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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49
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GOOD HILL MASTER FUND L.P. and GOOD HILL MASTER FUND II L.P.,

Plaintiffs,

DECISION AFTER TRIAL

-against-

Index No.: 600858/2010

DEUTSCHE BANK AG,

Defendant.
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O. PETER SHERWOOD, J.:

Following a 5-day non-jury trial during which the court received over 300 documents into evidence, the court reviewed post-trial briefs and heard extended closing arguments. The case is now ready for decision on the merits.

This is a breach of contract case between sophisticated, well counseled, financial institutions who, *inter alia*, traded in complex financial instruments called credit default swaps. Plaintiffs seek to recover funds they posted with defendant as collateral under the terms of swap agreements, given that the notes referenced in the agreements had been cancelled. Defendant refused to return the funds, contending that plaintiffs acted in bad faith and in a commercially unreasonable manner when plaintiffs sold the notes at a higher than justified price at defendant's expense.

THE FACTS

Non-party Good Hill Partners L.P. is the investment manager of two hedge funds, plaintiffs Good Hill Master Fund L.P. ("GH I") and Good Hill Master Fund II L.P. ("GH II" and together with GH I, "Good Hill"). In 2007, non-party Bank of America Securities LLC ("Bank of America"), formed three special purpose vehicles (the "SPVs") through which it created and sold synthetic residential mortgage-backed securities (the "RESIF 2007-C Securitization"). Bank of America created the RESIF 2007-C Securitization in order to shift the risk of loss due to defaults in a pool of mortgages it held and to reduce the amount of regulatory capital it was required to hold with respect to those mortgages. The RESIF 2007-C Securitization referenced a large pool of residential mortgages held by Bank of America. In October 2007, the SPVs issued the "RESIF 2007-C Notes" and 'RESIX 2007-C Notes" (collectively the "2007-C Notes) in various tranches (or classes)

designated A and B1 through B13. These tranches included the B6 tranche of the RESIF 2007-C Notes (the "B6 Notes") and B7-B12 tranches of the RESIX 2007-C Notes (Collectively, the "B7-B12 Notes"). Each tranche of the B6 through B12 Notes had a different risk profile and carried a different interest rate coupon, with rates increasing from the B6 Notes to the B12 Notes, corresponding to the increase in risk of the lower-numbered tranches. The B6 Notes were investment grade. The B7-B12 Notes were not.

In October 2007, GH I paid $53,939,000 for all seven tranches of the B6-B12 notes (the "B6-B12 Notes") out of a $10.3 billion RESIF 2007-C Securitization initial offering (JTX 17 at p. 1; Tr. 183:21; 61:7-11). Bank of America retained the rest of the offering (JTX 17: Tr. 47-48). In early 2008, Good Hill and defendant, Deutsche Bank AG ("Deutsche Bank"), executed three credit default swap contracts[1] that referenced the B6 Notes (the "Swap Agreements") pursuant to which Deutsche Bank purchased protection against three specific risks: (1) a writedown or forgiveness of the principal; (2) a failure to pay principal and (3) an interest shortfall. Upon occurrence of any of these events, Good Hill would be required to make a payment to Deutsche Bank. The Swap Agreements did not provide protection against a mere decline in the value of the B6 Notes.

In April 2009, during the great United States stock market decline, Bank of America approached Good Hill with an offer to re-purchase all of the B6-B12 Notes at a substantial discount to their face value. Good Hill demanded $0.70 on the dollar for the stack, which demand Bank of America rejected (*see* Tr. 360). Ultimately, the parties agreed on a price of $0.29, a price which was more than three times the price at which the Notes were marked on the books of Good Hill and Bank of America at that time. There had been no trades of the Notes. Bank of America wanted to acquire the B6-B12 Notes, the only tranches of the RESIF 2007-C securities it did not own, in order to gain the ability to unwind and terminate the entire securitization. Deutsche Bank emphasizes that at the time the deal was struck, there had been no discussion of any allocation of the purchase price among the B6-B12 Notes (*see* Deutsche Bank Post-trial Brief, pp. 11-12) ("Deutsche Bank Br., p. ").

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[1]In late 2008, the parties split each of the three contracts in two in order to accommodate the desire of one of Good Hill's largest investors to move its funds. As a result of waivers granted by Deutsche Bank, the Swap Agreements were amended to create six contracts with each of GH I and GH II being Deutsche Bank's counter-party in three contracts (*see* Tr. 70:10-16; 91:21-25; 92:18-93:8).

The sale was scheduled to close in early July 2009, but was delayed to August 17, 2009, in part to assure that Wells Fargo Bank, the Trustee for the securitization, would report the sale in a Servicer Report it was required to make as of that date.[2] Deutsche Bank contends that in April, Good Hill assumed that Bank of America intended to redeem the B6-B12 Notes, in which event the B6 Notes would be redeemed at par. As such, and as Deutsche Bank acknowledges, Good Hill's obligations to Deutsche Bank would have been extinguished given the hierarchy of payments under the then existing Indenture (*see* Deutsche Bank Br., p. 15). In its Pre-trial brief, Deutsche Bank contended that following the April agreement, Good Hill learned that Bank of America intended to surrender and cancel the Notes, without any redemption of the amounts outstanding under the Notes. Deutsche Bank added that this action would have entitled Deutsche Bank to receive 100% of the protection payment from Good Hill (*see* Deutsche Bank Pre-trial Br. pp. 4-5). In its Post-trial brief, Deutsche Bank points to an internal Bank of America document, dated June 25, 2009, that suggests Bank of America intended to pay 29% of par for each class of the B6-B12 Notes (*see* Deutsche Bank Br., pp. 14-15). As discussed below, Deutsche Bank argues that the B6 Notes should have been assigned a value of approximately 8.9% of par.

