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UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

AMERICAN RESIDENTIAL EQUITIES, LLC, in its own individual capacity and in its capacity as Trustee under that certain American Residential Equities, LLC Master Trust Agreement dated August 8, 2005,	:	Adv. Proc. 12-01934 (MG)
Plaintiff,	:	
v.	:	
GMAC MORTGAGE, LLC, as successor by merger to GMAC Mortgage Company, BALBOA INSURANCE COMPANY, and ALLY FINANCIAL, INC.	:	
Defendants.	:	
In re	:	
	:	Case No. 12-12020 (MG)
RESIDENTIAL CAPITAL, LLC, *et al.*,	:	
	:	Chapter 11
Debtors	:	Jointly Administered

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DEBTOR'S REPLY TO ARE'S OPPOSITION TO MOTION FOR DISMISSAL OF ADVERSARY PROCEEDING

Debtor, GMAC Mortgage, LLC ("Debtor" or "GMACM"),[1] submits this reply to the opposition of Plaintiff American Residential Equities, LLC, individually, and as Trustee ("ARE"). The arguments raised by ARE in its opposition are insufficient to overcome dismissal for two reasons.[2] First, with regard to ARE's section 541(d) argument, ARE and GMACM had an alleged debtor-creditor relationship,[3] not a trustee-beneficiary relationship, such that no express trust was created. Moreover, even if an express trust existed, there is no identifiable trust *res* that can be excluded from property of the Debtors' estate under section 541(d) of the Bankruptcy Code. Second with regard to ARE's choice of law argument, ARE has provided no substantive argument to support the application of any state's law other than Pennsylvania's.

I. ARE HAS FAILED TO SUFFICIENTLY PLEAD AN EXPRESS TRUST UNDER SECTION 541(d) OF THE BANKRUPTCY CODE.

Under section 541(d) of the Bankruptcy Code, ARE has the burden of establishing the existence of a fiduciary relationship between it and GMACM and that an express trust existed over a specific and identifiable trust fund or property. See 5 Collier on Bankruptcy ¶ 541.28 (16th ed. 2013). ARE, however, cannot meet either of those burdens. ARE's sole support for its "express trust" theory is that GMACM deposited funds into a bank account that was identified as

[1] Capitalized terms not defined herein shall have the meanings ascribed to them in *Debtor's Motion for Dismissal of Adversary Proceeding* [Docket No. 18].

[2] For the sake of brevity and page constraints, GMACM is not addressing every argument raised by ARE its opposition and relies instead on the arguments contained in GMACM's Motion to Dismiss.

[3] In referring to a "debtor-creditor" relationship, GMAC does not mean to imply nor concede that GMAC owes any debt to ARE (which GMAC does not).

"GMACM, in trust, for ARE."[4] The words "in trust", alone, are not sufficient, however, to convert what was simply a debtor-creditor relationship to a trustee-beneficiary relationship.

Moreover, even if an express trust had existed, there are no longer any alleged trust assets. The very account that ARE contends GMACM "looted" does not exist because GMACM's obligations thereto terminated more than two years prior to the commencement of these Chapter 11 Cases with the termination of the Servicing Agreement. Thus, even taking ARE's allegations as true, there is no identifiable trust *res* that can be excluded from property of GMAC's estate under section 541(d) of the Bankruptcy Code.

A. GMACM and ARE Had a Debtor-Creditor Relationship.

It is clear based on the Servicing Agreement that GMACM's relationship with ARE was that of a debtor-creditor and not that of a trustee-beneficiary. GMACM was not acting as an agent of ARE under the Servicing Agreement and did not owe any fiduciary obligations to ARE. Any such agency relationship was in fact disclaimed in the Servicing Agreement. Paragraph 13.08 of the Servicing Agreement specifically identifies GMACM as an "independent contractor and **not as an agent**." (emphasis supplied). Moreover, GMACM had "full control" of its acts in discharging its duties and responsibilities. See Amended Complaint Ex B, Servicing Agreement (the "Servicing Agreement"), ¶ 13.08.

