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), Petitioner, for an order, pursuant to CPLR § 7701, seeking judicial instructions and approval of a proposed settlement.	:	Index No. 651786/2011

THE BANK OF NEW YORK MELLON'S MEMORANDUM OF LAW IN SUPPORT OF ITS VERIFIED PETITION SEEKING JUDICIAL INSTRUCTIONS AND APPROVAL OF A PROPOSED SETTLEMENT

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Petitioner, The Bank of New York Mellon ("BNY Mellon" or "Trustee"), solely in its capacity as trustee under the five hundred and thirty (530) residential mortgage-securitization trusts ("Trusts") listed on Exhibit A to its Verified Petition ("Pet."), respectfully submits this memorandum of law and the accompanying Affirmation of Matthew D. Ingber, dated June 28, 2011 ("Ingber Aff."), pursuant to Section 7701 of the Civil Practice Law and Rules ("CPLR"), in support of its Verified Petition seeking judicial instructions and approval of a settlement.

PRELIMINARY STATEMENT

The Trustee has exercised its good faith judgment that a settlement of potential claims belonging to the Trusts is reasonable. That decision is extremely well supported. It takes into account the legal and factual defenses to the Trustee's claims, the extraordinary burden and cost of a litigation that could last many years, the inability of the prospective defendant directly liable on the claim to pay a judgment that comes anywhere near the settlement amount, and the strength of corporate separateness arguments that could shield that entity's parent company from having to satisfy any judgment.

The Trustee has commenced a proceeding under Article 77 of the CPLR because, among other reasons, not every Trust beneficiary may agree with the Trustee's judgment. The Trustee has received instructions from different groups of trust beneficiaries to take action with respect to certain Trusts that would conflict with the purpose of the settlement. (Pet. ¶ 14.) The Trustee has seen press accounts that certain trust beneficiaries may take legal action against BNY Mellon because of its participation in settlement discussions. (*Id.* ¶ 13.) There is a case pending before this Court brought by a group of trust beneficiaries that involves the same claims that the Trustee is seeking to settle, against the same parties, and involving two of the same Trusts. (*Id.* ¶ 14.) And there is a second case pending before this Court seeking an accounting relating to two other

trusts that are part of the settlement. (*Id.*) All of this creates a conflict involving the administration of trusts that requires judicial instructions pursuant to Article 77.

The Petition describes, among other things, the history of the matter that is being settled and the terms of the settlement. It also demonstrates that the Trustee's decision to enter into the settlement was made in good faith and was not outside the bounds of reasonableness. This memorandum of law serves a different purpose – namely, to provide legal support for the Trustee's *authority* to enter into the settlement, and for the Court's *authority* to approve the settlement and to make it binding on all Trust beneficiaries.

As discussed in more detail below, the Trustee has authority under the express provisions of the Governing Agreements and established law to commence and settle repurchase and servicing claims arising under the Governing Agreements. The Court has authority, pursuant to Article 77 of the CPLR, to issue judicial instructions where, as here, there is a "matter of interest" to the Trustee and Trust Beneficiaries. In exercising its authority to approve the Settlement, under well settled law the Court should not interfere with the Trustee's judgment unless the Trustee acted dishonestly or with an improper motive, failed to use its judgment, or acted beyond the bounds of a reasonable judgment. And finally, the Court will have jurisdiction over – and therefore can bind – all Trust Beneficiaries because the notice program proposed by the Trustee is extremely robust and fully satisfies New York and federal due process requirements.

FACTUAL BACKGROUND

The Trusts that are the subject of the settlement were established through a process known as securitization. In the typical residential mortgage-backed securitization, a loan originator, or "Seller" – here, principally Countrywide Home Loans, Inc. ("CHL") – sold loans secured by mortgages on residential properties ("Mortgage Loans") to another entity, called a

"Depositor." The Depositor conveyed them to BNY Mellon, as Trustee, to hold in trust. Certificates evidencing various categories of ownership interests in the Trusts were then sold through an underwriter to various investors ("Certificateholders" or "Trust Beneficiaries"). A "Master Servicer" – here, BAC Home Loans Servicing, LP (formerly Countrywide Home Loans Servicing, LP) ("BAC HLS") – was charged with responsibility for, among other things, collecting debt service payments on the Mortgage Loans, taking any necessary enforcement action against borrowers, and distributing payments on a monthly basis to the Trustee for distribution to the Certificateholders. (Pet. ¶ 2.)