In June and July, Good Hill and Bank of America had discussions concerning allocation of the 29% overall price by class. Deutsche Bank contends that Good Hill initiated the discussions with Bank of America in an effort to avoid its express obligation to make 100% protection payments to Deutsche Bank under the terms of the Swap Agreements[3] and in violation of its express and implied

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[2]Apparently, Wells Fargo was reluctant to issue a report in July, when it had no contractual obligation to do so, out of a concern for contingent liability (*see* Tr. 280-281; JTX 103).

[3]The Swap Agreements are evidenced by a series of forms created by the International Swaps and Derivatives Association, Inc. ("ISDA" and the forms "ISDA Forms") and adapted by the parties to reflect the terms of their agreement. Copies of the relevant ISDA Forms introduced in evidence, are as follows: (1) a Confirmation; (2) JXT 1, 2002 Master Agreement (undated); (3) JXT 2, 2002 Master Agreement and Schedule (dated May 16, 2007); (4) JXT 3 2002 Master Agreement (dated November 20, 2008); (5) JTX 4, Credit Support Annex (undated); (6) JTX 5, Paragraph 13 to Credit Support Annex (dated May 16, 2007); (7) JTX 6, Paragraph 13 to Credit Support Annex (dated November 20, 2007); (8) JTX 7, Standard Terms Supplement with Pay-As-You-Go (the "PAUG Terms"); and (9) JTX 8, 2003 ISDA Credit Derivatives Definitions (the "Definitions").

duty of good faith and fair dealing to Deutsche Bank. Citing the deposition testimony of Casey Neilson, the Bank of America banker on the transaction, Good Hill contends that Bank of America initiated the discussion (*see Neilson* Tr. 53). Good Hill adds that it was entitled to negotiate in its own interest as expressly provided for in the Swap Agreements (JTX 8, §9.1[b][iii]).

In its discussions with Bank of America, Good Hill proposed that the proceeds be applied by class as follows:

CLASS	**PRICE**	**CURRENT BALANCE**	**PROCEEDS**
B6	100.0%	$7,088,000	$7,088,000
B7	40.0%	$10,124,000	$4,049,600
B8	20.0%	$8,101,000	$1,620,200
B9	15.0%	$7,088,000	$1,063,200
B10	10.0%	$10,126,000	$1,012,500
B11	5.0%	$5,062,000	$253,100
B12	3.5%	$5,063,000	$177,205
	29.0%	**$52,651,000**	**$15,263,805**

(GHX 116).

In response, Bank of America proposed allocation of the proceeds as follows:

CLASS	**PRICE**
B6	52.0%
B7	44.0%
B8	32.0%
B9	22.25%
B10	18.00%
B11	12.50%
B12	9.90%

(*id.*).

Deutsche Bank argues that Bank of America's proposed allocation was made without any analysis and is unjustified (*see* Deutsche Bank Br., p. 18). Ultimately, Good Hill and Bank of America settled on an 83% allocation for the B6 Notes with substantially lower percentages for the remaining tranches. This allocation is supported by an analysis performed by Good Hill, which analysis Deutsche Bank argues is based on assumptions that are commercially unreasonable (*see* DBX 278, ¶¶ 12 and 82 [Report of Deutsche Bank's expert, Steven Hilfer]). Bank of America also conducted its own internal analysis of the allocation (*see Edgerton* Tr. 44:10-13; 52:12-12-15).

Deutsche Bank also argues that the 83% allocation was divorced from the market value of the B6 Notes and was inconsistent with the pricing relationship between the B6 Notes and the B7-B12 Notes (*see* DBX 278, ¶12). Despite its criticism of the process, Deutsche Bank does not assert any wrongdoing on the part of Bank of America. The Bank of America employees who were involved in negotiating the transaction insisted that there was no collusion between Bank of America and Good Hill (*see Edgerton* Tr. 72:3-11), that the negotiations were arms-length (*see* Tr. 103, 459; *Neilson* Tr. 30; *Edgerton* Tr. 45:10-13, 98:23-99:20; *Bartock* Tr. 759) and that each party was pursuing its own interests. According to Mr. Neilson, "nobody was doing anybody any favors" (*Neilson* Tr. 30:4-14).

The re-purchase closed on August 17, 2009. Thereafter, Wells Fargo issued a Servicer Report that reflected the 83% allocation. Deutsche Bank claims that the contents of the Servicer Report was dictated by Good Hill. Good Hill responds that there is nothing wrong with asking for documentation of a transaction (*see* Good Hill Br., p. 21). It adds that the Servicer Report was needed for calculation of the Floating Amount,[4] that there has been no showing that anything in the Servicer Report is inaccurate and that the Servicer Report merely describes the facts, it does not create them (*see id* at p. 20).

Upon the closing, Bank of America became the holder of all of the RESIF 2007-C Notes. On August 17, 2009, Bank of America entered into an agreement with the Trustee amending the Indenture to unwind the securitization and terminate all of the RESIF 2007-C Notes. As part of the

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[4]As is discussed more fully below, the Floating Amount is an amount of money to be paid by Good Hill to Deutsche Bank based on a writedown of the value of the notes. An event triggering the calculation and payment of a Floating Amount is a Floating Amount Event.

unwind, Bank of America forgave 17% of the principal of the B6 Notes and paid out the remaining 83% to the Noteholder (a Bank of America subsidiary). The Servicer Report documented these actions.

