UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, Plaintiff, -against- PAUL MANGIONE, Defendant.	No. 17 Civ. 5305 (NGG) (RML)

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF DEFENDANT PAUL MANGIONE'S MOTION TO DISMISS THE COMPLAINT

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March 15, 2018

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INTRODUCTION

The government's defense of its attempt to apply FIRREA to Paul Mangione cannot save this ill-conceived action. While FIRREA may not require that a federally insured financial institution be the object of the supposed fraud, the allegedly fraudulent conduct still must create or increase a real risk of loss to a federally insured institution. We thought the government agreed with this standard, given that the Complaint expressly adopts it. (Compl. ¶¶ 258-62.) But in an acknowledgement that the Complaint's "affecting" allegations concerning HSBC and Wells Fargo are insufficient under this standard, the government's opposition invents a more expansive one, claiming that an "unbounded range of effects" suffices. No case has ever held that the only limit on the government's ability to bring a FIRREA case is its own imagination. FIRREA imposes meaningful limitations that the government ignores here. The Court should reject this unprincipled effort to manufacture a claim because the alleged fraudulent conduct at issue did not, and could not, cause loss to either HSBC or Wells Fargo.

The government's fraud claims also fail under Rule 9(b). Despite the government's multi-year investigation into Deutsche Bank's RMBS practices, its allegations that Mr. Mangione was a "critical co-conspirator" in a bank-wide scheme to defraud investors in the HE4 and HE5 securitizations are razor thin. These allegations flow from only two sources: (i) quality-control reports that Mr. Mangione never received and (ii) two phone calls in which the Diligence Director relayed anecdotes of problems with Chapel's quality control to Mr. Mangione and assured him that the problems had been reported to superiors at the bank. In its opposition, the government trots out the well-worn mantra that Mr. Mangione raises trial arguments. But before a trial, the government must satisfy Rule 9(b), which requires the government to provide an "ample factual basis" to support charges of fraud. *O'Brien v. Nat'l Prop. Analysts Partners*, 936 F.2d 674, 676 (2d Cir. 1991). Instead, the government resorts to insinuation, innuendo, and the mischaracterization of evidence. Such tactics fall decidedly short of the heightened pleading standards of Rule 9(b).

ARGUMENT

I. THE ALLEGED SCHEME TO DEFRAUD DID NOT AFFECT A FEDERALLY INSURED FINANCIAL INSTITUTION

A. A FIRREA Complaint Requires Well-Pled Allegations of a Loss or Risk of Loss to a Federally Insured Financial Institution

FIRREA requires that the mail- and wire-fraud schemes alleged in the Complaint "affect[]" a federally insured financial institution by exposing the depository institution and its depositors to a risk, or increased risk, of loss. (Mem. 19-26.)[1] The government appeared to agree with this standard by wrongly touting that the alleged scheme "targeted" federally insured financial institutions and framing its FIRREA claims in terms of "suffered losses" or exposure to "loss or risk of loss." (Compl. ¶¶ 259, 262.) Once confronted with the reality that the two contractual service providers identified in the Complaint as federally insured institutions faced no plausible risk of loss, the government abandoned its pleadings and now argues that "a virtually unbounded range of effects . . . constitute a sufficient effect" under the statute. (Opp'n 18.)

The government cites no case that has adopted its expansive view of FIRREA. Instead, it cites the Second Circuit's decision in *United States v. Heinz*, 790 F.3d 365, 367 (2d Cir. 2015), to argue that "the *only* limitation that has been placed on the term 'affecting' is that the effect be 'sufficiently direct.'" (Opp'n 17, 20.) But the Second Circuit in *Heinz* had no occasion to address whether an "unbounded range of effects" could satisfy FIRREA's "affecting" element

[1] Unless otherwise defined, capitalized terms have the meaning ascribed to the them in the Memorandum of Law in Support of Defendant Paul Mangione's Motion to Dismiss the Complaint ("Mem."). References to "Opp'n" refer to the "Memorandum of Law of Plaintiff the United States of America in Opposition to Defendant's Motion to Dismiss the Amended [sic] Complaint."

because the financial institutions there, as co-conspirators in the fraud, incurred "significant payments and related fees" in the form of "more than $500 million in fines and restitution." 790 F.3d at 367.

The government's expansive position also ignores the weight of authority that has interpreted the "affecting" language of § 1833a and other similarly worded provisions of FIRREA in the context of actual or increased risks of loss. (Mem. 21 (citing authority).) The government dismisses these cases because they do not state that loss or risk of loss is necessary to state a claim. (Opp'n 21.) But the government cannot point to a single case where a court found that a non-financial effect alone is sufficient under FIRREA.[2]

To obscure its legally deficient interpretation of FIRREA, the government casts the "affecting" analysis as "inherently factual" and therefore "a question of fact for the jury to decide." (Opp'n 18-19.) The Court should reject this request for a free pass from scrutiny of the allegations in support of a key component of the government's case. Before the case ever reaches a jury, the government is required to present factual allegations that "raise a reasonable expectation that discovery will reveal evidence" in support of its FIRREA claim. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007). The government does not argue that additional factual development is necessary to establish that the alleged mail or wire fraud affected an insured institution, choosing instead to highlight the fact that no "court has ever dismissed at the pleading stage a FIRREA claim on the ground that the Government insufficiently alleged that a defendant's fraud affected a FIFI." (Opp'n 18.) But the government cannot point to a single