The documents that govern the Trusts are called Pooling and Servicing Agreements, or "PSAs," and in some cases indentures and related Sales and Servicing Agreements (collectively, the "Governing Agreements"). (*Id.* ¶ 3.) They are governed by New York law. (*Id.*) The Governing Agreements each contain a series of representations and warranties made by the loan originator for the benefit of the Trust – ranging from representations that loans were underwritten in accordance with underwriting guidelines, to representations that underwriting practices were legal, prudent and customary in the mortgage lending and servicing business. (*Id*. ¶ 4.) The Governing Agreements also impose servicing obligations on the Master Servicer, requiring, among other things, that the Master Servicer service and administer the Mortgage Loans in accordance with the terms of the Governing Agreements and usual standards of practice of prudent mortgage loan servicers. (*Id.* ¶ 2.)

Beginning in June 2010 and continuing through October 2010, a group of Certificateholders ("the Institutional Investors") consisting of some of the world's largest and most sophisticated investors made allegations concerning CHL's alleged breaches of representations and warranties in the Governing Agreements, and BAC HLS's alleged violations

of prudent servicing obligations. (*Id.* ¶ 5.) These allegations are described in paragraphs 27-34 of the Petition.[1]

In order to avoid the enormous risks, costs, and delays associated with preparing for and pursuing a litigation involving complex issues of law and fact, 530 trusts and hundreds of thousands of individual loans (and loan files), since November 2010 the Institutional Investors, with participation by the Trustee, have engaged in extensive, arm's-length settlement negotiations with CHL and its parent, Countrywide Financial Corporation ("CFC" and together with CHL, "Countrywide"), and BAC HLS and its parent, Bank of America Corporation ("BAC" and together with BAC HLS, "Bank of America").[2] (*Id.* ¶ 35.) Those negotiations have culminated in a request from the Institutional Investors that the Trustee enter into a settlement (the "Settlement") with Countrywide and Bank of America, memorialized in a settlement agreement, dated June 28, 2011 ("Settlement Agreement"), that the Trustee, in the exercise of its judgment, views as reasonable and in the best interests of the Trusts. (*Id.* ¶ 36.)

The Settlement Agreement requires Bank of America and/or Countrywide to pay $8.5 billion (the "Settlement Payment") into the Trusts, allocated pursuant to an agreed-upon methodology that accounts for past and expected future net losses associated with the Mortgage

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[1] The Institutional Investors included, or have grown to include, Blackrock Financial Management, Inc. and its affiliates, Pacific Investment Management Company LLC, Federal Home Loan Mortgage Corporation, Goldman Sachs Asset Management L.P., Maiden Lane LLC, Maiden Lane II LLC, Maiden Lane III LLC, Kore Advisors, L.P., Neuberger Berman Europe Limited, Western Asset Management Company, Metropolitan Life Insurance Company, Trust Company of the West and the affiliated companies controlled by The TCW Group, Inc., Teachers Insurance and Annuity Association of America, Invesco Advisers, Inc., Thrivent Financial for Lutherans, Landesbank Baden-Wuerttemberg and LBBW Asset Management (Ireland) PLC, Dublin, ING Capital LLC, ING Bank fsb, ING Investment Management LLC, New York Life Investment Management LLC, certain Nationwide Insurance entities, certain AEGON entities, Federal Home Loan Bank of Atlanta, Bayerische Landesbank, and Prudential Investment Management, Inc.

The Maiden Lane entities were formed by the Federal Reserve Bank of New York, pursuant to Section 13(3) of the Federal Reserve Act, to support lending to financial institutions severely affected by the 2007-2008 economic crisis. *See* http://www.newyorkfed.org/markets/maidenlane.html, last visited on June 28, 2011.

[2] BAC acquired Countrywide in July 2008.

Loans in each Trust. (*Id.* ¶ 38.) It also requires BAC HLS to implement, among other things, a series of servicing improvements designed to ensure that servicing performance by BAC HLS is at or above industry standards and to provide a mechanism for BAC HLS to identify high risk loans and to transfer them to subservicers for more individualized attention. (*Id.* ¶ 42.)

