SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Application of THE BANK OF NEW YORK MELLON, (as Trustee under various Pooling and Servicing Agreements and Indenture Trustee under various Indentures)

Index No. 651786/2011

CHICAGO POLICE'S BRIEF IN OPPOSITION TO PETITIONER'S MOTION FOR ENTRY OF PROPOSED FINAL ORDER AND JUDGMENT

Assigned to: Hon. Barbara R. Kapnick

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The Retirement Board of the Policemen's Annuity and Benefit Fund of the City of Chicago and the other members of the Public Pension Fund Committee (collectively, "Chicago") oppose approval of the proposed Settlement Agreement ("Settlement"). By this brief, Chicago also objects to certain provisions of the [Proposed] Final Order and Judgment (the "Proposed Order"), and particularly Bank of New York Mellon's ("BNYM") apparent attempt to obtain a release ***for itself*** against Certificateholders – even though BNYM has made no financial contribution to the Settlement, and BNYM's own misconduct as Trustee is the subject of ongoing proceedings before Judge Pauley in federal court (*see Ret. Bd. v. Bank of New York Mellon*, No. 11-cv-05459 (S.D.N.Y.) (the "Federal Action").

In exchange for its $8.5 billion settlement payment, the Settlement contains an express "release" of only Bank of America and its affiliates (collectively "BoA"), (PTX 1, ¶9), and the notice to Certificateholders of this action refers to a "release" of claims only against BoA (*see* PTX 617.7). Nonetheless, Petitioners' Brief in Support of Entry of the Proposed Order ("Pet. Br.") indicates that BNYM may well be seeking an improper release for itself through the "back door" of the Proposed Order's injunctive relief provisions and factual findings. Pet. Br. at 48 ("Paragraphs o, p, and q [of the Proposed Order] make explicit the legal conclusion that follows from the factual findings above, as well as the *res judicata* effect of that conclusion").[1]

Indeed, it appears that BNYM seeks not only to enjoin the further prosecution of the pending claims asserted against it by Chicago in the Federal Action, but to obtain an *in personam* judgment on its own behalf against an unknown number of persons who have not been identified

[1] *See, e.g.*, *In re Washington Mut., Inc.*, No. 08-12229, 2011 WL 57111, at *26-27 (Bankr. D. Del. Jan. 7, 2011) (approving settlement of adverse proceedings brought by and against JPMorgan Chase, but refusing as "not reasonable" requested order to enjoin suits against non-contributing parties, including the Creditors' Committee and Indenture Trustees, and further explaining (at *35) that any "[injunctive] provisions must be limited to the terms of permissible releases and not seek to expand those releases through the back door"); *see also Cobalt Multifamily Invs. I, LLC v. Shapiro*, No. 06-6468, 2013 WL 5418588, at *1 (S.D.N.Y. Sept. 27, 2013) (although a court "may properly bar claims of nonsettling *defendants* against settling defendants for contribution or indemnity… principles of due process and fundamental fairness preclude … a court from barring claims of *nonparties*.") (italics in original).

as parties. However, for this Court to even have jurisdiction to grant such relief against third parties, BNYM must either represent them as a fiduciary (which status BNYM expressly disavows) or serve them with process (which it has not). In such circumstances, the release that BNYM requests for itself appears to be not merely inappropriate, but proscribed by the Supremacy and Due Process Clauses of the U.S. Constitution.