[2] The government misstates the holdings in two cases to support its claim that the effect need not be financial in nature. *See United States v. Johnson*, 130 F.3d 1352, 1355 (9th Cir. 1997) (finding, where a bank employee embezzled over $1 million, "that the bank did suffer an unreimbursed financial loss totaling approximately $500,000" and stating in *dicta* that "Johnson's thievery affected the bank in non-financial ways"); *United States v. Bank of N.Y. Mellon*, 941 F. Supp. 2d 438, 458 (S.D.N.Y. 2013) (finding bank "affected negatively in a number of ways").

case where it has premised FIRREA liability on such attenuated circumstances as those presented here. That no court has dismissed a FIRREA civil-penalties case at the pleading stage does not make the allegations *in this case* sufficient. *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (requiring a complaint to contain "sufficient factual matter . . . to state a claim to relief that is plausible on its face"); *see also Ferrer v. Citigroup Mkts., Inc.*, 2011 WL 1322296, at *4 (E.D.N.Y. Mar. 31, 2011) (Garaufis, J.) (observing that the Federal Rules "do[] not unlock the doors of discovery for a plaintiff armed with nothing more than conclusions").[3]

B. HSBC as Trustee Was Not Plausibly Affected by the Alleged Scheme

HSBC—as trustee for the HE4 and HE5 collateral pools—faced no realistic prospect of loss because it never put any money at risk, was protected from expending its own funds by numerous provisions in the PSAs, and was not subject to litigation risk relating to the alleged fraud. (Mem. 22-24.) The government ignores the first point, electing instead to argue that (i) litigation risk—no matter how remote and speculative—is sufficient, (ii) that HSBC's performance of its contractual obligations suffices to show that it was affected, and (iii) that the PSAs' protective provisions have "no bearing . . . on the 'affecting' analysis." (Opp'n 21.) The government is wrong across the board.

First, the government concedes that the potential for litigation risk is based on lawsuits brought by investors "in a number of *other* securitizations" alleging that HSBC failed to perform its duties as trustee. (Opp'n 13 (emphasis added).) The government does not explain how it is

[3] The government ignores *United States v. Carollo*, 2011 WL 3875322, at *2 (S.D.N.Y. Aug. 25, 2011) and *United States v. Grass*, 274 F. Supp. 2d 648, 653 (M.D. Pa. 2003), both of which found, as a matter of law, that certain financial institutions were not affected by the wire fraud alleged in the indictment. (Mem. 21, 25.) The government does not even mention *Carollo*, which rejected allegations of exposure to "risk of loss" based on unexplained "expenses associated with litigation." 2011 WL 3875322, at *2. And the government attempts to distinguish *Grass* as a "categorical challenge to the type of effect alleged" (Opp'n 20 n.20) to mask the fact that the court rejected the very arguments the government raises here by holding that loss of income and increased expenses are insufficient to allege a FIRREA claim. *Grass*, 274 F. Supp. 2d at 653-54.

plausible that HSBC could be sued for failing to perform its contractual duties when, as alleged, HSBC pursued the exact remedies against Deutsche Bank that it was accused of failing to pursue in the cases referenced in the Complaint. (Mem. 23.) Instead, the government suggests that "HSBC was exposed to a number of varying litigation risks" (Opp'n 18 n.17), yet the government failed to plead any other potential litigation risks, and it cannot survive a motion to dismiss with "'naked assertion[s]' devoid of further factual enhancement." *Iqbal*, 556 U.S. at 678.[4]

Second, the government's claim that HSBC's "obligations were far more costly to execute" (Opp'n 13) is based on the false statement that HSBC was required to "monitor" the collateral pools for adherence to the representations and warranties in the MLPAs. (Mem. 24.) As the documents referenced in the Complaint show—and which the government does not dispute—the obligation to monitor the collateral pools was delegated to the "Credit Risk Manager," and the PSAs made plain that HSBC did not have a duty to conduct any "affirmative investigation" into potential breaches. (Mem. 24 (citing Ex. 22 at S-168 & Ex. 20 § 9.02(a)(xii)).)

That HSBC had the duty to enforce the representations and warranties in the MLPAs changes nothing. This was a risk that HSBC bargained for by agreeing to be trustee of a subprime securitization. Subprime loans, by definition, had a higher risk of incurring early payment defaults or requiring repurchase. The prosupps stated that "[d]elinquencies and losses

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[4] The government claims the fact that HSBC "avoided an investor lawsuit" by "acting appropriately" "does not obviate the risk created by the fraud in the first instance." (Opp'n 18-19 n.17.) But HSBC was always subject to litigation risk if it failed to honor its obligations under the PSA, and the government does not even try to explain how the underlying fraud made it less likely that HSBC would perform its contractual duties. Contrary to the government's argument that Mr. Mangione is asking the court to rule that the only litigation risk "is of the nature posited by" him (*id.*), its own pleadings prevent the Court from concluding that HSBC was subject to "varying litigation risks" because the government has not provided a well-pled basis for the Court to infer that any other litigation risk existed.