In exercising its good faith judgment that the Settlement is reasonable, the Trustee has weighed the legal and factual assertions of the Investors and Countrywide during seven months of settlement negotiations; considered the competing methodologies for arriving at the Settlement Payment and the reasonableness of that payment; considered the servicing improvements that would be implemented now, and how they would affect Certificateholders; and has taken guidance from counsel and independent financial and legal experts. More specifically, before entering into the Settlement, the Trustee has taken into account, among other things, the following:

- The Settlement was negotiated at arm's length by extremely sophisticated parties over a seven-month period. (*Id.* ¶¶ 10, 59.)

- The Trustee's experts in residential mortgage-backed securities and commercial finance have opined – without prior knowledge of the amount of the Settlement Payment – that a settlement in the range of $8.8 billion to $11 billion would be reasonable, *without taking into account, and discounting for, the legal defenses to the Trustee's claims*. (*Id.* ¶ 67.) This is based in part on the experts' calculations of actual and projected losses in the Trusts. (*Id.* ¶ 66.)

- Countrywide will be unable to pay a judgment that would exceed, equal or even approach the Settlement Payment. (*Id.* ¶ 81.) That conclusion is supported by a leading valuation expert who has opined on the maximum economic value that the Trustee could recover from Countrywide assuming that the Trustee obtained a judgment in its favor. (*Id.* ¶¶ 79-80.)

- Countrywide's position that the Trustee could not impose liability on Bank of America under theories of successor liability, veil piercing, or *de facto* merger is reasonable. That judgment is supported by well established precedent and recent cases seeking to impose liability on Bank of America for Countrywide's alleged misconduct, and has been reinforced by an independent expert legal opinion. (*Id.* ¶¶ 82-92.)

- Countrywide will assert as a defense that in order to satisfy the PSA's requirement that any breach of representation "materially and adversely affect the interests of the Certificateholders in the Mortgage Loan," the Trustee would have to prove, on a loan-by-loan basis, that the breach caused a substantial loss to Certificateholders. (*Id.* ¶ 70.) This defense is a reasonable one, and if accepted by a Court, could mean that the Trustee would have to bear the extraordinary burden of reviewing loan files for hundreds of thousands of loans (or a significant sample of such loans) in 530 trusts; determine as to each loan which of the dozens of representations and warranties were breached; and then prove that the loss to Certificateholders was caused by the breach of a specific representation and warranty and not by other factors that arguably bear no relation to the breach. (*Id.* ¶ 72.) The Trustee's good faith judgment that the defense is reasonable is supported by case law addressing nearly identical PSA language under similar facts, and by an independent expert legal opinion. (*Id.* ¶¶ 75-76.)

- The servicing components of the settlement meet or exceed industry standards. The Trustee has considered, among other things, the respective settlement positions of the Institutional Investors, Countrywide, and Bank of America, the nature of the proposed servicing improvements, the means by which the Settlement Agreement ensures compliance with industry standards, and the independent opinion of mortgage servicing experts. (*Id.* ¶¶ 93-95.)

In short, the Trustee has exercised its judgment – in good faith and in a manner that it believes is in the best interests of the Trusts. The Settlement takes into account the seriousness of the allegations, yet acknowledges the risk that Countrywide's defenses might prevail and that the Trustee, even if it obtained a judgment exceeding the Settlement Payment, would be unlikely to recover it. (*Id.* ¶ 59.)

But as discussed, not all Certificateholders may agree with the Trustee's judgment, and the Trustee now finds itself squarely in the middle of conflicts among Certificateholders looking to remedy alleged breaches in different ways. Given these conflicts, the magnitude of the Settlement, the number of trusts and loans at issue, and the number of parties whose interests may be impacted by the Settlement, the Trustee has filed the Verified Petition to give Trust Beneficiaries an opportunity to be heard in opposition or in support of the Settlement, and to

seek an order from the Court, among other things, (i) approving the Settlement, and (ii) declaring that the Settlement is binding on all Trust Beneficiaries.

ARGUMENT

I. THE TRUSTEE HAS THE RIGHT TO COMMENCE AND SETTLE REPURCHASE AND SERVICING CLAIMS

The Governing Agreements define the rights of the Trustee, and they could not be clearer: the Trustee has authority to bring and settle claims (i) to enforce the Seller's repurchase obligations upon a breach of a representation and warranty in the Governing Agreements, and (ii) that arise out of any breach of the Master Servicer's obligations under the Governing Agreements.

