fall into the category of curable and missing documents as opposed to noncurable, yes?

MR. DeLANGE: I disagree with that, your Honor.

THE COURT: I am looking at what you just gave me. The first column, after the scope category code and description

is the fault grade, and they are all 3s.
MR. DeLANGE: That's correct.
THE COURT: Then it says grade 3 noncurable. And in the first page, until we get down to FICO score, there is just a few here and there, whereas under the column grade 3 curable and missing documents there are many, many, true?
MR. DeLANGE: That is correct based on this chart.
THE COURT: And then if we go over to the next page, again, the largest numbers are in the curable category, although there are two columns that have large numbers in the noncurable. One is credit score not available, and the other is application date unknown or missing.
If you know, why would application date unknown or missing be incurable?
MR. DeLANGE: Why would it be incurable?
THE COURT: Yes. You would think, if you went back you could find it. There would be contemporaneous documents that you could approximate from.
MR. DeLANGE: There may be, your Honor, but you're actually highlighting a key point. If you have an application in a loan file that is not dated, as an underwriter, you have no idea when that information was provided. Was that information provided by a borrower nine months ago in connection with an application for another loan? Was it provided two weeks ago? Has their income changed? Has their

employment changed? Have they moved? If you don't have a dated application, you can't verify the information. And there's articles within the industry, if you have an unsigned loan application, an undated loan application, those are clear indicators of potential borrower fraud.

So what I want to point out, your Honor, on the curable, missing docs, defendants never disclosed this to investors. And unlike the Flagstar trial, where this Court heard testimony of an iterative process, there was no iterative process here with investors. Investors were kept completely in the dark. Investors did not know of all of these issues that were being identified. And, more importantly, these are issues that indicate the loans are outside of guidelines, period.

Now, they may be able to go find a missing doc for a loan that they happen to sample, but they didn't do anything with the remaining loans in the population, and you run a sample so you get an idea of the overall population. If you know 84 percent of your sample has material defects, the remaining population in the pool likely has the same percentage of material defects. None of this information is disclosed to investors. It's a completely secretive process.

If you look at the issues, these are issues that go directly to the computational data, as my adversary defined, that is included in the term sheets that FSAM clearly relied on. FICO scores are missing. Credit report incomplete.

Without a credit report you don't know what the FICO scores are. You have appraisals. You have occupancy type unknown. You have LTV ratios greater than 100 percent. All of this is the raw data that defendants were receiving and keeping secret. They were not disclosing it to investors and giving investors an opportunity to make an informed investment decision.

They also were not providing this information to the rating agencies so that they can procure their AAA ratings in order to sell them to investors like FSAM, who had underwriting guidelines requiring them to have greater than 90 percent of their investments in AAA rated securities.

This is the falsity evidence that we will present to the jury, and we have this evidence. Not just on the Bear Stearns deal, not just on the JP Morgan deal that I highlighted at the last hearing. We have this evidence for each of the 51 offerings. Due diligence reports the defendants are receiving identifying high percentages of material deficiencies. They don't disclose it to investors. They keep it secret. They don't disclose it to the rating agencies. They get their AAA ratings, and they go out and sell it. And they sell it to unsuspecting investors like FSAM.

THE COURT: Just so I am absolutely clear what you're saying, when in Exhibit 126 Bear Stearns gets a report that says 84 percent of the loans in this group are potential rejects, what is the statement that was made to your clients

that is proven false by that percentage?
MR. DeLANGE: There are numerous statements, your Honor. If you would turn to -- I am going to get the exhibit number. Just a second.
In Exhibit 7 to the declaration of Mr. Hendrickson.
THE COURT: OK.
MR. DeLANGE: Your Honor, Exhibit 7 is a free writing prospectus for this deal that Bear Stearns sent to FSAM and FSAM relied upon it. I do have a copy of the specific portions that I am going to reference.
THE COURT: Let me just look at your copy for a moment. Page 7?
MR. DeLANGE: I am going to start at page 45, which ends in Bates number 628.
THE COURT: OK.
MR. DeLANGE: For the record, what I have handed the Court is a portion of Exhibit 7 to the Hendrickson declaration. Exhibit 7 contains multiple documents that were sent to FSAM by defendants. This happens to be one of them.
Now, on page 45, this particular free writing prospectus happens to have the representations regarding compliance with underwriting guidelines. Clearly, that's false based on the information that I have provided.
THE COURT: But the assertion there was that either because the investments were made before this prospectus was

furnished or for other reasons, there is no evidence of reliance on anything in this prospectus.

MR. DeLANGE: That's wrong, your Honor. This is a free writing prospectus. This is not the final black of the prospectus. Defendants' argument is centered on only the final black line of the prospectus.

THE COURT: Thank you for clarifying that.