. . . generally have increased in recent months, and may continue to increase, particularly in the subprime sector" and that subprime originators have "recently experienced serious financial difficulties" stemming from "claims for repurchases" related to "early payment defaults" and "material breaches of representations and warranties . . . such as fraud." (Ex. 22 at S-23.)[5] In any event, the government does not allege that HSBC was not paid what it was entitled to under the PSAs. The government points to no case in which increased costs associated with the performance of contractual duties are sufficient to satisfy FIRREA's "affecting" element. In fact, the only court to address similar expense or lost-profit claims has squarely rejected such arguments. *Grass*, 274 F. Supp. 2d at 653 (rejecting FIRREA claim based on "unspecified lost income and expenses incurred").

Third, the government does not dispute that, under the PSAs, HSBC was not required "to expend or risk its own funds." (Mem. 10, 24.) Instead it claims that this provision provides "some measure" of indemnification, which has "no bearing . . . on the 'affecting' analysis." (Opp'n 21.) The government misses the point. HSBC never had to expend any funds unless it determined that it was adequately protected. (Ex. 20 § 9.02(a)(iii)-(xi).) There is no allegation that HSBC acted without adequate indemnification or that the collateral pool contained insufficient funds to compensate the trustee in the event it chose to act. (Ex. 20 § 1.01

[5] The government claims for the first time in its opposition brief that HSBC expended "significant attorney's fees, time and non-financial resources" enforcing Deutsche Bank's obligations (Opp'n 18, 19 n.18, 21 n.22) and would not have agreed to act as trustee "had it known the true quality of the loans securitized" (Opp'n 13-14). The court can swiftly reject these claims that do not appear anywhere in the Complaint as "[i]t is well established that plaintiffs cannot amend their complaint by asserting new facts or theories for the first time in opposition to Defendants' motion to dismiss." *Thomas v. City of New York*, 2013 WL 3810217, at *3 (E.D.N.Y. July 23, 2013). Even if pled, the government's musings about HSBC are nothing more than "information and belief" statements, which are not entitled to any weight here. (Mem. 40 n.16.)

(definition of "Available Distribution Amount"), § 9.05; Smith Reply Decl. Ex. 38 at S-113.)[6]

The protective provisions here are akin to those that insulated the financial institution from liability in *United States v. Agne*, 214 F.3d 47, 53 (1st Cir. 2000). The government attempts to distinguish *Agne* with the nonsensical proposition that it does not apply because the legal conclusion that the bank was not "affected . . . within the plain meaning of that term" was articulated on consideration of a trial record. (Opp'n 19-20.) Perhaps the government believes that the holdings of appellate courts reviewing a trial record are "less good" or "less binding." Or perhaps the government should have alleged facts that, *if proven*, would satisfy the rule. In any event, the government does not dispute the First Circuit's reasoning or conclusion that, based on the "protective terms" in the operative agreement, "the bank suffered no actual financial loss and experienced no realistic prospect of loss." *Agne*, 214 F.3d at 53.

Unable to distinguish the protective provisions in the PSAs from those that applied in *Agne*, the government argues that the indemnification provisions only cover "HSBC's affirmative exercise of powers under the PSA," and not "lawsuits against HSBC either as a co-conspirator in [Mr.] Mangione's fraud or as a result of its alleged failure to detect the defective loans." (Opp'n 21 n.22.) HSBC is not alleged to be a co-conspirator, nor does the government allege any facts in the Complaint to suggest that such a lawsuit is plausible. (Compl. ¶¶ 258-62.) And it defies credulity to suggest that HSBC could be sued for failing to detect defective loans when it never had that responsibility in the first place.

[6] Neither of the two cases the government cites to argue that the Court should ignore the PSA's protective provisions at the motion to dismiss stage support its argument. (Opp'n 21 (citing *United States v. Countrywide Fin. Corp.*, 996 F. Supp. 2d 247, 249 (S.D.N.Y. 2014) and *Johnson*, 130 F.3d at 1355).) Unlike Bank of America in *Countrywide*, HSBC does not face liability as a successor-in-interest to Deutsche Bank or any other alleged perpetrator of the supposed fraud. (Mem. 24 n.12.) And in *Johnson*, the bank was the actual victim of the defendant bank teller's embezzlement scheme and therefore suffered actual losses, some of which were reimbursed. 130 F.3d at 1355. HBSC is not alleged to have been victimized by the alleged scheme, nor is it alleged to have advanced funds that were later partially or fully reimbursed.

C. Wells Fargo as Master Servicer and Securities Administrator Was Not Plausibly Affected by the Alleged Scheme

The Complaint alleges that "one of Well Fargo's primary sources of remuneration" came from interest earned every month on the mortgage payments collected from borrowers and deposited in a distribution account before payments were made to investors (i.e., the "float"). (Compl. ¶ 262 n.52; Mem. 11.) Mr. Mangione's opening brief explained how it was ludicrous to suggest that Wells Fargo faced a risk of loss from potentially earning less from funds on deposit. (Mem. 2, 25.) Because the government offers nothing in opposition, this claim is abandoned. *See, e.g.*, *Barnett v. Countrywide Bank, FSB*, 60 F. Supp. 3d 379, 385 (E.D.N.Y. 2014) ("[A]rguments not made in opposition to a motion [to dismiss] . . . are deemed abandoned." (first alteration in original) (citation omitted)).