The Governing Agreements convey to the Trustee every right that the Depositor has in the Trusts. Those rights include, among other things, the right to require a Seller of the Mortgage Loans (here, Countrywide) to repurchase loans as to which the Seller breached a representation and warranty:

> [T]he Depositor sells, transfers, assigns, sets over and otherwise *conveys to the Trustee for the benefit of the Certificateholders*, without recourse, all the right, title and interest of the Depositor in and to the Trust Fund *together with the Depositor's right to require each Seller* to cure any breach of a representation or warranty herein by such Seller, *or to repurchase* . . . any affected Mortgage Loan in accordance herewith.

(Ingber Aff. Ex. G § 2.01(b) (emphasis added); *see also* Pet. ¶¶ 49, 51.)

If there was any doubt about the scope of the Trustee's rights under the Governing Agreements, Section 2.04 offers this reminder: "Depositor hereby assigns, transfers and conveys to the Trustee *all of its rights* with respect to the Mortgage Loans including, without limitation, the representations and warranties of each Seller made pursuant to Section 2.03(a) hereof, together with all rights of the Depositor to require a Seller to cure any breach thereof or to repurchase . . . any affected Mortgage Loan . . . ." (Ingber Aff. Ex. G § 2.04 (emphasis added);

see also Pet. ¶¶ 52, 53.) "All" of the Depositor's rights means what it says – namely, that the Trustee has *all* rights of the Depositor. In addition to the right to enforce the Seller's repurchase obligations, this includes the right to enforce the Master Servicer's servicing obligations under the Governing Agreements: "The Depositor may, but is not obligated to, enforce the obligations of the Master Servicer under this Agreement . . . ." (Ingber Aff. Ex. G § 3.03; *see also* Pet. ¶ 54.)

Courts have construed nearly identical PSA provisions as granting to trustees the authority to commence lawsuits to enforce the parties' repurchase and servicing obligations. In *LaSalle Nat'l Bank Assoc. v. Nomura Asset Capital Corp.*, 180 F. Supp. 2d 465 (S.D.N.Y. 2001), a trustee brought suit to enforce repurchase rights pursuant to a PSA under which a depositor conveyed to the trustee all of its "right, title, and interest" in the underlying mortgages. *Id*. at 470. The court held that the trustee, which had commenced litigation on behalf of the trust, was the real party in interest and that the conveyance language in that case – which mirrors Section 2.01 of the Governing Agreements – "includes the power to bring suit to protect and maximize the value of the interest thereby granted." *Id.* at 471. Another court construed the identical language in the identical section of a similar PSA as authorization for the trustee to commence litigation to enforce repurchase obligations: "Section 2.01 of the PSA in this case, when read together with other provisions of the PSA, grants [the trustee] the authority to institute this action as the real party in interest." *LaSalle Nat'l Bank Assoc. v. Lehman Brothers Holdings, Inc.*, 237 F. Supp. 2d 618, 633 (D. Md. 2002).

In fact, many courts have declined to permit anyone *other* than trustees to bring claims on behalf of securitization trusts, recognizing that absent strict compliance with the PSA's no-action clause, only the trustee has the requisite standing. *See Asset Securitization Corp. v. Orix Capital Mkts., LLC*, 12 A.D.3d 215, 215 (1st Dep't 2004) (finding that authority to commence litigation

on behalf of the certificateholders is committed to the trustee) (citing *LaSalle*, 180 F. Supp. 2d at 471); *Sterling Federal Bank, F.S.B. v. DLJ Mortg. Capital, Inc.*, No. 09 C 6904, 2010 WL 3324705, at *2-5 (N.D. Ill. Aug. 20, 2010) (finding that certificateholder's claim for breach of contract brought against servicer must be commenced by trustee).