In any event, to the extent that this Court has jurisdiction to craft factual findings that a later federal court could arguably consider binding, it should decline to do so. Regardless of whether this Court finally determines that BoA's $8.5 billion payment is a fair and reasonable settlement of the Trusts' claims *against BoA* (which Chicago and all other Objectors dispute), there is no basis for this Court to make factual findings that are wholly at odds with the evidence admitted at trial, and to thereby provide BNYM with an unwarranted "get out of jail free" card – especially where, as here, BNYM: (1) retained toothless counsel with a disabling conflict who were unable to sue BoA if there was no settlement; (2) failed to disclose in the Notice to Certificateholders either its attorney's conflict or BNYM's own conflict in seeking an apparently overbroad release on its own behalf; and (3) further undercut the Trusts' negotiating leverage by failing to demand loan files, to conduct any other meaningful factual investigation, or identify and develop all available legal theories for imposing liability on BoA. BNYM's failure to evaluate and then press at settlement negotiations the potential lawsuit's "strengths," through unconflicted counsel, thus irrevocably taints its proposal to release up to $100 billion in claims for a fraction of that sum, and this Court should not enter any order which "approves the actions of the Trustee in entering into the Settlement Agreement in all respects." *Cf.* Pet. Br. at 47.

I. This Court Should Not Enter an Order Which Petitioners Contend Can "Release" Certificateholders' Valuable Claims Against BNYM

Although BNYM has retreated from its original request for a full release for any "pre-

settlement" misconduct or failure to act – what Petitioners term an "Expanded Bar Order" (Pet. Br. at 44) – BNYM continues to seek an order that could arguably preclude (provided other requirements for *res judicata* are met) the pending class action claims that Chicago has brought against it in the Federal Action. Because a recovery against BNYM on these claims would benefit Certificateholders, this Court should not preclude them – especially where BNYM is making no financial contribution to the Settlement here. *See WaMu*, 2011 WL 57111, at *26-27.

The Federal Action alleges claims under the federal Trust Indenture Act ("TIA") and state law contract claims under the various pooling and servicing agreements ("PSAs") that arguably overlap, in part, with these proceedings. The operative complaint (or "SAC") in the Federal Action (ECF No. 89; copy attached) alleges that, from late 2007 forward, BNYM had public and private information that triggered its duty to act as a prudent person well before it received Gibbs & Bruns' first letter in 2010. SAC ¶¶13, 81-90. For example, the SAC alleges how, because BNYM had reviewed the legal loan files and identified pervasive documentation defects during the original certification process for the securitizations (*see* PSA §§2.01 and 2.02), it had long known about the more than 100,000 loan defects encompassed in the Settlement's purported servicing "improvements." *See* SAC ¶¶8-9; Tr. 3011:5-17 (Burnaman). Similarly, Fannie Mae's January 2009 letter (R-1342), that was forwarded to (among others) Loretta Lundberg and Robert Bailey, sets forth the same type of evidence of pervasive representation and warranty defects and Master Servicer defaults that was described in Gibbs & Bruns' later letters. *Id.*; SAC at ¶90. Thus, as Chicago showed in walking through the PSA provisions at trial with Jason Kravitt (Tr. at 2009-11) and Mr. Bailey (Tr. at 2454-55; 2462-64), BNYM had an obligation to (1) provide notice under PSA §2.03 upon "discovering" Countrywide's pervasive mortgage loan underwriting violations, and (2) provide its own notice, under §7.01(ii), of the Master Servicer's defaults of its §3.01 duties – which, when uncured, triggered an "event

of default" and BNYM's heightened "prudent person" liabilities under §8.01.

Three federal courts, faced with similar facts against MBS Trustees under similar PSA provisions, have sustained claims under the TIA and/or breach of contract. *See* Judge Pauley's ruling in the Federal Action (reported at 914 F. Supp. 2d 422 (S.D.N.Y. 2012)); *Policemen's Ann. & Ben. Fund of the City of Chicago v. Bank of Am., N.A.*, No. 12-2865, 2013 WL 1877618 (S.D.N.Y. May 6, 2013) (Forrest, J.) ("*BofA*"); and *Okla. Pol. Pens. & Ret. Sys. v. U.S. Bank, N.A.*, 291 F.R.D. 47 (S.D.N.Y. 2013) (Koeltl, J.). These decisions effectively reject BNYM's position – taken throughout the trial in this case – that it was merely "standing on its rights" by refusing to sue absent direction by Certificateholders holding 25% interests in each Trust (*see* Tr. at 1634:5-1635:17; 1719:14-20 (Kravitt)), or that it can avoid liability for its resulting bad faith and disloyal conduct. *See also Westmoreland Cty. Emp. Ret. Sys. v. Parkinson*, 727 F.3d 719, 725 (7th Cir. 2013) ("intentional dereliction of duty or the conscious disregard for one's responsibilities [is] bad faith conduct, which results in a breach of the duty of loyalty.").[2]