The government now claims that "Well Fargo's compensation depended entirely on the [unpaid principal balance ("UPB")] of HE4 and HE5." (Opp'n 14.) The Complaint never mentioned the "UPB" as a basis for compensation and speaks generically of "reduced servicer fees." (Compl. ¶ 262.) Even if the Complaint contained the factual detail the government imagines in its opposition, there would still be no legal basis to conclude that Wells Fargo was affected by receiving a smaller fee. For one thing, under the plain terms of the PSA, the master servicing fee for HE4 was *zero* (Mem. 10-11 n.5)—meaning that the government's claim of "reduced fees" on HE4 depends entirely on its now-abandoned claim about the income on the "float." And, that Wells Fargo may have received a master servicing fee in HE5 that was "reduced" from some unpled baseline does not equate to a "loss" under FIRREA's "affecting" element. (Mem. 25); *see also Grass*, 274 F. Supp. 2d at 654 (observing that the government's "contention with respect to lost income would convert the requirement that a wire fraud *affect* a financial institution to one requiring only that the wire fraud *access* a financial institution”).[7]

Equally unavailing is the government’s claim that Wells Fargo incurred increased costs to service the loans in HE4 and HE5. (Opp’n 14.) This too is an unpled claim, as the Complaint only alleges that Wells Fargo may “potentially hav[e] to advance to the RMBS trust the mortgage payments of defaulting borrowers, which Wells Fargo may not have recouped until the eventual foreclosure and sale of the mortgaged property.” (Compl. ¶ 262.) Because its position regarding potential advances was legally untenable (Mem. 25), the government conceives a new theory that Wells Fargo’s costs increased because it may have to bear the cost of foreclosure if a servicer’s contract was terminated. (Opp’n 14.)

The government’s newfound theory does not save the Complaint. Wells Fargo’s contractual obligations are not a new or increased risk—they were part of its job—and to the extent Wells Fargo had to “prosecute or defend any legal action,” it was not required to do so unless it “received reasonable indemnity for its costs and expenses.” (Ex. 20 § 4.03(b).) The government does not allege that Wells Fargo had to assume any of the servicers’ obligations at its own expense, that it was at risk of not receiving adequate indemnity, or that any servicer was at risk of being terminated because of the alleged fraud schemes such that it would ever have these obligations. This unpled sequence of events that would lead to Wells Fargo bearing any increased costs is far too attenuated to justify imposing FIRREA liability. (*See* Mem. 21 (quoting *United States v. Mullins*, 613 F.3d 1273, 1278 (10th Cir. 2010)).) There is simply no basis—pled or otherwise—for the Court to conclude that Wells Fargo suffered any loss or faced

[7] The government claims that, in *Grass*, the bank’s “only involvement” was “as a conduit for the transfer of funds” and labels Wells Fargo and HSBC as “indispensable parties to . . . [the] fraud.” (Opp’n 22 & n.23.) But HSBC’s and Wells Fargo’s federally insured status is happenstance, and there is no alleged requirement that either party be federally insured to serve in their respective capacities. Under the government’s theory, any indirect effect on a federally insured institution that played a peripheral role in a transaction that was tainted by alleged fraud would create FIRREA liability. Binding precedent forecloses such an unrestrained view of FIRREA. *Heinz*, 790 F.3d at 367 (“[E]ffect of the fraud” on the financial institution must be “sufficiently direct”).

a realistic threat of loss from the alleged fraud schemes.

II. THE COMPLAINT FAILS TO STATE A CLAIM THAT MR. MANGIONE VIOLATED THE MAIL OR WIRE FRAUD STATUTES

A. The Complaint Fails to Allege an Actionable Misstatement or Omission

The Complaint alleges a scheme with two unrelated parts—one related to the statements about Chapel's compliance with underwriting standards in the HE4 and HE5 prosupps and MLPAs, and the other related to the failure to include unsecuritized second liens in the CLTV ratio. (Compl. ¶¶ 127-28.) The government fails to allege with sufficient particularity under Rule 9(b) that the Chapel disclosures were false (or that Mr. Mangione was responsible for those disclosures), that the contractual MLPA provisions can provide a basis for fraud liability, or that Mr. Mangione was responsible for the decision to omit second liens from the CLTV calculation. (Mem. 27-34.) The government's response to these fatal pleading defects is unpersuasive.