On August 24, 2009, Deutsche Bank issued two Floating Amount Notices to Good Hill acknowledging that a Floating Amount Event had occurred (the 17% writedown)(*see* JTX 162-163). The 17% Writedown triggered an obligation of the Calculation Agent (Deutsche Bank) to calculate the Floating Amount "based solely on the basis of the Servicer Report" (JTX 7, PAUG Terms at §8[b]). Under the formula set forth in the PAUG Terms, Good Hill was obligated to pay Deutsche Bank approximately $5 million. Good Hill maintains that because Deutsche Bank was holding $27 million in collateral posted by Good Hill with Deutsche Bank, Good Hill was due a net return of $22 million. Deutsche Bank did not complete the calculation, apparently due to the intervention of its counsel, who asserted that by negotiating for and getting the 83% allocation for the B6 Notes, Good Hill breached the Swap Agreements by failing to act in good faith or in a commercially reasonable manner. Accordingly, Deutsche Bank refused to return the collateral demanded by Good Hill.

Good Hill alleges that, by refusing to return the collateral, Deutsche Bank breached the Swap Agreements. By way of defense and counterclaim, Deutsche Bank asserts that Good Hill (1) breached its obligations under the terms of the Swap Agreements to act in good faith and in a commercially reasonable manner and 2) manipulated the price of the B6 Notes in violation of §10[b] of the Securities Exchange Act of 1934 (the "34 Act"). Deutsche Bank asks that the court calculate the Floating Amount on the basis of commercially reasonable market-based values as of April 2009.

DISCUSSION

I. Good Hill's Breach of Contract Claim

It is undisputed that the Swap Agreements provided Deutsche Bank with protection against certain identified risks, specifically a "Writedown, a Failure to Pay Principal and an Interest Shortfall" (PAUG Terms at §3). As defined in §9 (c) of the PAUG Terms (JTX 7), a "Writedown" means, *inter alia*, "the forgiveness of any amount of principal by the holders of the Indenture" through which the B6 Notes were issued. It is also undisputed that a "Writedown" occurred on August 17, 2009 when, after acquiring the B6-B12 Notes, Bank of America entered into an amendment of the Indenture with Wells Fargo as Trustee to terminate all of the RESIF 2007- C

Notes, including the B6 Notes. As part of the termination, Bank of America wrote down, or forgave, 17% of the principal of the B6 Notes. It also paid out the remaining 83% of the principal for the B6 Notes to the Noteholder and forgave higher amounts of principal of the lower B7-B12 tranhces. The Servicer Report confirms these actions (*see* JTX 158).

On August 24, 2009, Deutsche Bank issued Floating Amount Notices to GH I and GH II confirming that a Floating Amount Event had occurred (*see* JTX 162 and 163). The Swap Agreements provide that when a Floating Amount Event occurs, the "Seller (Good Hill) will pay the relevant Floating Amount to Buyer (Deutsche Bank)" (JTX 7, PAUG Terms at §3). The Floating Amount is "an amount equal to . . . the relevant Writedown Amounts" and

> each Writedown Amount . . . shall be calculated using the Applicable Percentage which takes into account the aggregate adjustment made to the Applicable Percentage in respect of all Delivery Dates that have occurred prior to the date of such calculation

(*id*). Under the terms of the PAUG, the "Calculation Agent (Deutsche Bank) shall be responsible, for determining and calculating . . . the occurrence of a Floating Amount Event and the related Floating Amount" (*id* at § 8 [b]). Specifically, the PAUG Terms mandate that the

> "Calculation Agent (Deutsche Bank) . . . shall make such determinations and calculations <u>based solely on the basis of the Servicer Reports</u>, to the extent such Servicer Reports are reasonable available to the Calculation Agent"

(*id*) (emphasis added). Despite the unambiguous text of § 8(b), Deutsche Bank refused to make the required calculation. Deutsche Bank relies on § 1.14 of the Definitions which states:

> "[w]henever the Calculation Agent (Deutsche Bank) is required to act or exercise judgment, it will do so in good faith and in a commercially reasonable manner"

(JTX 8, § 1.14. *See also* JTX 2-3, Schedules at Part 4 [h]). In a remarkable feat of legerdemain, Deutsche Bank reinterprets this obligation to require Deutsche Bank to rely on the Servicer Report, "but only if Deutsche Bank could do so in good faith and in a commercially reasonable manner" (Deutsche Bank Br., p. 27). Deutsche Bank then explains that "[n]ot surprisingly, the twin express requirements of good faith and commercial reasonableness precluded Deutsche Bank from basing a Floating Amount calculation on a manipulated, contrived or commercially unreasonable Servicer Report" (*id*). By this logic, Deutsche Bank maintains that it was "unable" to calculate the Floating

Amount because the "principal paid" on the B6 Notes was "allocated in a manner . . . inconsistent with our understanding of market valuation" (JTX 162-163 at 1).

Good Hill notes correctly that calculation of the Floating Amount has nothing to do with market valuation. It is strictly a function of the amount of the Writedown multiplied by the face amount of the B6 Notes and the "current factor", all of which can be found in Servicer Report. Deutsche Bank is neither "precluded" from basing calculation of the Floating Amount on the Servicer Report nor "unable" to do the arithmetic. Rather, it is required to make the calculation based on information provided to it in the Servicer Report (*see* JXT7, PAUG Terms at § 8 [b]). Accordingly, Good Hill has established its breach of contract claim.