In *BofA*, which involves the repurchase claims of Washington Mutual ("WaMu") Trusts, Judge Forrest sustained claims alleging that the Trustee had to act when faced with "actual knowledge of [the mortgage loans'] deteriorating credit quality" and the "steady stream of public disclosures regarding WaMu's systemic underwriting abuses." 2013 WL 1877618, at *11-12. *See also Bk. of N.Y. Mellon Trust Co., N.A. v. Morgan Stanley Mortg. Cap., Inc.*, No. 11-0505, 2013 WL 3146824 (S.D.N.Y. June 19, 2013) ("A party 'discovers' a breach when it knows or ***should know*** that the breach has occurred."); *Morgan Guar. Tr. Co. of N.Y. v. Bay View Franchise Mortg. Accept. Co.*, No. 00 Civ. 8613 (SAS), 2002 WL 818082, at *5 (S.D.N.Y. Apr. 30, 2002) (same). In other words, although BNYM (as an "Indenture" Trustee) might ordinarily claim only a limited responsibility to act, where, as here, BNYM was confronted with evidence

[2] Unless otherwise noted, all emphasis is added and internal citations are omitted.

of huge credit losses across the Covered Trusts and pervasive, uncured representation and warranty violations, it could not bury its head in the sand and refuse to pursue the Trusts' repurchase claims, as a prudent person would in protecting its own interests.

Nor, as numerous cases hold, could BNYM evade its full "prudent person" duties by declining to provide the §7.01(ii) Notice of Servicer Default, or by "working hard" to neutralize the Institutional Investors' October 18, 2010 notice, as Kevin McCarthy (Tr. at 4988:13-15; 5015:10-16; 5020:12-5022:17) and Jason Kravitt (Tr. at 1733:14-21) testified. *See also* R-1445. For example, as Judge Koeltl noted in *U.S. Bank*, it is well-established that a party to a contract cannot raise as a defense to its performance the failure of a condition that the party itself caused:

> The defendant points out that either the trustee or holders of 25% or more of the securities has to give written notice of a breach of a material covenant or agreement, and the breach would have to continue unremedied for sixty days to trigger an Event of Default. ***However, the trustee cannot rely on its own failure to give notice to escape its own liability.***

U.S. Bank, 291 F.R.D. at 70 (sustaining breach of contract claims in action against Trustee of Bear Stearns-sponsored MBS trusts). And this rule has been black letter law for over a century:

> It is a fundamental principle of equity that a party may not insist upon performance of a condition precedent when its nonperformance has been caused by the party himself…. This concept is firmly established in [New York]. Over 134 years ago, in *Young v. Hunter*, 6 N.Y. 203, 207 (1852), the Court of Appeals referred to the "... well-settled and salutary rule, that a party cannot insist upon a condition precedent, when its non-performance has been caused by himself." The principle is aptly stated in 3A CORBIN ON CONTRACTS §767, p. 540:
>
> > One who unjustly prevents the performance or the happening of a condition of his own promissory duty thereby eliminates it as such a condition. He will not be permitted to take advantage of his own wrong, and to escape from liability for not rendering his promised performance by preventing the happening of the condition on which it was promised.