MR. DeLANGE: I want to make clear, while this particular document has representations regarding underwriting guidelines, for those deals where FSAM did not receive an affirmative statement regarding underwriting guidelines, it would be a material omission to not identify for FSAM and other investors that they knew 80 percent of the loans were materially defective in the sample they reviewed.

With respect to the specific data, there is representations --

THE COURT: Just stop on that for a minute.

MR. DeLANGE: Sorry.

THE COURT: If hypothetically there is no representation about the guidelines in some of these deals, and nevertheless 84 percent or whatever high percentage of the loans are found not to comply with the guidelines, isn't that what you mean by defective? How is that actionable?

MR. DeLANGE: It's an omission to make representations --

THE COURT: They are not saying that these loans are bad. The omission is that 84 percent in this example are defective because they do not comply with the guidelines, right? It doesn't mean they are defective based on some false statement or something like that. They may be. We don't know. So you're saying that if you know that 84 percent of a given loan pool does not comply with your own guidelines, but you make no representation about compliance with your guidelines, it's still an actionable omission to fail to reveal this noncompliance with the guidelines. How could that be?

MR. DeLANGE: They are making affirmative representations regarding the quality of the underlying collateral.

THE COURT: Where is that?

MR. DeLANGE: It's in the LTVs and the ratings. They have preliminary ratings of AAA, which is on page 180 of the document before your Honor.

THE COURT: Here there is a full discussion of the guidelines.

MR. DeLANGE: That is correct. This particular deal, they made representations --

THE COURT: What I would like to look at is the representations in a deal where there wasn't representations in that.

MR. DeLANGE: I have an example like that that I can

show you as well.
THE COURT: Go ahead.
MR. DeLANGE: I am going to look at Exhibit 2 of the Hendrickson declaration. And I have extra copies if that's easier.
THE COURT: We have it in this form. That's why we didn't have that available. But if you could hand us a copy, that's great. OK.
MR. DeLANGE: This is an Argent Securities deal. Again, a deal that was underwritten by JP Morgan and sold to FSAM. This is, again, marketing materials that were sent by JP Morgan to FSAM. This has representations regarding the ratings on the different tranches. It has representations regarding the LTV ratios for the loans within the pool. It has representations regarding owner occupancy rates. This particular document does not have representations in it affirmatively regarding underwriting guidelines.
THE COURT: Show me an example within this of a representation that you say is false in the omission sense that you referred to previously.
MR. DeLANGE: I will start on page 3, your Honor. It ends in Bates stamp 884.
THE COURT: Yes.
MR. DeLANGE: There is a representation of the expected ratings from Moody's, S&P and Fitch on each of these

deals, and they are showing expected ratings of AAA on the particular tranche that FSAM had purchased, and all the purchases at issue in this case were AAA. That information is false. To the extent that they had information from due diligence providers --

THE COURT: You're saying that if they had provided Moody's or Standard & Poor's or Fitch with the kind of data that we just went over in the 84 percent document, there is no way Moody's, Standard & Poor's or Fitch would have rated it AAA. What is your evidence of that?

MR. DeLANGE: We have expert testimony from our expert, Mr. Kolchinsky, who identifies information that was not provided to rating agencies, and had that information been provided -- he used to work for the rating agencies, he rated structured products -- they would not have received a AAA rating.

THE COURT: So what I have read in the papers about the rating agencies giving everything a AAA rating no matter what is inconsistent with his testimony.

MR. DeLANGE: That is correct, your Honor. And part of it, the rating agencies were not provided the information that I provided you examples of.

In addition, you have representations regarding the loan-to-value ratios on page 17 of this document. You have representations regarding owner occupancy on page 20 of this

document. These are specific parameters that FSAM reviewed and relied upon in making its investment decision.

THE COURT: You're saying these are false because the data they got that was never disclosed showed that there was not a factual basis for many of these representations.

MR. DeLANGE: That's exactly right, your Honor. They are getting information from the independent due diligence provider that is telling them the loans are materially defective. They are telling them why. And the reasons why, some of them go directly to the calculations of these variables. If you're not following your guidelines, the data included in here is not reliable, and your making representations about the loans. And what is important for a mortgage-backed security is the loans. The value of an RMBS is the quality of the loans within that pool.

THE COURT: This has been very helpful. Let me cut you off however. I think we now need to hear from your adversary.

MR. SLIFKIN: Well, when we started this discussion, we were talking about underwriting guidelines and whether there was a representation that there was compliance with underwriting guidelines.

THE COURT: Let's take this one where there is no representation about underwriting guidelines. But there is a representation, for example, that there will be expected AAA

ratings from Moody's, Standard & Poor's and Fitch. And your adversary says there is expert testimony that if the rating agencies had known what the offerers knew from their own due diligence about these loans, they would have known that there never would have been a AAA rating. So that was a false representation because they didn't have an honest expectation that this would be the ratings if they had made known to the underwriters what they should have made known to the underwriters. What about all of that?