II. Deutsche Bank's Defenses

Deutsche Bank maintains that it is entitled to retain virtually all of the posted collateral because

1. Good Hill breached its express and implied obligations to act in good faith and in a commercially reasonable manner; and

2. Good Hill manipulated the price of the B6 Notes by its bad faith 83% allocation.

The court will address these contentions in turn.[5]

A. The Express Good Faith Obligation Claim

Deutsche Bank argues that as the "Secured Party" under the terms of the Credit Support Annex, it can request additional credit support (a "Delivery Amount") and that Good Hill, as the Pledgor, may request the return of excess collateral (the "Return Amount") (*see* Deutsche Bank Br., p. 33). It argues that Good Hill's request for the return of a portion of the posted collateral following cancellation of the B6 Notes was a Return Amount demand under §3 (b) of the Credit

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[5]Deutsche Bank also observes that a decline in Good Hill's net asset value below a certain dollar amount or by a certain percentage is an Additional Termination Event which allowed Deutsche Bank to take protective action to reduce its exposure to Good Hill, including closing out trades (*see* Deutsche Bank Br. p. 30). Deutsche Bank would have the court "infer" that the timing of one of three Good Hill requests for a waiver of this requirement shows that Good Hill "acted malevolently . . . as part of a scheme designed to deprive Deutsche Bank of the benefits of the Swap Agreement" (Deutsche Bank Br., p. 43). Deutsche Bank did not develop proof sufficient to establish a basis for making the inference.

Support Annex (JTX 4, § 3 [b]) and that any such calculation relating to the collateral must be made in good faith. Section 3 (b) states:

> (b) Return Amount. Subject to Paragraphs 4 and 5, upon a demand made by the Pledgor on or promptly following a Valuation Date, if the Return Amount for that Valuation Date equals or exceeds the Secured Party's Minimum Transfer Amount, then the Secured Party will Transfer to the Pledger Posted Credit Support specified by the Pledgor in that demand having a Value as of the date of Transfer as close as practicable to the applicable Return Amount (rounded pursuant to Paragraph13). Unless otherwise specified in Paragraph 13, the "Return Amount" applicable to the secured Party for any Valuation Date will equal the amount by which:
> (i) the Value as of the Valuation Date of all Posted Credit Support held by the Secured Party exceeds
> (ii) the Credit Support Amount.

This provision has no bearing on the issues before the court. It concerns the amount required to be posted to support the right to payment of the Secured Party should there be an Event of Default. A Return Amount is based on a protected party's "Exposure" to the risk of certain potential future events (e.g. loss of principal or Events of Default) which in turn is based on marked - to- market valuations of the Referenced Obligation (*see* JTX 4, CSA ¶¶ 3 [a] - [b], 13; Tr. 498:24-499:10). The "Delivery Amount," which is the mirror image of the "Return Amount," is also calculated based on the protected party's "Exposure" (*see id.*). As of the date Good Hill requested return of the posted collateral, there was no Referenced Obligation because Bank of America had paid off the B6 Notes. Accordingly, Deutsche Bank's "Exposure" (*see id.*, § 13) was zero and the collateral should have been returned (*see* Tr. 162:7-163:4; 498:21-499:17 and 761:23-762:10). Paragraph 8(d) of the Credit Support Annex addresses this requirement in unambiguous terms:

> Final Returns. When no amounts are or thereafter become payable by the Pledgor (Good Hill) with respect to any Obligations . . . , the Secured Party (Deutsche Bank) will Transfer to the Pledgor all Posted Credit Support (the Collateral) and the Interest Amount, if any.

Deutsche Bank asserts that CSA ¶ 8 (d) does not apply because there remains the "Obligation" of Good Hill to make Floating Payments to Deutsche Bank (*see* Deutsche Bank Br., p. 34-5). In practice, where swaps are unwound and each side owes the other money, the parties may either exchange payments or net them with one payment being made to the party to whom a balance

is owed (*see* Tr. 510:22-511:16). This sensible practice is also confirmed by the terms of the ISDA Master Agreement. Section 2(c), entitled "Netting of Payments" provides that when each of the two parties owe amounts to each other, whether "in respect of the same Transaction" or as applied to "two or more Transactions", the obligation of the party owing the lesser amount is satisfied, and the obligation of the party owing the larger amount simply becomes an obligation "to pay to the other party the excess of the larger aggregate amount over the smaller amount" (JTX 1, § 2 [c]). To the extent that Kimberly Summe, Deutche Bank's "summary witness" (Tr. 467:4-18) testified to the contrary as to her "intent" as drafter of the ISDA Master Agreements (*see* Tr. 483:20-21), that testimony is barred by the parol evidence rule. Further, the court finds that her opinion is at odds with the plain meaning of § 2 (c).

Even if the Swap Agreements could be construed to bar netting, that provision would be unenforceable here because Deutsche Bank frustrated efforts to close out the swaps when it refused to calculate the Floating Amount pursuant to the PAUG Terms on the transparently false ground that it was "unable to determine the related Floating Amount that is due under each transaction" (JTX 304, pp 3-6). If an Obligation existed as of August 24, 2009, it was due simply to the refusal of Deutsche Bank to calculate the Floating Amount, which would have allowed the parties to exchange payments consistent with ¶ 8 (d) of the Credit Support Annex.