Ellenberg Morgan Corp. v. Hard Rock Café Assocs., 116 A.D. 2d 266, 271, (1st Dept. 1986); *see also In re Bankers Tr. Co.*, 450 F.3d 121, 128 n.4 (2d Cir. 2006) (citing RESTATEMENT (SECOND) OF CONTRACTS at §225); *MBIA Ins. Corp. v. Coöperatieve Centrale Raiffeisen-*

Boerenleenbank B.A., No. 09-10093, 2011 WL 1197634, at *14 (S.D.N.Y. Mar. 25, 2011) ("well established" that "party to a contract cannot rely on the failure of another to perform a condition precedent where [the party itself] has frustrated or prevented the occurrence of the condition") (collecting cases); *cf. Walnut Place LLC v. Countrywide Home Loans, Inc.*, 96 A.D.3d 684, 685 (1st Dept. 2012) ("The 'prevention/impossibility' doctrine … only applies, where, unlike here, nonperformance of a condition precedent was caused by the party insisting that the condition be satisfied.").

BNYM's wrongful refusal throughout the Settlement negotiations to recognize that it had full "prudent person" obligations to ***all*** the Covered Trusts is a factor that should be weighed in this Court's consideration of whether to approve the fairness of the Settlement here, ***regardless*** of the Institutional Investors' agreement to temporarily "forbear" on its October 2010 Notice, or the inability of investors in most Trusts to overcome the 25% threshold limitations of the PSA's "no action" clause. Indeed, because BNYM's improper refusal to act as the Certificateholders' fiduciary likely reduced their recovery by billions of dollars, BNYM's misconduct ***also*** serves as a basis for suing BNYM to make up the difference.[3] As Chicago alleges in the Federal Action (SAC ¶¶99-100), and as shown at the trial here, BNYM's (and other Trustees') failure to commit to sue to enforce ***all*** the MBS Trusts' repurchase rights caused BoA to discount its assessment of its repurchase liability exposure to the private label security ("PLS") trusts ***by $4 billion***. *See* BoA's 1st quarter 2011 Form 10-Q ("1stQ 2011 10-Q"), R-350 at 170 ("It is difficult to predict how a trustee may act or how many investors may be able to meet the prerequisite presentation thresholds . . . [BoA's] model reflects an adjustment to reduce the range of possible loss for the

[3] *See, e.g.*, *Matter of Donner*, 82 N.Y.2d 574, 578 (1993) (where financial advisor had fiduciary duty to preserve assets, it was surcharged for failing to act promptly and prudently to do so); *cf. Cruden v. Bk. of N.Y.*, 957 F.2d 961, 968 (2d Cir. 1992) ("no action" clause does not bar suits against the Trustee).

presentation threshold for all private-label securitizations of approximately $4 billion").[4]

Moreover, as Petitioners themselves point out, BoA "argued for a 19.8% 'presentation' haircut to account for the fact that claims might lie fallow because trustees do not always pursue them." Pet. Br. at 37. Though BNYM expert Brian Lin purportedly disregarded this "haircut" in his post-hoc evaluation of the adequacy of the final settlement amount (PTX 444.108), Lin's position is beside the point because neither he nor BNYM played any role in negotiating it. In contrast, Kent Smith testified that the Institutional Investors took into account the difficulties of enforcing the Trusts' repurchase rights in formulating their settlement offers (Tr. at 663:10-23) and BoA's 1stQ 2011 10-Q – which was filed on May 5, 2011 (*see* www.edgar.sec.gov) and ***after*** the $8.5 billion figure was reached – confirms that BoA had ***not*** backed off its prior view that BNYM's fecklessness affected BoA's assessment of its exposure. Kravitt's failure to tell "anybody" that BNYM was prepared to sue on Certificateholders' behalf absent a settlement (Tr. at 2032:12-16) thus likely caused it to leave $3 billion or more on the negotiating table. *See* fn. 4.

Tellingly, BNYM has even tried to exploit its non-existent "right" to refuse to enforce repurchases in those PLS Trusts where no 25% "presentment" level had been reached to coerce the silence of would-be objectors to the Settlement. *See* Exs. R-131.33 ("For the many investors whose holdings are too small to instruct the Trustee . . . the alternative is the status quo."), and R-132 at ¶5 (asserting that without a settlement for 341 Trusts, objectors would have "no remedy at all"). Although Ms. Lundberg testified that she would not recommend allowing the Trusts' multi-billion-dollar repurchase rights to lapse if the Settlement were not approved (Tr. at 4629:10-15), Kevin McCarthy testified to the contrary (Tr. at 5024:6-5025:16). That BNYM's