MR. SLIFKIN: There is absolutely no evidence of that whatsoever.

THE COURT: I thought he said there was expert testimony.

MR. SLIFKIN: The expert testimony from Mr. Kolchinsky, he assumed the information the ratings received, he assumed what information they did receive. He assumed it was false. And he assumed, with no analysis, his ultimate conclusion that the ratings might have been different. None of the documents he relied upon, which are in his Appendix 4, which is Exhibit 18 to Mr. Earnhardt's declaration, none of those documents concern communications with rating agencies.

Now, I had expected the argument with respect to the rating agencies to be, now, the ratings are premised on the computational data. If the computational data is wrong, then the ratings may be wrong. There is no evidence in the record

from the agencies that it would have made a difference. But now I am hearing, no, no, the ratings agencies premise, according to counsel, their decision on the quality of the due diligence, the compliance of the underwriting guidelines. There is no evidence of that whatsoever, including from their expert. He focuses on data, and with respect to their expert, he simply assumes his conclusion.

THE COURT: Well, putting experts aside, if an offerer knows from his own internal due diligence that a huge percentage, 84 percent in the example we have looked at, have problems, and the problems are broken down so that you can see that some of these problems are not curable, some of the problems haven't been cured even though they might be theoretically curable, and they all or many of them on their face go to the quality of the loan, why isn't it a reasonable inference that if that had been disclosed to the rating agencies, they would never have rated it AAA?

MR. SLIFKIN: I think you need to get into the details of the evidence you have actually seen here, your Honor.

You were shown a document that shows potential problems with a -- potential problem, not fatally defective, potential rejects in a certain deal. As your Honor pointed out, most of them are potentially curable. Some they say are potentially not curable. Let's assume that's the case. No evidence that those loans actually went into a deal, were

actually securitized as opposed to being getting kicked out during the due diligence process.

With respect to the ones that were curable, why is there not an equally reasonable inference for a rating agency to say, oh, well, there is some missing appraisal reports here. That's easy enough. Let's go get the appraisal reports. If they can get them, they will securitize them. If they can't get them, they won't securitize them. But why would that affect the rating?

THE COURT: What your adversary would say, I infer, is that may be true with a little bit here and a little bit there, but when it is so endemic, to use a term that I don't know where I have heard this before, but so pervasive, that's raising a different kind of red flag.

MR. SLIFKIN: Where is the evidence of a pervasive problem?

THE COURT: 84 percent.

MR. SLIFKIN: 84 percent are potential rejects. What you haven't been shown is, is this the end of the process or is this the beginning of the process? Were those cured or not cured? Which of these loans was secured in a transaction that was in fact at issue here? There is no evidence of any of that.

The evidence is, and the way I understood it, the suggestion from plaintiffs was, look, if some outside authority

thinks these are EV3s, you think they are not EV3s, they are EV1s or EV2s, then we can have a debate as to whether or not the underwriting guidelines were actually complied with. But if you look at what they say they relied upon, it is not a representation with respect to underwriting guidelines; it's representations with respect to FICO scores, owner occupancy, and so forth. And as we pointed out at the last hearing, let's say there is a FICO score of 650, that may be within the guideline or it may be outside the guideline, depending upon what the guideline says. It may be rated EV3, it may be rated EV1. But that doesn't mean it's not 650. It's still 650. So you can say, all of these loans are outside the guidelines, but they are still 650. And if what plaintiffs were relying upon was that the FICO scores were 650, whether it was within a guideline or outside a guideline is irrelevant. The only question is, is the data false? And for plaintiffs to switch backwards and forwards between the guidelines and the due diligence process and then the hard data and backwards and forwards is improper.

If I might say a word about omissions, your Honor. I was just trying to persuade the Court that there is a strong distinction between underwriting guidelines and computational data and compliance with one does not suggest falsity of the other.

Now, counsel says, well, you omitted this data. Of

course, we know common-law fraud is very similar to 10b-5 and the cases treat them essentially interchangeably. We know the pure omissions are not actionable unless there is some absolute legal obligation to make that statement.

THE COURT: If anything, that is even stronger in common law than it is under 10b-5.

(Continued on next page)

MR. SLIFKIN: Exactly right, your Honor. So then you need to show a statement that is misleading by reason of the omission. But there is no statement being made about underwriting guidelines. What they say is misleading is the FICO scores. But, as we just went through, it is irrelevant whether there was compliance or non-compliance or anything he said about underwriting guidelines is irrelevant to the accuracy of the FICO score.

THE COURT: Maybe I need to see Mr. Kolchinsky's testimony. If you say that you expect a triple-A rating, that is an affirmative representation, and therefore, if you did not have a good faith basis for making that representation, then it's not a question of omission, it is a question of an affirmatively false statement. So, the argument was that your adversary was saying was they knew or should have known and recklessly disregarded that if the rating agencies knew what they knew, they never would have given them triple-A. And you say no there is no expert who testified, no one from the rating agencies nor their expert testified to that.