The 17% Writedown triggered a Floating Amount Event and the requirement to calculate and pay Deutsche Bank a Floating Amount of approximately $5 million (Tr. 162-63; 762). At the same time, Deutsche Bank was required to return to Good Hill any excess collateral, which in this case amounts to approximately $22 million.

B. <u>The Obligation to Act in a Commercially Reasonable Manner Claim.</u>

Deutsche Bank argues that "under multiple provisions of the Swap Agreements [ ] [*see*, e.g. JTX 8 [2003 Definitions] at § 1.14; CSA at ¶¶ 11 [d] and 13 [I] [iii] [c]; and JTX 1 [2002 Master] at §14 [Def. of Close-out Amount] at § 1.14]", Good Hill was obligated to perform in a "Commercially Reasonable Manner" (Deutsche Bank Br. p.45). Deutsche Bank does not explain how the cited provisions apply to the conduct at issue in this case. In any event, the obligations Deutsche Bank seeks to impose on Good Hill are obligations of Deutsche Bank, not Good Hill. For example, the first of the provisions cited above, JTX 8 at §1.14, provides that "[w]henever the

Calculation Agent (*Deutsche Bank*) is required to act or to exercise judgment, it will do so in good faith and in a commercially reasonable manner." Moreover, §1.14 which relates to circumstances requiring the exercise of discretion or judgment, does not apply at all because pursuant to §8 (b) of the PAUG[6], Deutsche Bank is obligated to calculate the Floating Amount "based *soley* on the basis of the Servicer Report to the extent such Servicer Reports are reasonably available to the Calculation Agent.[7] There simply was no discretion or "judgment" to be exercised.

According to Deutsche Bank, Good Hill was required to use commercially reasonable processes to arrive at the 83% allocation for the B6 Notes (*see* Deutsche Bank Br., 46). In its view, the 83% allocation Good Hill negotiated for the B6 Notes was grossly out of line with the marked price shown on Good Hill's books as of April 2009 and therefore the 83% allocation was commercially unreasonable (*see id.,* 46-47). In support of this theory, Deutsche Bank's expert witness, Steven Hilfer, testified that the 29% price for the B6-B12 stack was "commercially unreasonable" (Tr. 649) because of the "magnitude" of the difference between the marked price on the books of Good Hill (and others) and the actual sale price (Tr. 652). This attack lands far wide of its target. Mr. Hilfer (and Deutsche Bank) assumes that the marked prices which are mere estimates unsupported by actual sales, represented the value of the B6-B12 Notes and that the notes should have been sold consistent with the then-current marked price. During most of 2009, the time

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[6]It is undisputed that in the event of any inconsistency between the Definitions (JTX 8) and the PAUG Terms (JXT 7), the PAUG Terms governs (*see* JTX 7, first paragraph).

[7]In this case, a Servicer Report was available. Deutsche Bank's claim that Good Hill's efforts to assure that a Servicer Report reflecting facts concerning sale of the B6 Notes would be issued is proof of bad faith lacks merit. There was no showing that the reported facts were inaccurate. Moreover, Mr. Neilson testified that inquiries as to how termination of the transaction would be documented "was not an unusual question" (*Neilson* Tr. 119:10-12)(*see also id* 152:9-25). More importantly, the PAUG Terms contemplate that the Servicer Report would be used in connection with setting the Floating Amount. The agreement of Bank of America and Good Hill to schedule the closing for a date that coincided with the date the Trustee was required to issue the Servicer Report was both sensible and entirely appropriate.

Similarly, there was nothing nefarious about Good Hill's willingness to keep the transaction confidential because Good Hill knew that Bank of America wanted to keep the deal secret (*see id.* 144:20-145:9). Also, there was nothing unusual about Good Hill recommending language for inclusion in the Omnibus Termination Agreement (*see id.* 150:10-20).

period during which the events at issue unfolded, the financial markets were extremely dysfunctional (*see* Tr. 62:11-63:8). As Casey Neilson, a former Bank of America employee who was involved in the issuance and termination of the RESIF 2007-C Securitization testified, "[t]here was a disconnect between where the market had things priced and where the fundamental value of the mortgages were viewed from the prospective of Bank of America, therefore creating an opportunity" (*Neilson* Tr. 14:13-16; *see also id.* at 30:25- 31:3; 93:14-21 [Bank of America's "fundamental analysis . . . was higher than $29, substantially higher"]). At that time, most estimates of market value were extremely low (*see id.* at 14:23-26; *see also* Tr. 33; 63). Mr. Hilfer fixed the market value of the B6-B12 Notes at 8.7% as of July 31, 2009, a price far below their fundamental value. That price was clearly "unacceptable" (Tr. 452) to Good Hill, the only potential seller of the Notes. Bank of America perceived a much higher fundamental value and seized the opportunity to re-purchase the notes and extinguish the debt (*see Neilson* Tr. 18:4-5). It was willing to pay 29% for the entire stack of notes even though Bank of America had them marked at between 6.45% and 8.64% (*see* DBX 292).