[4] The $4 billion in BoA's 1stQ 2011 10-Q related to both Countrywide PLS and also BoA's other PLS. Countrywide PLS, however, constituted approximately 78.8% of the unpaid principal balance of the total PLS mortgage loan liabilities – so BNYM's refusal to sue on Countrywide PLS, as noted below, ultimately resulted in BofA being able to reduce its settlement exposure on those securities by over $3 billion. PTX 23.8.

senior lawyer, whom Mayer Brown described as BNYM's "APEX" official, is ready to forfeit the billions that BoA is willing to pay unless Certificateholders and this Court endorse BNYM's preferred settlement terms puts the lie to BNYM's position that it has consistently acted to benefit Certificateholders – and is sufficient without more to show why this Court should not approve BNYM's actions in entering into the Settlement "in all respects." Pet. Br. at 47.

II. This Court Lacks the Authority to Enter Petitioners' Requested Relief

A state court may not enjoin a party from prosecuting an *in personam* action in federal court. *See Donovan v. City of Dallas*, 377 U.S. 408, 412-13 (1964) ("state courts are completely without power to restrain federal-court proceedings in *in personam* actions"); *Gen. Atomic Co. v. Felter*, 434 U.S. 12, 17 (1977) ("the rights conferred by Congress to bring . . . actions in federal courts are not subject to abridgement by state-court injunctions"). State court injunctions directed to the parties rather than the federal court itself are no less invalid. *Donovan*, 377 U.S. at 413.

BNYM, perhaps recognizing the obstacles that the Supremacy Clause poses to its request for injunctive relief, has pivoted to argue that the factual findings it seeks in its Proposed Order will have a "res judicata" effect that could be used to bar future actions by Certificateholders against it. Pet. Br. at 47-48. The Constitution, however, presents obstacles to this proposed relief under the Due Process Clause, because Petitioners failed to name Certificateholders as parties and serve them with process. Thus, this Court's authority to enter the requested relief against absent Certificateholders is limited to very narrow circumstances that are not met here.

As the U.S. Supreme Court has held and the Second Circuit has recently reiterated, entry of an *in personam* judgment against persons who have not been named as parties and served with process violates due process, absent certain very specific exceptions. *See Taylor v. Sturgell*, 553 U.S. 880, 892-93 (2008); *Hansberry v. Lee*, 311 U.S. 32, 40-41 (1940); *Blackrock Fin. Mgmt. Inc. v. Ambac*, 673 F.3d 169, 177-78 (2d Cir. 2012); *Briscoe v. City of New Haven*, 654 F.3d 200,

203 (2d Cir. 2011); *see also Cobalt Multifamily*, 2013 WL 5418588, at *3, n.5 (discussing *Taylor* exceptions). While one of the exceptions under *Taylor* ("exception 3") is for representative actions, including those brought by Trustees, there are significant pre-requisites to that exception, namely: "at a minimum: (1) the interests of the nonparty and her representative are aligned … and (2) either the party understood herself to be acting in a representative capacity or the original court took care to protect the interests of the nonparty." *Taylor*, at 900.[5]

Here BNYM, through Mayer Brown, has repeatedly denied acting as Certificateholders' fiduciary – which may itself doom its ability to seek any *res judicata* effect from the Settlement for its own benefit under *Taylor*. Moreover, even if later courts were to conclude that this Court "took adequate care" to protect absent Certificateholders by evaluating the Settlement's fairness and the proposed release of BoA, *Taylor's* first requirement would remain unsatisfied with respect to the release of non-party Certificateholders' rights ***against BNYM***.

III. Approval of the Settlement and Releases is Barred by BNYM's Attorney Conflicts

A strict *prima facie* bar against simultaneous representations of adverse parties applies in both federal and New York courts. *Aerojet Props. v. State of N.Y.*, 138 A.D.2d 39, 41 (3d Dept. 1988). Even in exceptional cases where an attorney's conflict may be permissible, "the lawyer ***must***, at the very least, disclose to all affected parties the nature and extent of the conflict and obtain their consent." *Matter of Kelly*, 23 N.Y.2d 368, 376 (1968).