It is this indisputable right to commence litigation that provides the Trustee with the equally indisputable right to settle it. Indeed, "implicit in the authority to commence proceedings to remedy defaults is the power to negotiate and agree upon settlements. . . ." *In re Delta Air Lines, Inc.*, 370 B.R. 537, 548 (Bankr. S.D.N.Y. 2007) (overruling bondholder objections to trustee's settlement and approving settlement), *aff'd sub nom. Ad Hoc Comm. of Kenton Cnty. Bondholders v. Delta Air Lines, Inc.*, 374 B.R. 516 (S.D.N.Y. 2007), *aff'd*, 309 Fed. Appx. 455 (2d Cir.), *cert denied*, 130 S. Ct. 539 (2009); *see also Levine v. Behn*, 169 Misc. 601, 606 (Sup. Ct. N.Y. County 1938) (observing "that a bank has the right to sue and be sued and that as an incident to the right to sue or be sued is the power to compromise or settle suits"), *aff'd*, 257 A.D. 156 (1st Dep't 1939), *reversed on other grounds*, 282 N.Y. 129 (1940); *Kelton Corp. v. Cnty. of Worcester*, 426 Mass. 355, 359 (1997) (defendant, as part of power to sue and be sued, "has the inherent implied power to effect a settlement"); *Evans v. Tucker*, 101 Fla. 688, 697 (1931) (referring to "general rule" that "as an incident to the power to sue and collect, the administrator [of an estate] has the right to compromise any demand of decedent provided he acts honestly and within the range of reasonable discretion for the true interest of the estate"); *Codman v. Dumaine*, 249 Mass. 451, 458 (1924) (the power "to sue and be sued carried with it as a necessary incident the power to compromise either the whole claim or to secure relief for a time for the prosecution of an action founded on the claim").

This makes perfect sense. It would be absurd to allow a trustee to consider the merits of filing a lawsuit, exercise its discretion in filing the lawsuit, and manage the lawsuit, only to then eliminate the Trustee's ability to settle the lawsuit in a manner that it believes is in the best interests of the trusts. That is not to say that a trustee has *unlimited* authority to settle; as discussed *infra*, the trustee must act in good faith and within the bounds of reasonableness. But the *right* to negotiate and agree upon a settlement is fundamental, and to eliminate that right would violate the most basic principles of trust law, contract law and common sense. *See, e.g.*, Restatement (Second) of Trusts, § 192 (1959) (stating that trustees can properly compromise or abandon claims affecting the trust property); *Matter of IBJ Schroder Bank & Trust Co. (186 Trust)*, 271 A.D.2d 322, 322 (1st Dep't 2000) (finding that trust provisions giving the trustee the power to commence a lawsuit includes the power to settle it); *cf. In re Smart World Techs., LLC*, 423 F.3d 166, 174-75 (2d. Cir. 2005) (holding that power to sue conferred by Bankruptcy Code "presumably includes the derivative power to settle suits").

It is hardly surprising, therefore, that unless the trust agreement contains explicit limitations on the trustee's authority to settle claims – and there are none here – under settled law a trustee has the right to settle or compromise any claims that it has the authority to assert. *See, e.g., Suffolk Cnty. Nat'l Bank v. Licht*, 256 A.D. 1080, 1080 (2d Dep't 1939) ("The stipulation [in compromise of the trust's claim] was within the power of the trustee and was, therefore, valid, *in the absence of any contrary provision in the declaration of trust*.") (emphasis added).

That is all the Trustee is doing here. It has the authority to assert repurchase and servicing claims against Countrywide and Bank of America, and has exercised its good faith judgment to settle those claims in advance of lengthy, costly and unpredictable litigation. That is well within the Trustee's authority under the Governing Agreements.

II. THE COURT IS AUTHORIZED TO PROVIDE JUDICIAL INSTRUCTIONS AND APPROVE THE SETTLEMENT

Under well established principles of trust law and the express language of Article 77 of the CPLR, the Court is authorized to provide judicial instructions relating to the Settlement. Indeed, this is the paradigmatic case in which judicial instructions are required.

Section 7701 of the CPLR is unambiguous: with certain exceptions not relevant here, "[a] special proceeding may be brought to determine a matter relating to any express trust." This is an exceedingly broad provision, encompassing *any* trust matters of interest to trustees and trust beneficiaries. *See In re Greene*, 88 A.D.2d 547, 548 (1st Dep't 1982) (Section 7701 is to be "broadly construed to cover any matter of interest to trustees, beneficiaries or adverse claimants concerning the trust"). Section 7701 applies here, for at least two reasons.