1. The Complaint Fails to Allege that Statements Concerning Chapel Loans and Its Origination Practices Were Materially False

The government claims to have satisfied Rule 9(b)'s requirement of identifying the specific quality-control reports containing information that conflicted with the prosupps' Chapel disclosures by generally alleging that "Clayton and Adfitech prepared the reports . . . on a monthly basis" and at some unknown time "the Diligence Director reviewed the reports." (Opp'n 25-26.) But this is a far cry from what Rule 9(b) demands when relying on contradictory internal reports. (Mem. 28.) At the very least, the government must identify the specific reports on which it relies, identify the loan-level defects that conflict with the disclosures, and identify the date when the reports were prepared and provided to Deutsche Bank. (Mem. 27-28.) The government's failure to provide this information is even more egregious in light of its possession of the very reports it purports to describe. *See U.S. ex rel. Kirk v. Schindler Elevator Corp.*, 926

F. Supp. 2d 510, 521-22 (S.D.N.Y. 2013) ("[The] degree of particularity required should be determined in light of . . . whether the plaintiff has had an opportunity to take discovery . . . .").[8]

The government also wrongly argues that it can rely on the grades assigned by Adfitech and Clayton to support its falsity claim. (Opp'n 27.) The underlying defect that supports the final grade, and how that defect relates to whether the loan complied with guidelines, is what would permit an inference of falsity. (Mem. 28-29 & n.13.) Without this information, the grades are mere conclusions dressed up as factual claims. (*Id.*) The government's opposition reinforces that, at best, it alleges a mere possibility that an immaterial number of nonconforming loans wound up in the HE4 and HE5 issuance, which is insufficient under the less-onerous notice pleading standard, much less Rule 9(b). (Mem. 29 n.13.)[9]

The government's reliance on *Federal Housing Finance Agency v. JPMorgan Chase & Co.*, 902 F. Supp. 2d 476, 486-90 (S.D.N.Y. 2012), is misplaced. There, the plaintiff conducted a "forensic review" of loan files drawn from three of the securitizations at issue. *Id.* at 487. Rather than rely on conclusory findings that a certain percentage of loans failed to comply with guidelines, the plaintiff "recounted in the Amended Complaint[] the underwriting failures," provided specific examples of the underwriting violations, and described "specific loans and the reasons for which those loans were found to be in breach." *Id.* The Complaint here pales in comparison, and the government cannot feign hardship in providing these details when it could

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[8] As discussed *infra* in Section II.B.2, the government's repeated claim that Mr. Mangione "had actual knowledge of the [quality-control] results" is pure fiction premised on an unsupportable interpretation of a phone conversation referenced in the Complaint. (Opp'n 11-12, 25, 26; Compl. ¶ 209.)

[9] Documents produced to Mr. Mangione on the day he served his opening brief, and which the government represented that it relied on in drafting the Complaint, show why the government's reliance on grades alone is misleading. Those documents show that an Adfitech Severity Code 3 indicates that "some underwriting guideline (including internal guidelines if provided) was not strictly followed," but "[i]n many cases, the underwriter that originally approved the loan may have simply failed to fully document how the underwriting decision was reached." (Smith Reply Decl. Ex. 37.) Critically, as many as three Severity Code 3 defects for a single loan still meant that the loan was "[g]enerally good quality." (*Id.*)

have easily identified the loan defects that allegedly support the quality-control grades.[10]

The two April 2007 phone conversations between the Diligence Director and Mr. Mangione suffer from the same fatal flaws. (Opp'n 24.) The government has no way of linking any of the statements about loan quality to the loans in the HE4 and HE5 collateral pools as there is no statement by the Diligence Director that the Chapel issues persisted or otherwise materially tainted the HE4 and HE5 securitizations. (Mem. 30); *see also IKB Int'l S.A. v. Bank of Am.*, 2014 WL 1377801, at *19 (S.D.N.Y. Mar. 31, 2014) (rejecting due-diligence employee's statement where there was no "connection between the comments from . . . the . . . employee and the specific loans that made up the securitization in issue").

The lone example that the government cites of a conflict between the Diligence Director's statements and the prosupps illustrates the flaws in the government's falsity argument. (Opp'n 24.) The government claims that the Diligence Director's statement that Chapel "ha[d] no real true QC . . . [because] it was volume oriented last year" conflicts with the prosupps' disclosures about Chapel's "quality control program." (Opp'n 24.) But the statement about problems that existed at an unspecified point "last year" says nothing about the state of the program in 2007 and lacks any connection to the specific loans in the HE4 and HE5 collateral pools. Absent contemporaneous information showing that the Chapel loans in the HE4 and HE5 collateral pools suffered from material underwriting defects, there is no basis to conclude that the prosupp statements were false when made. (Mem. 30-31.)

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[10] The government mischaracterizes Mr. Mangione's argument as one requiring "detailed evidentiary matter." (Opp'n 25.) The government conflates "evidentiary matter" with well-pled facts, which the government must—but failed to—allege to support its falsity claim. *Iqbal*, 556 U.S. at 678. Consequently, *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63 (2d Cir. 2001) and *In re Dynex Capital, Inc. Sec. Litig.*, 2006 WL 314524 (S.D.N.Y. Feb. 10, 2006) are inapposite.