This adversary proceeding is the first time since the Servicing Agreement was executed that ARE has ever referred to GMACM as its trustee, referred to any trust account or referred to any trust funds. In fact, in the almost 3 years that the Florida Action was pending, not in one single pleading did ARE contend that it had a trust relationship with GMACM. Nor did ARE ever demand a return of trust property in those pleadings; rather ARE sought to be paid amounts

[4] Notably, the word "trust" is only in found in one instance in the Servicing Agreement.

that GMACM allegedly "owed" to it. In the Complaint, ARE alleged that it requested an audit of GMACM's books "to assess the amounts **owed to it** under the Servicing Agreement." Ex. H to Motion for Dismissal, at ¶18 (emphasis supplied). In paragraph 28(m), ARE alleged that GMACM breached the Servicing Agreement by "**failing to pay ARE** its April 2010 remittance pursuant to Section 3.01 of the Servicing Agreement." Id. at ¶ 28(m) (emphasis supplied). ARE's express trust theory here is simply an attempt to bypass the normal claims procedure and to give itself priority over other unsecured creditors, something that this court should view with skepticism.

Under Pennsylvania law, the elements of an express trust are: (1) an express intent to create a trust; (2) an ascertainable *res*; (3) a sufficiently certain beneficiary; and (4) a trustee who owns and administers the *res* for the benefit of the beneficiary. In re Verrone, 277 B.R. 66, 72 (Bankr. W.D. Pa. 2002). Whether an express trust exists is determined not by any particular words, but by the intent of the parties, as established in writing or conduct. See Bair v. Snyder County State Bank, 171 A. 274, 275-76 (Pa. 1934). Thus, the fact that the custodial account was identified as GMACM "in trust" for ARE, alone, is not sufficient to create an express trust, particularly against the backdrop of the parties' business relationship as set forth in the Servicing Agreement.

A similar argument was made and rejected by the Second Circuit Court of Appeals in In re Ames Dep't. Stores, Inc., 144 Fed. Appx. 900 (2d Cir. 2005), which affirmed the district court's and the bankruptcy court's ruling that funds sought by a claimant were part of the debtor's estate and not subject to a constructive trust under section 541(d).[5] The creditor in In re

[5] Of course, here ARE has explicitly avoided pleading entitlement to a constructive trust. Opposition at 7 ("we are dealing not with an attempt to impose a constructive trust after the fact. . ."). The reason for ARE's desire to avoid characterizing its requested relief as a constructive trust is because characterizing it as much would relegate ARE to a general unsecured claim. See XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.), 16 F.3d 1443, 1448 (6th

Ames, LFD Operating ("LFD"), argued that Ames was holding the proceeds from the sale of shoes that belonged to LFP and thus should not be included as part of the debtor's estate. Like ARE, LFD relied on language in the parties' written agreement that "all proceeds from the sale of the merchandise of [LFD] to customers . . . shall be the property of [LFD] from the time of such sale, that Ames shall act as [LFD]'s agent in the collection and holding of such proceeds, and that Ames shall hold such proceeds in trust for [LFD] until such time as they are paid over to [LFD]." Id. at 901 (alteration in original). The court held, however, that such language was not determinative of whether a trust was created and that when "the relative rights of a bankrupt's creditors are at issue, it is particularly important that substance not give way to form." Id. (internal quotation marks and citations omitted). Rather, the court looked at the parties' actual business relationship and concluded that "none of the hallmarks of an agency or trust relationship" exists. Id. For example, the court considered the fact that LFD exercised no control over the sales proceeds. See id.; see also, In re Neil Rodger Schnetzka, No. 1:05-bk-0788-MDF, Adv. No. 1:06-ap-00067, slip op. (Bankr. M.D. Pa. Dec. 27, 2006) (denying complaint for recovery of proceeds of real estate under both theory of express trust and imposition of constructive trust).