Bank of America and Good Hill also agreed on an allocation of the price by class. The allocations, including the 83% allocation for the B6 Notes, were results of separate internal analyses performed by Bank of America and Good Hill. The B6 Notes were the most secure of the seven tranches constituting the stack. Both Bank of America and Good Hill had reasons for wanting to allocate the sale price by class (*see Neilson* Tr. 53:3-25, 56:1-13; Trial Tr. 667:11-669:20; *Edgerton* Tr. 40:1-41:8; *Babcock* Tr. 35:15-36:12) and they agreed that the B6 Notes should be allocated a higher price, compared to the more risky B7-B12 tranches (*see Edgerton* Tr. 146:9-14). The practice of allocating price by class with higher allocations going to the more senior classes is "standard", "customary", and "expected" (Trial Tr. 148:11-17; *Edgerton* Tr. 40:1-12; 194:12-196:11; Trial Tr. 374:21-375:13). In this case, the 29% price for the entire stack and the 83% allocation for the B6 Notes were agreed to following separate analyses and good faith arms-length negotiations (*see Edgerton* Tr. 45:10-13) during which negotiations each party was pursuing its own interests (*see*

Neilson Tr. 30:4-14; *Edgerton* Tr. 72:3-11).[8] Deutsche Bank has not established that either the 29% price or the 83% allocation was commercially unreasonable.

The court also finds that the concept of "market value" simply does not come into play with respect to a Floating Amount Event or the calculation of the Floating Amount under the PAUG Terms (*see* Tr. 574-75). Accepting that the ISDA Credit Derivates Definitions (JXT 8) contain references to commercial reasonableness, and assuming further that the Definitions could be interpreted to relate to the negotiations between Bank of America and Good Hill around a sale of the B6 Notes (an assumption not reflected in the provisions of the Swap Agreements and as to which Swap Agreements Bank of America is not a party), any conflict must be resolved by reference to the PAUG Terms (*see* Tr. 486). The PAUG Terms do not require any market valuation in determining the Floating Amount. Instead, they provide for making a straight forward mathematical calculation.

In any event, Section 9.1 (b) (iii) of the 2003 ISDA Credit Derivatives Definitions expressly reserves each party's authority to deal in its own self-interest "in the same manner as each of them would if such Credit Derivative Transaction did not exist, regardless of whether any such action might have an adverse effect on a Referenced Entity, any Underlying Obligor or the position of the other party to such Credit Derivative Transaction or otherwise" (JTX 8, § 9.1 [b] [iii]).[9] Thus, Good Hill was free to sell the B6 Notes for whatever price it could get in an arms-length deal.

C. The Implied Duty of Good Faith and Fair Dealing Claim

The duty of good faith and fair dealing is implied in every contract (*see 1-10 Industry Assocs., LLC v Trim Corp. of Am.*, 297 AD2d 630, 631 [2d Dept 2002]["Under New York law, a covenant of good faith and fair dealing is implied in all contracts."]; *see also Rowe v Great Atlantic & Pac. Tea Co., Inc.*, 46 NY2d 62, 69 [1978]). Regardless, whether the duty to act in good faith is

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[8]Mr. Hilfer's testimony was largely unpersuasive. In places he was evasive and even disingenuous (*see* Tr. 658-706). The court has discounted most of his testimony.

[9]At a price of 29%, Good Hill received approximately $15 million for the entire stack of B6-B12 Notes. If as Deutsche Bank argues, Good Hill's purported contractual obligations of good faith and commercial reasonableness mandated that the B6 Notes be sold at 8.7%, Good Hill would have been obligated to pay Deutsche Bank a Floating Amount approaching $27 million. Although not determinative of the issues in the case, a sale on the terms Deutsche Bank suggests would have made no economic sense.

express in the terms of the contract or implied under New York law, the "covenant of good faith encompasses any promises which a reasonable person in the position of the promisee would be justified in understanding were included in the agreement, and prohibits either party from doing anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract" (*1-10 Industry Assocs.*, 297 AD2d at 631; *Dalton v Educ. Testing Serv.*, 87 NY2d 384, 389 [1995]). Moreover, "[a] party's actions may implicate the implied covenant of good faith when it acts so directly to impair the value of the contract for another party that it may be assumed that they are inconsistent with the intent of the parties" *(Bank of China v Chan,* 937 F2d 780, 789 [2nd Cir 1991]). "A party may be in breach of its implied duty of good faith and fair dealing even if it is not in breach of its express contractual obligations" (*Chase Manhattan Bank, N.A. v Keystone Distribs., Inc.,* 873 F Supp 808, 815 [SDNY 1994]).

However, "the implied obligation is in aid and furtherance of other terms of the agreement of the parties. No obligation can be implied . . . which would be inconsistent with other terms of the contractual relationship" (*Murphy v American Home Products Corp.,* 58 NY2d 293, 304 [1983]). Thus, "[t]he convenant of good faith and fair dealing cannot be construed so broadly as to effectively nullify other express terms of the contract, or to create independent contractual rights" *(National Union Fire Ins. Co. of Pittsburgh, PA v Xerox Corp.*, 25 AD3d 309, 310 [1st Dept 2006] lv dismissed 7 NY3d 886; *see also North Star Contracting Corp. v City of New York*, 203 AD 2d 214, 216 [1st Dept 1994] ["a court will not make an inference of any implied agreement which is destructive of the express terms of the parties' contract"]). In fact, "[t]he implied covenant 'does not extend so far as to undermine a party's general right to act on its own interests in a way that may incidentally lessen the other party's anticipated fruits from the contract'" (*U.S. Bank Nat. Ass'n v Abels & Hall Builders*, 696 F Supp 2d 428, 445 [SDNY 2010], citing *Thyroff v Nationwide Mut. Ins. Co.*, 460 F3d, 400, 408 [2d Cir 2006] [internal citation omitted]; *see also Moran v Erk*, 11 NY 3d 452, 456 [2008]; *Citibank. N.A. v. United Subcontractors, Inc.,* 581 F Supp 2d 640 [SDNY 2008], aff'd, 355 Fed Appx. 507 [2d Cir 2009]).