First, the Trusts are express trusts. *See In re Marcus Trusts*, 2 A.D.3d 640, 641 (2d Dep't 2003) (holding that an express trust was created because "[i]t is undisputed that all of the essential elements of a trust – a designated beneficiary, a designated trustee, a clearly identifiable res, and delivery of the res by the grantor to the trustee with the intent of vesting legal title in the trustee – are present"); *see also Mayo v. GMAC Mortg. LLC*, Index No. 08-00568, 2011 U.S. Dist. LEXIS 3349, at *16-17 (W.D. Mo. Jan. 13, 2011) (stating that a mortgage securitization trust "was established as an express trust under the laws of New York") [3]; *LaSalle Nat'l Bank Assoc. v. Nomura Asset Capital Corp.*, 180 F. Supp. 2d 465, 471 (S.D.N.Y. 2001) (referring to a mortgage securitization trust under a PSA as an express trust under New York law).

The alternative to an express trust – a constructive trust – "is distinguished from an express trust in that it is not based upon the intention of the parties and is imposed by the court without regards to intention, while an express trust is grounded upon intention." Russell J. Davis

[3] A compendium of unpublished decisions is attached to the Ingber Affirmation as Exhibit J.

et al., 106 N.Y. Jurisprudence Trusts § 165 (2nd ed. 2006); *see also Equity Corp. v. Groves*, 294 N.Y. 8, 13 (1945) ("An express trust arises because the parties intended to create it. A constructive trust is not based upon the intention of the parties but is imposed in order to prevent one of them from being unjustly enriched at the expense of another.") (internal quotations omitted).

It is evident from the face – and mere existence – of the Governing Agreements that the parties intended to create the Trusts. For example, the PSA defines "Trust Fund" as "the corpus of the trust *created* under this Agreement . . . ." (Ingber Aff. Ex. G at 43 (emphasis added).) Section 10.01 refers to amendments to permitted activities of the "trust *created* by this Agreement." (*Id.* Ex. G § 10.01 (emphasis added).) And in Section 2.02(a) of the PSA, the Trustee declares "that it holds or will hold such other assets as are included in the Trust Fund, *in trust* for the exclusive use and benefit of all present and future Certificateholders." (*Id.* Ex. G § 2.02(a) (emphasis added); *see also id.* § 10.08 ("The death or incapacity of any Certificateholder shall not operate to terminate this Agreement or *the trust created hereby*.")) (emphasis added). There is no doubt that the parties intended to create the Trusts.

Second, there are several "matters of interest" to the Trustee and the Trust Beneficiaries. First and foremost is the Settlement itself. As noted, the Settlement Payment is $8.5 billion. It is a Settlement on behalf of 530 trusts and involves hundreds of thousands of individual loans. There are thousands of Trust Beneficiaries whose interests will be impacted by the Settlement. Some of these Trust Beneficiaries reportedly have objections even to settlement *discussions*; others reportedly have considered recourse against the Trustee for its participation in the settlement process. (Pet. ¶ 13; *see also* Ingber Aff. Exs. C and D.) Seeking approval of a material settlement is one of the most basic grounds for commencing an Article 77 proceeding.

See In re Application of IBJ Schroder Bank & Trust Co., Index No. 101530/1998 (N.Y. Sup. Ct. N.Y. County Aug. 16, 2000) (Article 77 proceeding approving trustee's proposed settlement involving assets of the trust); *In re Tanenblatt*, N.Y.L.J. Oct. 5, 1993 at 26 (Sur. Ct. Nassau County 1993) (Article 77 proceeding to authorize and approve fiduciary's entry into a written stipulation of settlement of pending litigation against estate); Restatement (Second) of Trusts § 192, comment d (trustee may seek judicial instructions with respect to settlement of claims).

An equally compelling basis for seeking judicial instructions is where the trustee is faced with conflicting, or potentially conflicting, instructions from trust beneficiaries – another matter of considerable interest for the Trustee and the Trust Beneficiaries. *See In re Bankers Trustee Co.*, Index No. 604336/1996 (N.Y. Sup. Ct. N.Y. County July 24, 1997). In *In re Bankers Trustee*, this Court granted a trustee's request for judicial instructions regarding the enforcement of a promissory note, which the trustee believed had the potential to cause a conflict among trust beneficiaries. In ruling that it had authority to issue judicial instructions, the Court noted one of the essential purposes of an Article 77 proceeding: "[T]he judicial instructions will permit conflicts relating to priorities among [trust beneficiaries] to be resolved in one proceeding instead of in piecemeal in a number of proceedings. *Id.* at 6; *see also In re Bankers Trustee Co.*, Index No. 114077/1998, at 2-3 (N.Y. Sup. Ct. N.Y. County Mar. 8, 1999) (granting trustee's request, pursuant to Article 77, for judicial instructions regarding the disposition of certain trust funds that were the subject of conflicting letters of direction from trust beneficiaries).