The case of In re National Warranty Corp., Adv. Nos. 6:90-6019-H and 6:90-6025-H, slip op. (Bankr. D. Ore. Jan. 8, 1991), even though unpublished, is also illustrative. In the National Warranty case, NWC had an agreement with the debtors (the owners of an automobile dealership) pursuant to which NWC would provide extended warranty services to the debtors in exchange for a fixed fee, which consisted of a percentage of the price paid for the warranty by the car purchaser. See id. at 3. Additionally, NWC administered the extended warranty as well

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Cir. 1994) ("Nowhere in the Bankruptcy Code does it say 'property held by the debtor subject to a constructive trust is excluded from the debtor's estate.'").

and advanced funds to purchase insurance and to pay for claims on repairs. These advances were to be paid by the debtors, along with the percentage of the warranty price and an administrative fee. NWC argued that under 541(d) the court should impose a constructive trust or an equitable lien on the funds that the debtors were to pay to it. The court disagreed and held that "the debtors' failure to remit funds collected from the sale of the extended warranties merely represents a breach of the dealer agreement which would excuse NWC's performance . . . ." See id. at 8.

Similarly, any allegation by ARE that GMACM failed to remit funds to it under the Servicing Agreement, even if those funds were in the custodial account, is merely a breach of the Servicing Agreement. Like the facts in In re Ames, whether a fiduciary relationship existed between ARE and GMACM can be found by looking at the four corners of the Servicing Agreement. It is undisputed that the Servicing Agreement is the controlling document governing the parties' relationship.

Under the terms of the Servicing Agreement, the mortgage proceeds were deposited into one custodial account, the proceeds of which belonged to both GMACM and ARE. GMACM had a "first priority" interest to its unreimbursed servicing advances and its servicing fee. See Servicing Agreement, ¶ 3.03. ARE was entitled only to the remaining net value after GMACM's withdrawals. See id., ¶¶ 2.05, 3.01. GMACM was responsible for remitting the amounts due to ARE on a monthly basis. See id. Under the Servicing Agreement, ARE had no control over the servicing advances made by GMACM. ARE was also not entitled to receive payments on demand. Furthermore, the "net" amount of the mortgage proceeds to which ARE was entitled, was wholly dependent on the withdrawals to which GMACM was entitled.

Moreover, GMACM had the discretion and authority to withdraw funds for investment, to move the funds and to earn interest on the funds. See id. at ¶ 2.05. Finally, ARE did not direct or control how GMACM handled the mortgage proceeds. The obligations between GMACM and ARE with regard to the mortgage proceeds were set forth in the Servicing Agreement. Moreover, the Servicing Agreement provided remedies to ARE in the event of a breach of GMACM's payment obligation. See id., ¶ 11.01(a); In re Neil Rodger Schnetzka, No. 1:05-bk-0788-MDF, Adv. No. 1:06-ap-00067, slip op. at 6 (Bankr. M.D. Pa. Dec. 27, 2006) (holding that "[r]ather than a trust, the agreement seems more akin to a simple contract that to a trust"). Based on these undisputed facts, as set out in the Servicing Agreement, it is clear that no express trust agreement existed between GMACM and ARE. See In re B.I. Fin. Serv. Group, Inc., 854 F.2d 351, 354 (9th Cir. 1988) (finding no express trust was created under California law and stating that "[p]ayment of money may create either a debt or a trust, depending on the parties' intent.").

B. ARE Has Failed To (And Cannot) Identify a Specific Trust *Res*.

ARE has the burden of proving the existence of an express trust and of proving title to a specific and identifiable trust *res*. See 5 Collier on Bankruptcy ¶ 541.28 (16th ed. 2013). In ARE's Amended Complaint, ARE refers, generically, to "Trust Funds" and a "Trust Account," but no such funds or account currently exists or even existed at the time of the commencement of the Chapter 11 Cases. It is for that very reason that ARE brought a breach of contract claim against GMACM in the Florida Action and it is for that reason that ARE never made a demand for a return of any trust property in the Florida Action.