You would agree that if someone had testified to it, then that would have been evidence of an affirmative false statement, yes?

MR. SLIFKIN: If there were testimony that the data would have led to a different result, yes, I would agree with that.

THE COURT: So let's see what he said.
MR. SLIFKIN: We're trying to pull it out. I should correct one thing, your Honor. Let me say one thing with respect to Mr. Kolchinsky and then correct what might be a misimpression which I heard from your Honor. There is actually an affidavit from Standard & Poor's that was created in this case. So there is not -- there is no record from rating agencies. There is a piece of paper. Mr. Kolchinsky did not look at any of this on a deal-by-deal basis. He didn't look at any of the data and say that data, if false, would have led to this, to a different rating. He provided no analysis in that regard at all. He simply said, well, I assume if all the data, all of the materials given to the rating agencies are false, then I assume it would have led to a different rating.
So, I should be clear, plaintiff -- neither side put this into the summary judgment record, and actually I believe the affidavit was obtained by plaintiffs late. But, so the Court has no misimpression from what I said, both sides do have a declaration of a gentleman called Sharif Mahdavian.
THE COURT: The usual spelling.
MR. SLIFKIN: The usual spelling, of course. And he's with Standard & Poor's. I don't know if we have copies but we can provide them to the Court. Let me just read --
THE COURT: Go ahead.
MR. SLIFKIN: Paragraph 16 of his declaration was

obtained by plaintiffs in lieu of his deposition. Paragraph 16: "If the loan level data provided to S&P contained materially inaccurate representations of income, inflated appraisals or other material inaccuracies or misrepresentations, S&P's loss coverage estimates could potentially be affected, depending upon the particular legal, structural and collateral characteristics of the RMBS being rated and the nature and extent of any discrepancies." Now --

THE COURT: Putting aside the 100 qualifications in that sentence, your point is that's not what I was just shown.

MR. SLIFKIN: Exactly.

THE COURT: Okay. But --

MR. SLIFKIN: That's not loan level data.

THE COURT: Yes.

MR. SLIFKIN: Sort of bait and switch that's going on here.

THE COURT: Your adversary referred to Mr. Kolchinsky, so let me ask your adversary, where in Mr. Kolchinsky's report would you like me to look?

MR. DeLANGE: Your Honor, I'm looking specifically at the testimony which is Exhibit 70.

THE COURT: Okay. Hold on. Exhibit 70 to whose declaration?

MR. DeLANGE: To my declaration, your Honor. It is the final two pages of that exhibit starting at page 212. It

starts at line 20.
THE COURT: Line 20.
MR. DeLANGE: On page 212.
THE COURT: I'm sorry. Hold on.
MR. DeLANGE: Of Mr. Kolchinsky's deposition. Where he provides --
THE COURT: Okay.
MR. DeLANGE: So the question --
THE COURT: "Q. So it is your opinion that at the times relevant to the issuance of the securities in this case, the rating agencies' ratings hinged on the proper application of loan sampling and loan due diligent processes, correct?
"A. It is my opinion that those functions would have helped to provide correct data for the rating agencies, which would then change the rating.
"Q. So it is your opinion that the ratings hinged on the proper application of loan sampling and loan due diligence processes, correct?
"A. No, I don't think that that's the core of the opinion. Obviously, what I'm opining on is the data that was being fed to the rating agencies' models, if it was correct, the ratings would not have been triple-A. There is evidence here that the due diligence was insufficient to make the data correct, but I don't think I'm opining on those things that you say."
So, that is a little bit helpful to you, but it's

largely dependent on other testimony or on his report. Because, the key sentence there is "obviously what I'm opining on is that the data that was being fed into the rating agencies' models, if it was correct, the ratings would not have been triple-A."

So, what is the testimony or other reference in his report to what he considers the data that was being fed into the rating agency models?

MR. DeLANGE: Your Honor, Mr. Kolchinsky's report is Exhibit 169.

THE COURT: I have that. Where would you like me to look at?

MR. SLIFKIN: Your Honor, it might be helpful while counsel is looking at that, we would certainly want you to look at paragraph 19 of the Kolchinsky report.

THE COURT: Okay.

MR. SLIFKIN: Where he says I've assumed that the allegations in the complaint concerning defendant's misconduct and the low quality of the underlying loans are substantially true and correct.

So this then comes full circle to the point we made, where is the evidence of the data falsity. I think the Kolchinsky testimony is actually quite helpful in that basically he says no, I'm not talking about loan due diligence or adherence to guidelines. I'm talking about the data. But

in his report he merely assumes the alleged defect, data defects that are in the complaint.