2. The Complaint Fails to Allege that Mr. Mangione Made Any Statements About Chapel or Its Underwriting Standards

The government does not dispute that Mr. Mangione was a whole-loan trader at Deutsche Bank with no oversight of, or responsibility for, a subsidiary of Deutsche Bank—DB Home—to which the prosupps expressly attributed the disclosure of the challenged Chapel underwriting standards. (Opp'n 33.) Yet the government maintains that Mr. Mangione is responsible for every disclosure in the prosupp—even those attributed to a Deutsche Bank subsidiary—because he was purportedly "intimately involved in every aspect of the offering documents's [sic] drafting and issuance." (Opp'n 32-34.) As the cases cited by the government confirm, allegedly fraudulent statements in corporate documents "may be charged to one or more corporate officers provided specific factual allegations link the individual to the statement at issue." *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 545 (S.D.N.Y. 2011) (citation omitted). The documents referenced in, and relied upon in drafting, the Complaint show that Mr. Mangione's involvement in the securitization process fell outside of his core function and was limited, at best. (Mem. 4-9.) In fact, the allegations purporting to show Mr. Mangione's involvement in the securitization process do not show any responsibility whatsoever for the drafting or approval of the Chapel disclosures.[11]

Unable to tie Mr. Mangione to the Chapel disclosures, the government claims, without support, that Mr. Mangione knew that the disclosures provided by DB Home were false. The

[11] The government asserts that Mr. Mangione's recitation of the threadbare allegations of his involvement in the offering documents "conveniently omitted" his "approval of HE5's prosupp." (Opp'n 8 n.7.) The email chain referenced in the Complaint shows that someone else responded that it was "fine" to "send down [the] final version" of the HE5 prosupp. (Mem. 9 (citing Ex. 18).) The government does not dispute the authenticity of the document submitted in the opening brief or provide any documentary support for its claim. *See Mazza Consulting Grp., Inc. v. Canam Steel Corp.*, 2008 WL 1809313, at *1 (E.D.N.Y. Apr. 21, 2008) (Garaufis, J.) ("If the documents referenced in the complaint contradict the facts alleged by the plaintiff, the documents control and the court need not accept as true the plaintiff's allegations.").

government cannot conceal its failure to directly link the allegedly fraudulent statements to the party accused of fraud with conclusory claims of knowledge. (Mem. 31-32.) The Complaint must link Mr. Mangione to the allegedly false Chapel disclosures, and its failure to do so is fatal to its fraud claims. (Mem. 31 (citing *DeAngelis v. Corzine*, 17 F. Supp. 3d 270, 281 (S.D.N.Y. 2014)).)[12]

3. The Complaint Fails to Allege that the MLPAs Contained an Actionable Misstatement

The government's opposition confirms that its attempt to fashion a fraud claim from purported breaches of contractual representations and warranties is frivolous. According to the government, it is sufficient to allege that Mr. Mangione knew, at the time someone else executed the MLPAs, that the representations and warranties "were false and that investors would rely on them." (Opp'n 28.) The government cites no authority for its novel view of contract-based fraud liability, which stands in stark contrast to binding Second Circuit precedent. *See U.S. ex rel. O'Donnell v. Countrywide Home Loans, Inc.*, 822 F.3d 650, 662 (2d Cir. 2016) ("[A] contractual promise can only support a claim for fraud upon proof of fraudulent intent not to perform the promise at the time of contract execution.").

The government tries to distinguish *Countrywide* by claiming that it "dealt with promises of future performance." (Opp'n 28 n.30.) But future performance is exactly what the MLPA contemplates as, under its express terms, Deutsche Bank agreed to provide loans that conformed with the representations and warranties, and if they did not, it would repurchase the nonconforming loan. (Mem. 32 (citing Ex. 5 § 7).) The government does not allege that Mr.

[12] None of the cases cited by the government hold a defendant responsible for the statements of a subsidiary over which the defendant had no involvement or control. (Opp'n 32 (citing inapposite cases where individuals played a meaningful role in drafting the challenged statements or exercised control over the entity or individuals that made the statements).)

Mangione, or Deutsche Bank, did not intend to honor the representations *and warranties*, including the repurchase remedy, at the time of contracting. (Mem. 32-33.) The *Countrywide* decision applies with equal force here. *See* 822 F.3d at 662 n.13 (refusing to impose criminal fraud liability where "the parties bargained *precisely* in the alternative fashion to provide investment-quality loans or to repurchase defective loans sold").

4. The Complaint Fails to Allege a Duty to Disclose the Existence of Unsecuritized Second Liens

In its opposition, the government ignores Mr. Mangione's argument that he did not have a duty to correct the purported failure to include unsecuritized second liens in the CLTV calculation. (Opp'n 28-29.) The government thus does not dispute that Mr. Mangione neither had responsibility for Deutsche Bank's disclosure policy, nor determined how Deutsche Bank calculated CLTV, nor was the person responsible for the failure to disclose the second liens in the first place. (Mem. 34.) Absent such particularized allegations, the government's claims against Mr. Mangione based on the failure to disclose unsecuritized second liens in the CLTV ratio fail outright. (Mem. 33-34.)[13]

B. The Complaint Fails to Allege that Mr. Mangione Acted with Fraudulent Intent

The government concedes that, after years of investigation, the only allegations supporting its core claim that Mr. Mangione purportedly engaged in a bank-wide scheme to defraud investors in the HE4 and HE5 offerings relate to the Chapel quality-control reports that Mr. Mangione never received and the April 18 and 20 calls that are unrelated to the Chapel

[13] The government devotes an entire subsection to addressing a strawman argument regarding the materiality of underwriting disclosures. (Opp'n 29-32.) The materiality of underwriting disclosures is not subject to dispute because the government does not allege sufficient well-pled facts for the court to infer that a material number of nonconforming loans violated those disclosures. (Mem. 29-30.) Even under the government's erroneous standard that loans with a Severity Code 3-5 or EV3 failed to comply with guidelines, it can only allege that an immaterial number of those loans were securitized in HE4 and HE5. (Compl. ¶¶ 220 n.41, 223, 227.)

disclosures. (Opp'n 24, 36.) To overcome its inability to allege an adequate foundation for knowledge or intent, the government's opposition relies on baseless conclusions about the quality-control reports and outright mischaracterizations of the phone calls. (Opp'n 10-12, 25, 39.) The Court need not countenance such tactics where, as here, the government's fraud scheme makes no sense and the documents the government relied upon in crafting its claims undermine any inference of fraudulent intent.