That is precisely why judicial instructions are so essential here. As discussed, the Trustee has been presented with conflicting demands and requests from different groups of Certificateholders relating to certain of the Trusts, and is involved in litigation commenced by Certificateholders seeking to enforce repurchase remedies against Countrywide and Bank of

America in different ways. (Pet. ¶ 14.) For example, in December 2010, one group of Certificateholders sought to direct the Trustee to assert an action against Countrywide concerning one of the Trusts. (*Id.*) In February 2011, that same group commenced an action – in this Court – against CHL, BAC and BNY Mellon (as nominal defendant) alleging similar breaches of representations and warranties as the Institutional Investors, and two months later amended the complaint to add another trust at issue here. *See Walnut Place LLC v. Countrywide Home Loans, Inc.*, Index No. 650497/2011 (N.Y. Sup. Ct. N.Y. County). In May 2011, a group of Certificateholders issued a notice of Event of Default with respect to one of the Trusts that mimics, in several respects, the notice served by the Institutional Investors here. Also in May 2011, yet another Certificateholder filed an action against the Trustee – also in this Court – seeking an accounting relating to two of the Trusts, based principally on allegations against Countrywide that overlap with the allegations here. *See Knights of Columbus v. Bank of New York Mellon*, Index No. 651442/2011 (N.Y. Sup. Ct. N.Y. County). And on June 8, 2011, the Trustee received a letter from a group of Certificateholders requesting that the Trustee commence a lawsuit against Countrywide and BAC HLS, among others, to compel them to produce documents relating to one of the Trusts. (*See* Pet. ¶ 14.)

In short, although the Trustee has made a judgment that the Settlement is in the best interests of the Trusts, some Certificateholders may believe that piecemeal litigation involving separate trusts is the better course of action. That presents the Trustee with a classic conflict that requires judicial instructions pursuant to Article 77. *See In re Bankers Trustee Co.*, Index No. 114077/1998, at 2-3; *In re Bankers Trustee Co.*, Index No. 604336/1996, at 6; *see also In re Estate of Fales*, 106 Misc. 2d 419, 422 (Sur. Ct. N.Y. County 1980) (providing instructions regarding trustee conduct that was the subject of conflicting requests from trust beneficiaries);

Restatement (First) of Trusts § 170 (1935), comment q (proper for court to provide instructions where trust beneficiaries express conflicting interests).

III. THE COURT SHOULD DEFER TO THE TRUSTEE'S JUDGMENT THAT THE SETTLEMENT IS REASONABLE

The decision by the Trustee to enter into the Settlement was made in good faith and was not outside the bounds of reasonableness. For that reason alone, the Settlement should be approved.

It is black letter law that "[i]f discretion is conferred upon the trustee in the exercise of a power, the court will not interfere unless the trustee in exercising or failing to exercise the power acts dishonestly, or with an improper even though not a dishonest motive, or fails to use his judgment, or acts beyond the bounds of a reasonable judgment." *In re Stillman*, 107 Misc. 2d 102, 110 (Sur. Ct. N.Y. County 1980); *see also* Restatement (Second) of Trusts, § 187 (1959) ("Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.").