Now we are on summary judgment, and we pointed out in our opening papers at 18 there is no evidence that with respect to the metrics discussed by plaintiffs, owner occupancy, LTV, appraisals, there is no evidence that they're false. And of course the other metric they relied upon is the rating which that's just a wholly circular argument.

THE COURT: Well, I'm looking at the portion of his report at page eight of his report that begins on page -- page eight, paragraph 48, 46, there is some that comes before that, he's saying though not with respect to anything with the loan, but as a general custom and practice, at paragraph 48, each originator of loans that are included in the RMBS Trust will have made reps and warrantys in respect of the loans sold or transferred to the RMBS Trust by that originator. These would typically include language that states that the loans cannot have been originated in violation of federal or state law, and that the information presented pertaining to the loans in the applicable sale agreement is true and correct in all material terms. This information would typically include a representation that the loans were underwritten in accordance with the originator's underwriting guidelines, which typically include information relating to such matters as credit history with local and national merchants and lenders, installment debt

payments, and any record of defaults, bankruptcy, possession, suits or judgments. And would, for example, establish the maximum permitted LTV for each type of loans. The rating agencies would have been operating under the understanding that should the trustee or custodian subsequently find any loans breached, the originators would cure such breach, for example, by replacing the loan or repurchasing it at the original purchase price. Rating agencies generally took as a formality the proper implementation of the due diligence processes in forming those loans to be rated RMBS notes, and took for granted the accuracy and adequacy of this loan level information being uploaded by the structure bankers into the rating models. These inputs would then directly influence the assessment of the default frequency and loss of earning for each loan which has a direct impact on its determination of the amount of subrogation and credit enhancement required to achieve each ratings level. Then he goes on with examples.

Now, let me ask plaintiff's counsel, putting aside the fact that he's just here describing the typical situation which may or may not be the situation as to any given one of these pools, he says the assumption is that if there were problems that could be cured, they would be. And what you showed me before was due diligence that, for the most part, but not all, showed a great percentage of curable defects.

So how do we know whether or not they were cured?

MR. DeLANGE: We don't, your Honor. The process was secret. That's the whole point.
THE COURT: But the burden here is on you.
MR. DeLANGE: That is correct, your Honor. What we do know is that certain of the loans that they reviewed in the sample may have been cured. Some of them were just waived in or defendants provided an override. We also know that they did not extrapolate, they did not take this information and extrapolate it to the remaining population of the loan pool. So they know in our example that 84 percent of this pool has material defects. They did nothing with the remaining population of the pool. They didn't go try to cure those defects. They didn't notify the rating agencies of those defects. They didn't notify investors and FSAM of those defects that we know.
THE COURT: All right.
MR. DeLANGE: And your Honor, if I could point you in Mr. Kolchinsky's report, this is critical with respect to the sensitivity of the ratings and the data that goes in to starting at paragraph 89 on page 16. It describes the sensitivity of the data and how even small changes in the data would require large increases in the credit support and would blow up basically the triple-A structure that was created for these types of securities. I'm sorry 89 is on page 50.
THE COURT: I see. I'll just read that into the

record. The default or loss risk of each tranche of a RMBS which lies at the core of the rating process is highly sensitive. To changes in the data or assumptions, especially items like the LTV, FICO, and DTI, as such even small differences or minor differences to the assumptions can dramatically alter the ratings of structured financed securities.

MR. DeLANGE: Your Honor --

THE COURT: Pardon?

MR. DeLANGE: I was going to say he continues in paragraph 90 to explain by way of example.

THE COURT: He gives an example.

MR. DeLANGE: And then provides a sensitivity chart on the next page.

MR. SLIFKIN: Just so we're clear, paragraph 90 is a hypothetical. It is not an example from an actual transaction.

THE COURT: I see that. All right.

MR. SLIFKIN: Let me try and clear up a couple of points if I may.

THE COURT: Go ahead.

MR. SLIFKIN: The due diligence being performed, we're seeing in these reports, this is on a whole loan credit where, let's take an example, Bear Stearns is buying a large number of loans from an originator or even a number of originators. And they're deciding whether or not what is being represented to

Bear Stearns as being included in the deal is in fact what's in there or not. And they come to some accommodation and some are kicked. There may be pricing changes.

Then there is another step as to some of those loans are securitized in certain deals. The testimony is very clear from Bear Stearns they would even buy defective loans, because they had what is called a scratch and dent business where they were securitized the defective loans because there is a market for everything on Wall Street.

There is no evidence there is any scratch and dent deals here. There is no evidence that the defective loans went into the deals here.

So just to look at a due diligence report really tells you nothing about the specifics of the deals here. And I would just point out to the Court, in the presentation by plaintiff's counsel, you see a due diligence report from one transaction, and then you see a free writing prospectus from a different transaction. Then you see a prospectus where one of the defendants isn't even the originator. Isn't -- I don't mean originator, I mean sponsor of the deal. That merely is the underwriter.