1. The Complaint Fails to Allege a Sufficient Motive to Commit Fraud

The government goes to great lengths to claim that Mr. Mangione "and no one else" had "a desperate desire to unload toxic Chapel . . . subprime loans from the subprime balance sheet" (Opp'n 37), but it cannot avoid admitting that the only reason Mr. Mangione was allegedly motivated to do so was that his "bonus" was tied in some unarticulated way to the successful securitization of subprime loans. (Opp'n 37-38.) Under settled law, "compensation, including discretionary bonuses, is not sufficient to allege motive." *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 479 n.241; *see also ECA, Local 134 IBEW Joint Pension Tr. of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 201 (2d Cir. 2009) ("[I]ncentive compensation can hardly be the basis on which an allegation of fraud is predicated.").[14]

The government's motive allegations also defy economic and common sense. (Mem. 36.) The government alleges, on the one hand, that Mr. Mangione schemed to offload toxic collateral to investors to maintain the profitability of the subprime balance sheet, but on the other hand, alleges that Mr. Mangione declined to sell the most junior tranche of the security that

[14] The two cases the government cites underscore the insufficiency of its allegations here as in each case the plaintiff alleged a direct link between the specific transaction at issue and the corporate defendants' compensation from that transaction. (*See* Opp'n 37 (citing *Dexia SA/NV v. Bear, Stearns & Co.*, 929 F. Supp. 2d 231, 241-42 (S.D.N.Y. 2013) and *Abu Dhabi Commercial Bank v. Morgan Stanley & Co. Inc.*, 651 F. Supp. 2d 155, 179 (S.D.N.Y. 2009)).)

would suffer the "near certain[]" losses that, according to the government, Mr. Mangione schemed to avoid. (Compl. ¶¶ 89, 92, 93, 192, 195 n.29, 237; Opp'n 37-38.)[15] The government tries to convert Mr. Mangione's argument about the retention of the residual into an argument about Mr. Mangione's belief about the ultimate performance of the securitization. (*See* Opp'n 38-39 (citing inapplicable caselaw).) The issue is not Mr. Mangione's subjective belief but whether the government's fraud theory is plausible considering that Mr. Mangione would have been the first victim of the alleged scheme and suffered the very losses the government claims he sought to avoid. Contrary to the government's claim, these are not trial arguments. (Opp'n 39.) They are practical observations based on the government's own allegations and the documents referenced therein, which the Court is not obligated to ignore simply because they render the government's fraudulent intent theory implausible. (Mem. 36); *see also Nelson v. Publ'rs Circulation Fulfillment, Inc.*, 2012 WL 760335, at *4 (S.D.N.Y. Mar. 7, 2012) ("A court may dismiss a mail or wire fraud claim where the alleged scheme to defraud does not demonstrate fraudulent intent because it defies logic or economic reason.").

2. The Complaint Fails to Allege Strong Circumstantial Evidence of Conscious Misbehavior

Despite being unable to point to a single quality-control report that Mr. Mangione actually got (Mem. 37), the government maintains that the Court can infer that Mr. Mangione received the Chapel quality-control reports—and therefore knew the Chapel disclosures were

[15] The government's claim that Mr. Mangione "argues (without any supporting allegation) that DB 'retained the riskiest component' of HE4 and HE5" is disingenuous. (Opp'n 38.) Documents the government relied upon in drafting the Complaint show that Deutsche Bank retained a portfolio of residual positions. (Ex. 3(a).) The government also alleges that Mr. Mangione declined to sell the HE4 residual. (Compl. ¶¶ 206-07.) The government's claim that there is no authority for the concept that the court cannot consider the Complaint's silence about the fate of the HE5 residual ignores settled law that requires the Court to consider opposing inferences when evaluating whether the government has alleged a strong inference of scienter. *Loreley Fin. (Jersey) No. 3 Ltd. v. Wells Fargo Sec., LLC*, 797 F.3d 160, 176-77 (2d Cir. 2015) ("An inference is 'strong' if it is 'cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'")

false—because a Diligence-Director subordinate said that "he would locate the [Chapel quality-control] results and provide them to [Mr.] Mangione." (Compl. ¶ 209.) This language is suspiciously not quoted directly from the transcript, and for good reason: the subordinate never said it. (Mem. 16; Ex. 26 at 4:8-19.) The text of the transcript shows—and the government does not dispute—that the subordinate said that he did not "know if we have any exhibits for" Chapel and that he would need to "see what [the Diligence Director] has in regards to that." (*Id.*) The government had ample opportunity to investigate whether Mr. Mangione received a single quality-control report and cannot rely on inferences it knows are false to survive a motion to dismiss. *Wood ex rel. U.S. v. Applied Research Assocs., Inc.*, 328 F. App'x 744, 747 (2d Cir. 2009) ("[W]hile Rule 9(b) permits scienter to be demonstrated by inference, this must not be mistaken for license to base claims of fraud on speculation and conclusory allegations.").[16]