Before the court can exclude trust property from property of the estate under section 541(d), the claimant must identify a specific trust property. Where funds are sought, a claimant

who seeks imposition of a constructive trust does so over a specified amount. For example, in In re Ames, the creditor sought to exclude from the estate $8.9 million (later amended to $9.3 million) of proceeds. In Neil Rodger Schnetzka, the creditor sought $90,414.97 of proceeds. Here, ARE cannot, and has not, stated what amount it seeks to exclude from the estate. It has not identified an existing trust *res*. Where trust property has been commingled, the claimant must show that it can sufficiently trace the trust property specifically and directly back to the improper transfers giving rise to the trust. See In re Advent Mgmt. Corp., 104 F.3d 293, 296 (9th Cir. 1997). Here, however, ARE has not identified the alleged "trust property." Clearly, the trust property cannot simply be the "Trust Fund" where no such trust fund currently exists.

Under the Servicing Agreement, GMACM's obligations under the custodial agreement ceased upon termination of the Servicing Agreement. See Servicing Agreement, ¶ 6.02. GMACM could "clear" the custodial account at that time. See id., ¶ 2.05(x). Without a custodial account, any alleged trust fund is lost. See In re MJK Clearing, Inc., 371 F.3d 397, 402 (8th Cir. 2004) ("if the account is depleted after the trust fund has been deposited, the trust fund is treated as lost"). And, where the trust fund or property cannot be identified in its original or substituted form, the purported beneficiary becomes merely a creditor of the estate. See In re Fox, 232 B.R. 229, 239 (Bankr. D. Kan. 1999); 5 Collier on Bankruptcy, ¶ 541.28[4] (16th ed. 2013) ("the result is the same where the trust property has been disposed of or dissipated in such a manner as to leave nothing in its place"); see also In re Vichele Tops, Inc., 62 B.R. 788, 792 (E.D.N.Y. 1986) (holding that the claimant's burden is not satisfied by an allegation that the wrongfully acquired property became a part of the trustee's estate).

If the alleged trust *res* consists of funds, the claimant who wishes a bankruptcy court to impose a trust on those funds must demonstrate that they have been traced and are identifiable.

See e.g., Matter of Esgro, 645 F.2d 794, 797 (9th Cir. 1981); In re Bullion Reserve of N. Am., 836 F.2d 1214, 1218 (9th Cir. 1988); In re Vichele Tops, Inc., 62 B.R. at 792. This requirement exists because bankruptcy courts must "necessarily act very cautiously in exercising such a relatively undefined equitable power in favor of one group of potential creditors at the expense of other creditors, for ratable distribution among all creditors is one of the strongest policies behind the bankruptcy laws." In re N. Am. Coin & Currency, 767 F.2d 1573, 1575 (9th Cir. 1985). The tracing requirement is necessary to prevent creditors from using a trust claim as a substitution for a writ of attachment to, in effect, 'secure' a general unsecured damages claim for breach of contract. See Great-West Life & Ann. Ins. Co. v. Knudson, 534 U.S. 204, 213-14 (2002). Here, ARE is just that, a general creditor, with an unsecured claim. Nothing that ARE has alleged makes its claim any different from that of other putative creditors.

II. ARE HAS FAILED TO PROVIDE ANY SUBSTANTIVE AUTHORITY TO DISPUTE THAT PENNSYLVANIA LAW APPLIES TO ARE'S TORT CLAIMS

ARE spends two pages attempting to refute GMAC's well supported arguments that Pennsylvania law applies to ARE's contract and tort claims. While ARE baldly says that Pennsylvania law does not apply, ARE fails to refute GMACM's position that, assuming the choice of law provision in the contract is not broad enough (which it is), under New York's choice of law principles, this court must look to the state with the most interest in the outcome of the litigation. ARE does not even state which state's law it contends applies and does not provide any authority to establish that a state other than Pennsylvania has an interest in the outcome of the litigation. In fact, while arguing that this Court should look to the place of the injury, ARE does not identify the state where any of the alleged injury occurred. ARE has simply failed to provide any substantive authority to refute the application of Pennsylvania law.

III. CONCLUSION

Accordingly, for the reasons set forth herein, GMACM respectfully requests that the Court dismiss the above-captioned adversary proceeding with prejudice and grant such other and further relief as it deems just and proper.

Dated: June 6, 2013
New York, New York

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