We are talking about ratings. What one has to do, I believe, your Honor, is go back and say, okay, which ratings are wrong. What is the evidence that those rating is wrong. And why. It is a very unclear process, and Mr. Kolchinsky's

broad statement, you know, doesn't get you anywhere. Actually, I think his testimony put together with his report where he essentially says, well, I'm not talking about the results of the loan level due diligence process. That's not what I'm talking about. I'm talking about actual hard data that goes into these models, which he describes in some of the passages you've seen, brings us back full circle to what we were talking about earlier. Which is, yes, there is underwriting compliance, there is no evidence they've relied upon those statements even where they have those statements. You were shown a deal an exhibit from Mr. Hendrickson's declaration. I urge the Court to look at paragraph four of Mr. Hendrickson's declaration where he merely says these documents were in our files. Not that they were relied upon. And then we go to the data issues where there is no evidence of falsity, your Honor.

THE COURT: All right. So, we actually are coming up on the -- I was going to call it the witching hour, but I would say maybe it should be called the playing on Congress hour where sequestration kicks in. So I am going to give each side 10 minutes, because we only have 27 minutes before 8 o'clock to talk about any issue they want to talk about. But they are going to be limited strictly to 10 minutes. So we'll start with defense counsel.

MR. SLIFKIN: Shall I go first, your Honor?

THE COURT: Yes.

MR. SLIFKIN: Thank you. Let me say something back on standing. I am not going to rehash what's in our papers. The law is very clear in New York set forth in the Second Circuit in the Banque Arabe case, but obviously going back to over a hundred years, that there is no assignment of litigation rights absent an expressed assignment. There is no expressed assignment here.

You asked me about equitable subrogation earlier. And the last hearing and I went through the test. But I said this is essentially restricted to the insurance context. Outside the insurance context, there is a test and they simply don't make the elements of the test. We went and did some more research and so I'm relying on other people who are sitting here. But in doing our research, we have found no New York case, no New York case, that applies equitable subrogation outside of the insurance context.

We found one case from Nebraska that did that in the 1960s, and nothing since then. It would truly be astonishing to blow open the Banque Arabe test based upon that doctrine. We submit it would be unprecedented. And we are talking about court claims here --

THE COURT: It wouldn't be unprecedented. It would be unprecedented outside Nebraska.

MR. SLIFKIN: That's right.

THE COURT: Go ahead.

MR. SLIFKIN: So, why would your Honor want to do that. Is it because of the equities, because there is an equitable aspect to this. And equities are part of the test along with other things.

So I want to say a word about the equities. And our view about why is it that these sophisticated entities, this New York based asset manager, this Belgian huge -- largest bank in Belgium I believe, why they didn't do their contract right. Why they didn't do this explicitly. Because it is clear from the documents that they weren't explicit. Well, because they say the result here is absurd. It should not be allowed to stand.

The reason they didn't do this explicitly because they didn't think they had these rights. Right. This is not -- this was not done before the mortgage market exploded. This was all done when losses had already been incurred. Very significant losses. Why didn't they sign a claim, why didn't they bring a claim. Why are we here with a New York State law claim as opposed to a Section 11 and 12 claim where we wouldn't even be talking about reliance because it isn't an element.

The reason is because the statute of limitations elapsed. Why did they allow it to elapse? Because they don't think they had a claim.

That brings us back to the evidence with respect to reliance and falsity. They know they have no claim with

respect to compliance with underwriting guidelines, the alleged misstatement there. Because they didn't read it. They knew they didn't rely upon it, they knew they didn't read it. So they knew they didn't have a claim.

With respect to falsity, the other data they know there is no evidence of that. They know there is no evidence that the FICO scores are wrong. Or the appraisal are wrong. There is no evidence of it. And that is the reason they didn't bring a claim, and that's the reason they didn't assign a claim because they thought they don't have a claim.

I know you told me you didn't want to hear about it, but I will say one word about causation.

THE COURT: No, no, that was last time. I'm happy to hear, seriously, anything you want to talk about, but you've got six minutes left.

MR. SLIFKIN: Well, I'll try to be very, very brief. This is not, we are not bringing an ordinary garden-variety, well, they didn't disaggregate properly. Dr. Mason, who is their damages expert, and more importantly their causation expert, makes very plain that he does no analysis of these deals and these alleged rep -- misrepresentations. He does an analysis of the entire industry. An analysis not merely of alleged misrepresentations by the entire industry, but also of the practice of the industry in loosening and changing guidelines, even if they are being completely open and honest

about it. He's basically saying the losses here and the problem with the economy is caused by the mortgage industry.

That's not good enough. It has to be tied to the specific misrepresentations made by these three defendants in these 52 deals. And to say, well, there were lots of other people involved here, that actually hurts their case.