The government's arguments about the April 18 and 20 phone calls are likewise meritless. In opposition, the government relies exclusively on the April 20 call, which it claims shows an intent to "lie" to investors because Mr. Mangione supposedly instructed the Diligence Director to tell a potential purchaser of the HE4 residual, OSI—to whom Deutsche Bank declined to sell the residual for reasons unrelated to due-diligence results (Compl. ¶¶ 206-07)—that there were no results for Chapel. (Opp'n 11, 35-36.) The supposed "lie" is based on a cherry-picked statement from the April 20 phone call where Mr. Mangione observed that

[16] To bolster its false claim, the government states that Mr. Mangione's receipt of the reports is consistent with his testimony that he "received diligence results for 'every pool' of subprime loans acquired by DB." (Opp'n 25 n.27.) The government tries to confuse the Court by conflating summary due-diligence reports (referred to as "Exhibit 1s"), which Mr. Mangione would receive in connection with bulk whole-loan purchases from third-party originators, with the Chapel quality-control results for which there were no summary reports and for which Mr. Mangione had no responsibility. (Mem. 4-5, 7-8.) The government also cannot rely on its claim that Mr. Mangione had "easy *access* to the reports" (Opp'n 39) since it lacks a well-pled basis. The Complaint relied on Mr. Mangione's supposed receipt of the reports and does not allege which reports he had access to or how Mr. Mangione would access them. (Mem. 37-38.) Regardless, the "easy access" claim fails outright because the government did not identify the reports with sufficient particularity as discussed *supra* in Section II.A.1.

Deutsche Bank was the originator but asked in the next sentence for the Diligence Director to "show me what you have in terms of due diligence." (Ex. 25 at 6:3-9, Ex. 25(a).) The view that Mr. Mangione instructed the Diligence Director to lie is also undermined by the fact that three days after the call, Mr. Mangione was still investigating what information was available for Chapel. (Compl. ¶ 209; Mem 16.) If the decision to "lie" to the investor was made on April 20, there would be no need for Mr. Mangione to continue to inquire, as the government alleges, about "the results of the due diligence [on Chapel]." (Compl. ¶ 209.)[17]

Nor does the government dispute that it omitted key facts that show Mr. Mangione sought assurances that the issues with Chapel had been remedied and reported to the highest levels of the bank. (Mem. 38-40.) Instead, the government asks the Court to ignore the evidence that undermines its inference of fraudulent intent because Mr. Mangione's arguments are "quintessentially factual in nature." (Opp'n 40.) But the Court is required to "take into account plausible opposing inferences" that can be "draw[n] from the facts alleged," which include the facts the government intentionally overlooks in the documents it relied on in manufacturing its fraud claims. *Loreley Fin.*, 797 F.3d at 177. At bottom, the government takes issue with the fact that Mr. Mangione did not halt the HE4 and HE5 securitizations after the Diligence Director told him about the issues he encountered during the Chapel quality-control process. (Opp'n 3.) But the failure to make further inquiries after being told that the issues were remedied and reported to Deutsche Bank's highest echelons cannot constitute "highly unreasonable" conduct that

[17] The supposed "lie" is one of the many mischaracterizations of the phone calls in the government's Complaint and opposition. Another is the government's repeated claim that Mr. Mangione said: "Yeah, I think they originate crap." (Opp'n 10.) The transcript of the call, which the government does not dispute, shows that this interpretation is wrong. As explained in the opening brief, the Court "need not adopt the subjective characterization of documents properly before it" (Mem. 13 n.6) and can listen for itself to the phone calls to hear what was actually said. (Ex. 24 at 6:23; Ex 24(a); Ex. 25 at 6:3-7:25; Ex. 25(a).)

represents "an extreme departure from the standards of ordinary care." *Kalnit v. Eichler*, 264 F.3d 131, 142 (2d Cir. 2001).[18]

CONCLUSION

For the foregoing reasons, the Complaint should be dismissed in its entirety with prejudice.

Dated: New York, New York
March 15, 2018

Respectfully submitted,

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[18] The government all but abandons its claims regarding the scheme to conceal the existence of unsecuritized second liens, arguing only in a footnote that the jury should decide whether the dissemination of the exact information that the government claims was concealed undermines an inference of fraudulent intent. (Opp'n 40 n.41.) But, in analogous circumstances, courts have no problem dismissing fraud claims where there are no allegations of active concealment and the bank provided the exact information that was allegedly concealed. *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 479 (inference of fraud undermined by "absence of a plausible allegation" that concealed information was "hidden from customers"). The government also does not dispute—and therefore concedes—that its failure to allege a claim for mail or wire fraud is also fatal to its civil-penalty conspiracy claim alleged in Claim III. (Mem. 27.)