As the court explained in *Richbell Information Services, Inc. v Juniper Partners L.P.* (309 AD 2d, 288, 302 [1st Dept 2003]), there is "tension between, on the one hand, the imposition of a good faith limitation on the exercise of a contract right and, on the other, the avoidance of using the

implied covenant of good faith to create new duties that negate explicit rights under a contract." In *Lehman Bros. Intl. v AG Fin Prods., Inc.*, (36 Misc 3d 1233 [A], 2013 NY Misc LEXIS 1010 [Sup Ct, NY County 2013]), Justice Marcy Friedman observed that:

> In the face of the tension, cases which uphold causes of action for breach of the implied covenant appear to fall into two main categories: In the first, an implied covenant claim may be recognized where a contract provides for a party's exercise of discretion but does not expressly require that the discretion be exercised reasonably. In the second, an implied covenant claim may be recognized where a party "exercise[s] a [contractual] right malevolently, for its own gain as part of a purposeful scheme to deprive plaintiffs of the benefits" of the contract. In support of the claim, a party may not merely assert that the opposing party should not be permitted to exercise an explicit contractual right or seek to "create new duties that negate specific rights under a contract" but, rather, must allege "bad faith targeted malevolence in the guise of business dealings." (*Richbell Info. Servs.*, 309 AD 2d at 302) (internal quotation marks and citations omitted).

In this case Deutsche Bank is asserting the latter type claim. Specifically, it asserts that Good Hill is precluded from abusing its position and dealings with Bank of America to "engineer . . . commercially unreasonable and untenable 83% allocation of the purchase price of the B6 Notes for the sole purpose of reducing its liability under its separate Swap Agreements with Deutsche Bank" (Deutsche Bank Br., pp. 27-28).

As the party asserting breach of the implied duty of good faith and fair dealing, Deutsche Bank has the burden of proof (*see Tractebel Energy Mktg., Inc. v AEP Power Mktg., Inc.*, 487 F 3d 89, 98 [2d Cir 2007]; *One West Bank, FSB v Greenhut*, 36 Misc 3d 1205 (A), [Sup Ct Westchester Co 2012]; *Manion v Pan American World Airways, Inc.*, 105 Misc 2d 927, 938 [Sup Ct NY Co 1980]).

In cases concerning credit default swaps, as in any case, parties are entitled to rely on the express terms of their agreement, and the duty of good faith imposes no obligations beyond those set forth in the agreement (*see, e.g., United Subcontractors, Inc.*, 581 F Supp 2d at 646; *VCG Special Opportunities Master Fund Limited v Citibank, N.A.*, 594 F Supp 2d 334 [SDNY 2008], aff'd, 355 Fed Appx 507 [2d Cir 2009]). In *United Subcontractors*, the court explained that the duty of good faith does not require the parties to adjure their own interests, so long as they comply with the terms of their agreement:

> Citibank's right to terminate the Swap Agreement does not arise from a finding within the discretion of the bank. Citibank's termination rights arose from financial data generated by the borrower. Citibank and [defendant] agreed that if the financial data reached a certain ratio, Citibank could terminate the agreement. The duty of good faith and fair dealing does not apply in such a situation. Where a contract allows a bank to withhold consent for particular conduct and sets no express restrictions on the bank's right to do so, the bank is not prohibited from unreasonably or arbitrarily withholding such consent. This analysis is not changed by the fact that Citibank knew the Requisite Lenders were drafting a waiver. A party to a contract is allowed to act in its own self-interest consistent with its rights under the contract.

(581 F Supp 2d at 645-646 quoting *State St. Bank & Trust Co. v Inversiones Errazuriz Ltda.*, 374 F 3d 158, 170 [2d Cir 2004]).

Further, the obligation of good faith does not impose obligations beyond those imposed by the parties' contract, nor can it override any of its specific provisions. No duty is implied that "would be inconsistent with other terms of the contractual relationship" *(Dalton*, 87 NY 2d at 389; *Murphy*, 58 NY 2d at 304; *see also North Star Contracting Corp v City of New York*, 203 AD 2d 214, 215 [1st Dept 1994] ["a court will not make an inference of any implied agreement which is destructive of the express terms of the parties' contract"]). In fact, "[t]he implied covenant 'does not extend so far as to undermine a party's general right to act on its own interest in a way that may incidentally lessen the other party's anticipated fruits from the contract"' *(US Bank Nat. Ass'n v Ables & Hall Builders*, 696 F Supp 2d 428, 445 [SDNY 2010], citing *Thyroff*, 460 F3d at 408 [internal citation omitted]; *see also Moran*, 11 NY 3d at 456; *United Subcontractors, Inc.*, 581 F Supp 2d 640; *VCG Special Opportunities Master Fund Limited v Citibank, NA.*, 594 F Supp 2d 334 [SDNY 2008], aff'd, 355 Fed Appx 507 [2d Cir 2009]). The record shows that there were arms-length negotiations between Bank of America and Good Hill with each party pursuing its self-interest. Deutsche Bank has not met its burden of proving that Good Hill acted malevolently and in bad faith.