And as I pointed out last time and I'll conclude with this, your Honor, you know, when we actually drill down on what they're now saying their claim is, which is data falsity, the causation opinion actually hurts them because Dr. Mason's opinion is causation was entirely related to underwriting guidelines and what they were and whether they were complied with for the entire industry. He says nothing about losses being caused by data falsity. Thank you, your Honor.

THE COURT: Thank you very much. Let me hear finally from plaintiff's counsel.

MR. DeLANGE: Thank you, your Honor. We've spent a lot of time arguing reliance and I just want to start with that. And make it clear Exhibit 72, it was provided to the Court along with the undisputed testimony from Mr. Hendrickson, Mr. Albus, and others, establishes that FSAM relied on defendant's representations. They are affirmative representations and also their omissions. Their material omissions of the information that they knew and they kept secret and they didn't provide it to investors.

THE COURT: On the omissions point, your adversary among other things makes the point, which is I think unquestionably true, that a fraud claim cannot be premised on omissions per se, unless there is a duty to speak such as a fiduciary duty which was not present here. So, if you have a statement that is rendered a half truth by omissions, that's another possibility. But a pure omission case would not lie, absent a special duty.

MR. DeLANGE: There is two responses to that, your Honor. First, they did speak to the quality of the underlying collateral. They made representations throughout the term sheets, throughout the free writing prospectuses, all the marketing materials were making representations about the quality of the collateral. After all, in a mortgage backed security investment, that's the only thing that matters. Is the borrower going to make his or her principal and interest payments. That's how RMBS Trust is created.

Secondly, the law is clear in New York that if you have knowledge, peculiar knowledge with defendants, they have an obligation to disclose that. And here, the loan level information that they had was clearly undisputed, not available to investors. FSAM did not have the opportunity to go into the loan level review and confirm the accuracy of the data and the information and the representations that defendants were making.

THE COURT: All right.

MR. DeLANGE: With respect to falsity, again, I've showed several examples. We have similar examples for all 51 offerings and I'd reiterate to the Court defendants did not move on falsity. They moved on four issues, falsity was not one of them. Nevertheless, we submitted evidence establishing the falsity of their representations, establishing the material omissions.

I want to respond to standing quickly. Defendants argue that the language is not good enough. The language clearly assigns all right, title and interest. The Second Circuit in Banque Arabe held similar language assigning all right, title and interest in a transaction was sufficient. They also stated that transferring all right, title and interest in an asset may not be sufficient but they didn't reach that ruling. Importantly, they looked at the overall commercial purpose. What was the commercial purpose of the transaction in Banque Arabe that supported an assignment of the claims.

Here, you have undisputed testimony, these were intercompany transfers. Why would a company transfer assets within its corporate family and lose its rights to assert claims against defendants. Valid claims against defendants here. The language supports it. That this was an assignment. In addition, there is testimony from both sides of the

transaction, testimony from FSAM that clearly the intent was to assign the claims. Testimony from DCL that clearly the intent was to assign the claims. The language supports it. The Court's prior orders have looked at it, and rejected the challenge to standing.

(Continued on next page)

MR. DeLANGE: With respect to equitable subrogation, it is interesting that counsel cannot find any case outside of the insurance context. I am sure in the research, counsel also found that there is no case in New York that says you can't. And there is no case in New York that says equitable subrogation is limited to the insurance context only.

Here we meet the standards for equitable subrogation. Was the payment compelled or was it made to protect a party's interest? Here we meet both of those. It was compelled pursuant to the transaction documents in the sale of the insurance business to Assured. It was also to protect the interest of the corporation, to protect FSAM, to protect them from the loss in value, I should say the decreased value of these RMBS that they purchased from defendants.

With respect to causation, defendants mischaracterize Dr. Mason's report. Causation can be proven both through an expert and through the evidence. And the evidence here, in the context of mortgage-backed securities, again, I will go back to what a mortgage-backed security is, it is the quality of the loans that are within that pool. That's how it's valued, based on the perceived risk of the receipt of principal and interest payments from those loans. If those loans are not originated in accordance with guidelines, if they have misstated appraisals, if they have credit ratings that they don't deserve, the values of those securities is not going to be what

is represented. That evidence will be provided.

In addition, Dr. Mason testifies that the violations here, the quality of the underlying collateral caused the decreased value. He then performs a separate analysis, and that separate analysis is, having concluded that the failure to disclose the quality of the collateral had caused a decline in value, is there some other factor that I have to account for? And he does an analysis to determine whether or not the financial crisis was an independent intervening factor that he needs to account for in his analysis. And he runs a robust model, a model that defendants' expert was able to replicate, and he comes to the conclusion that it was not an independent intervening factor.