In this matter, Mayer Brown, though retained by BNYM, wrongfully acted to negotiate Certificateholders' economic interests in circumstances where its own conflicts interfered with its ability to maximize Certificateholders' recoveries, and it did so without ever giving the

[5] This action also does not fit within any of *Taylor's* other exceptions – *i.e.*, this is not a "test case" (exception 1); it does not involve pre-existing "substantive legal relationships" such as assignee and assignor (exception 2); the Certificateholders never "assumed control" of the litigation (exception 4); the action was not conducted through a proxy (exception 5); and the action does not involve a "special statutory scheme" that "expressly foreclose[es] successive litigations by nonlitigants," such as bankruptcy or probate proceedings (exception 6). *Id.* at 893-95.

required disclosure to – let alone obtaining the required consent from – Certificateholders. For example, *In re Project Orange Assocs. LLC*, 431 B.R. 363 (Bankr. S.D.N.Y. 2010), the court disqualified counsel ("DLA") which sought to represent the debtor in negotiations despite counsel's having obtained a limited conflict waiver from General Electric ("GE"), a DLA client that was also the debtor's biggest creditor. As the court stated:

> [T]he Conflict Waiver severely limits DLA's ability to act in the best interests of the Debtor with respect to GE. Under the terms of the Conflict Waiver, DLA is barred from both bringing suit and threatening to bring suit against GE or its affiliates for monetary damages or equitable relief. . . . While the Conflict Waiver purportedly allows DLA to negotiate with GE "on all matters" . . . ***the Court does not believe that DLA can negotiate with full efficacy without at least being able to hint at the possibility of litigation***"

Id. at 375 (citation omitted); *see also Credit Index L.L.C. v. RiskWise Int'l, L.L.C.*, 192 Misc. 2d 755, 764 (N.Y. Sup. Ct. 2002) ("a law firm cannot sue, or threaten to sue, a current client"), *aff'd* 296 A.D. 2d 318 (1st Dept. 2002).[6]

As described above, by BoA's own calculations, BNYM's conflicts, and its toothless counsel's inability to even threaten to sue, cost Certificateholders dearly at the negotiating table – and Mayer Brown's inability to serve both BNYM and the interests of all Certificateholders (while also purporting to "zealously" negotiate against a current client) put BNYM's counsel in a similarly conflicted position. *See* fn. 6 above. As such, the existence of these critical conflicts, let alone the failure to disclose them and to obtain the required consents from all interested parties, incurably tainted the Settlement.

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[6] In *Bluebird Partners, L.P. v. Bk. of N.Y.*, 21 Misc. 3d 1140(A), 2008 WL 5131174, (N.Y. Sup. 2008), BNYM sought to disqualify a law firm ("KBTF") from representing a bondholder in an action brought against BNYM as Trustee for failing to protect trust collateral, where KBTF represented BNYM – as Trustee – in a simultaneous but unrelated *Enron* action that was being brought at the direction of certain holders. In its motion, BNYM itself argued that KBTF had a conflict "because a law firm cannot sue or threaten to sue, a current client." *Id*., at *6. The court, however, noted KBTF's argument that because BNYM, as an "indenture trustee" was acting at the direction of holders, BNYM's *own* interests were not implicated by KBTF's multiple representations – *i.e.*, that BNYM was not a client in the traditional sense and that the true affected parties were the holders. Here, Mayer Brown was not only conflicted by its simultaneous representation of BofA and BNYM (uncured by the required consents from all interested parties), but by its representation of a client, BNYM, that also had its own conflicts with the MBS holders.

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Respectfully submitted,[7]

/s/ Beth A. Kaswan

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[7] In light of the page limitations imposed for this brief, Chicago reserves its right to contest the Settlement on other grounds raised in the Steering Committee's brief.