Here, the swap documents expressly permitted Good Hill to trade in the Referenced Obligation without regard to the existence of the swap or any adverse effect it might have on Deutsche Bank's position in the swap (*see* JTX8 at 9.1 [b] [iii]). Under this provision of the Swap Agreements, Good Hill was free to negotiate a favorably-priced sale with Bank of America and to

negotiate an allocation of the sale price that placed a higher value on the most senior of the seven tranches.

There is nothing nefarious about Good Hill's request for proper documentation of the transaction in a Servicer Report or its request to see and comment on the Termination Agreement between Bank of America and the Trustee. As discussed above, such comments are neither uncommon nor inappropriate.

The 83% allocation was advantageous to Good Hill and disadvantageous to Deutsche Bank. This fact is hardly sufficient to establish bad faith. Deutsche Bank purchased protection against a writedown, not a decline in market value. It received some protection ($5 million), albeit not as much as it would have liked. The size of the writedown was the product of analyses and arms-length negotiations and was consistent with the fundamental value of the B6 Notes as Good Hill and Bank of America saw it at the time. Good Hill was entitled to sell the B6 Notes to Bank of America at the best price that could be agreed upon in a good faith, arms-length negotiation.

III. The Securities Laws Claim

Deutsche Bank also claims that Good Hill's actions amounted to a scheme to manipulate the price of the B6 Notes in violation of Section 10 (b) of the Securities Exchange Act of 1934 (the "34 Act") and Rule 10b-5 promulgated thereunder (*see* Deutsche Bank Br., p. 55). Deutsche Bank asserts that under federal law, Good Hill is prohibited from seeking to fix its Floating Amount obligation or seek a Return Amount based on the manipulated 83% allocation.

Under the 34 Act, "manipulation" is, in essence, a term of art that refers to "practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity" (*ATSI Comm. Inc. v the Shaar Fund, Ltd.*, 493 F3d 87, 100 [2d Cir 2007] quoting *Santa Fe Indus. v Green*, 430 US 462, 476-477 [1977]). Such a claim requires a showing of: "(1) manipulative acts; (2) damage; (3) caused by reliance on an assumption of an efficient market free of manipulation; (4) scienter; (5) in connection with the purchase or sale of securities; (6) furthered by the defendant's use of the mails or any facility of a national securities exchange" (*ATSI*, 493 F3d at 101, citing *Schell v Conseco, Inc.*, 43 F Supp 2d 438, 448 [SDNY 1999]; *see also Cowen & Co. v Merriam*, 745 F Supp 925, 929 [SDNY 1990]). The proponent of the claim must show that the "alleged manipulator engaged in market activity aimed at deceiving investors as to how other market participants have valued the security" (*ASTI*, 493 F 3d at 100).

The court has already held that Deutsche Bank has not shown that Good Hill acted in bad faith and that Good Hill appropriately negotiated the 83% allocation in its self-interest and at arms length. Such conduct is the anthesis of market manipulation as envisioned by Section 10b-5. Moreover, the defense fails because: (1) there was no market to manipulate, as there is no trading of the B6 Notes except for Bank of America's repurchase of them; and (2) there were no investors that could have relied on anything or been misled in connection with a purchase or sale, as the only investor in the B6 Notes was Good Hill. The transactions involved here were the result of arms-length negotiations by sophisticated, well-counseled parties. There was no "trickery" or deception of the kind proscribed by Section 10(b).

IV. Damages

As of August 14, 2009, Good Hill had posted $27,114,476 in collateral with Deutsche Bank pursuant to the terms of the Swap Agreements. The collateral was posted to secure any potential payment obligations owed by Good Hill to Deutsche Bank, including the occurrence of a Floating Amount Event. Upon the occurance of the Writedown and termination of the B6 Notes, Good Hill became entitled to a return of the posted collateral, less the Floating Amount (*see* JTX 1, 2002 ISDA Master Agreement, at § 2 [c]).

The Floating Amount may be calculated using the formula set forth in the PAUG. Application of that formula yields a Floating Amount owed to Deutsche Bank by Good Hill in the amount of $4,972,254.87 (*see* Good Hill Br., p. 9). Because, as of August 17, 2009, Deutsche Bank held collateral in the amount of $27,114,476, Good Hill is due a return of funds in the amount of $22,142,221.13, plus interest.

Judgment shall be entered in favor of Good Hill and against Deutsche Bank in that amount together with pre-judgment interest at the statutory rate from August 18, 2009, until the date judgment is entered. In addition, Good Hill is entitled to recover its costs and attorney fees in accordance with § 11 of the ISDA Master Agreement.

The parties shall meet and confer at their earliest convenience to attempt to reach an accord as to the amount of fees and costs owed. If the parties are unable to reach an agreement, counsel shall appear before the court at a status conference on March 28, 2016, at 10:00 am, at which time the court will either assign the matter of the amount of fees to a Special Referee or set a date for a

hearing before the court. Not less than 14 days prior to that time, Good Hill shall present to Deutsche Bank a proposed judgment and counsel shall meet and confer regarding same. The proposed judgment shall be presented not later than March 28, 2016.

This constitutes the decision and order of the court.

DATED: February 3, 2016

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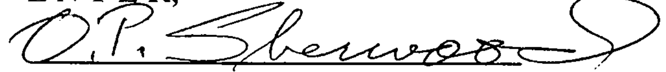

O. PETER SHERWOOD
J.S.C.