The last point I want to hit is the underwriter deals, where defendants say they are not liable for deals where they served solely as an underwriter. In their moving papers, they dedicated a paragraph to it, with a citation to this Court's opinion on a motion to dismiss in Deutsche Bank. And they said the role of the defendants here was, quote, too attenuated, cited to the Deutsche Bank opinion.

In our opposition, we have provided detailed evidence that eviscerates that argument. Their role was not attenuated. Their role was identical. It was the same whether they were the sponsor and the underwriter or if they were the underwriter only, including determining the due diligence, hiring the due

diligence vendors, reviewing the due diligence results, having final authority on whether or not to reject override wave-in loans from the due diligence providers.

Having received the opposition, in their reply, defendants changed their arguments, and they said, well, we didn't make a statement. They didn't move on that first of all. Second of all, I am surprised they would make such a representation because the evidence is clear, and it's in Exhibit 72, for each one of the deals, where the defendants serve as underwriter, the representations to FSAM came directly from the defendants. Defendants sent them the term sheets. Defendants sent them the free writing prospectuses. Defendants made representations to FSAM. For each one of those deals, they made the statements. Their role was not attenuated. It was exactly the same as the sponsor deals.

THE COURT: Thank you very much.

Let me just ask defense counsel one final question. I don't have this case in front of me, but one of the cases on the equitable subrogation issue was Pittsburgh-Westmoreland Coal Co. v. Kerr, 220 N.Y. 137 (1917). Was that an insurance case?

MR. SLIFKIN: I will follow my rule and be completely honest with the Court. I have absolutely no idea.

THE COURT: From the title it doesn't look like it, but you can't always tell from the title.

MR. SLIFKIN: Well, the issue is, are those tort claims or are they non-tort claims? Here we are talking about tort claims.

THE COURT: I understand that. But here is what Justice Chase, a very famous judge in the New York Court of Appeals, said in that case. Equitable subrogation "includes so wide a range of subjects that it has been called the mode which equity adopts to compel the ultimate payment of the debt by one who in justice, equity and good conscience ought to pay." That doesn't exactly sound like a statement that is intended to read justice, equity and good conscience, but only when insurance companies are in play.

MR. SLIFKIN: That's correct. But in the 95 years since that case was decided, there has been a great deal of decisions with respect to equitable subrogation, and there has been a very specific articulation of the test put forward by the New York courts. And all we are saying is, yes, that is a broad proposition. There has been worked out a specific jurisprudence in this regard, and the jurisprudence shows a couple of things. One, that there is no New York case using equitable subrogation to transfer tort claims from one party to another, as far as we have seen, and we referred your Honor to the Hamlet of Willow Creek Development Company. Now, admittedly, it's the Second Department, but it is in 2009, only four years ago now, or three years ago, where the Second

Department articulates a clear test, which test is simply not met here, because it was not a debt to an existing liability. It's simply a claim. There is no compulsion here on what DCL did and it is not protecting DCL's interest.

THE COURT: Very good. Thanks very much to all counsel. The Court will take the matter under advisement.

MR. DeLANGE: Could I raise an issue before you leave?

THE COURT: Yes.

MR. DeLANGE: At the last hearing, you had mentioned checking our calendars so we can set a trial date.

THE COURT: Thank you very much. What did you come up with?

MR. DeLANGE: I have not conferred with defense counsel, but with the Court's guidance on no earlier than May and no later than August, any time late May, early June would work for plaintiffs.

THE COURT: In a moment of weakness, since we last met, I agreed to try a case beginning June 10 in Fresno, California. That will probably go to the end of June. How long a case do you think this would be?

MR. DeLANGE: I think for plaintiffs to put on their case in chief, we estimate about two weeks to two and a half weeks.

MR. SLIFKIN: The issue with that is are we going to try all three defendants together or not?

THE COURT: Those are all fair issues. Let me just ask this. We are not going to set a trial date tonight. Does anyone have a problem with trying this case in July?

MR. SLIFKIN: I will speak for myself, and I will speak for my colleague. I am scheduled to go on vacation July 28 to Africa, and Mr. Earnhardt's wife is scheduled to have a baby a few days prior to that time.

THE COURT: I won't order her appearance.

MR. SLIFKIN: He wants to stay married to her for some period of time into the future.

THE COURT: The first lesson that any husband learns if he wants to stay married is to leave his wife alone.

All right. I cannot allow, assuming for the sake of argument that summary judgment is denied, I cannot allow this case to go, in terms of trial, beyond August on the very worst case scenario. So I think we are talking July. I am sorry about that, but it would have to be early July then. But when I issue my opinion in this case, depending how it comes out, if there is going to be a trial, we will convene a conference call setting an exact date.

MR. BERGER: Your Honor, the date that Mr. Slifkin gave was the end of July anyway. It was July 28.

THE COURT: July 3 is a good day to start it.

Very good. Thanks very much.

(Adjourned)