That standard is easily satisfied here. *First*, the Trustee did not act dishonestly or with an improper motive, which occurs only "if the trustee in exercising or failing to exercise a power does so because of spite or prejudice or to further some interest of his own or of a person other than the beneficiary." Restatement (Second) of Trusts, § 187, comment g. There is nothing of that sort here. The Trustee exercised its judgment that an $8.5 billion Settlement Payment, coupled with servicing provisions that will ensure (at the very least) compliance with industry standards and require more individualized attention to high-risk loans, was in the best interests of the Trusts. (Pet ¶¶ 61-62.) The Trusts will receive the entirety of the Settlement Payment. (*Id.* ¶ 38.) Following court approval of the Settlement, that payment will be allocated among the

Trusts pursuant to an agreed-upon formula that accounts for past and future net losses in the Trusts. (*Id.* ¶¶ 38-40.) An independent financial advisor, without input from the Trustee, will perform any calculations required in connection with that formula, and the allocable share for each Trust will then be distributed to Trust Beneficiaries in accordance with the terms of the Governing Agreements. (*Id.* ¶38.) The Trustee itself will not receive any part of the Settlement Payment. In short, the Trustee has never sought to advance its own interests in any way, and has taken considerable steps to ensure that the allocation process is fair and reasonable.

Second, the Trustee did not fail to use its judgment. It entered into the Settlement precisely *because* of the exercise of its judgment.

Finally, the Trustee's judgment to enter into the Settlement was not outside the bounds of reasonableness. It was eminently reasonable. As a threshold matter, the Court is not required to undergo an independent analysis of the Settlement, or to substitute its own judgment for that of the Trustee. *See In re Application of IBJ Schroder Bank & Trust Co.*, Index No. 101530/1998, at 6 (N.Y. Sup. Ct. N.Y County Aug. 16, 2000) (holding that "the trustee's *decision* to compromise the . . . action is within the scope of the trustee's powers, is reasonable and prudent, and is entitled to judicial deference") (emphasis added).[4]

Instead, consistent with the requirement of *judicial* deference, the Court should reject the decision to settle only if *no reasonable person* could, upon the facts known, decide to settle the claims at issue. *See Dlugaski v. Port Auth. of N.Y. and N.J.*, Index No. 307484/09, 2010 WL 2610649, at *2 (N.Y. Sup. Ct. Bronx County June 30, 2010) (in the context of a judicial "abuse of discretion" standard: "[d]iscretion, in this sense, is abused when the judicial action is

[4] Nor should the Court consider whether the Settlement is, in fact, the *best* settlement, or the *best* resolution, for all Trust Beneficiaries. *See id.* (refusing to "invalidate the proposed settlement merely because certain beneficiaries believe a greater recovery might be obtained if the . . . action is submitted to an expensive and unpredictable litigation").

arbitrary, fanciful or unreasonable, which is another way of saying that discretion is abused only where no reasonable man would take the view adopted by the court"); *People v. Rubin S.*, 87 Misc.2d 951, 955 (Sup. Ct. Queens County 1976) (same); *see also Town of Hempstead v. State Div. of Human Rights*, 233 A.D.2d 451, 452 (2d Dep't 1996) (an agency determination must be upheld "[u]nless the award is so arbitrary and capricious as to constitute an abuse of discretion").

There was nothing arbitrary or unreasonable about the Trustee's decision. As discussed in the Petition, the Trustee participated in settlement discussions with the Institutional Investors, Countrywide and Bank of America for seven months. (Pet. ¶ 64.) During that time, it considered the legal and factual assertions of the Institutional Investors, Countrywide and Bank of America; analyzed the competing methodologies for arriving at the Settlement Payment; considered and analyzed the servicing procedures set forth in the Settlement Agreement; weighed the benefits to the Trusts of receiving $8.5 billion and vastly improved servicing against the risks and costs in waiting for an uncertain – and perhaps unattainable or unrecoverable – judgment many years from now; and evaluated the reasonableness of the Settlement by, among other things, receiving opinions from independent experts in residential mortgage-backed securities and commercial finance, mortgage servicing, accounting and valuation. (*Id.* ¶¶ 65-67, 94-95.) These experts opined on various issues, including: (i) the amount of a settlement range that could serve as a starting point for assessing the reasonableness of the Settlement Payment; (ii) the maximum economic value that the Trustee could recover from Countrywide assuming that the Trustee obtained a judgment in its favor; and (iii) the reasonableness of the servicing improvements, and in particular whether the servicing provisions are consistent with (or exceed) customary and usual standards of practice of prudent mortgage loan servicers. (*Id.* ¶¶ 65, 94-95.) In addition, the Trustee was guided by counsel on the legal issues – including the viability of

Countrywide's defenses and Bank of America's corporate separateness arguments – and has received separate opinions from experts in corporate and contract law on these issues. (*Id.* ¶¶ 75, 83.)

This exercise of judgment unquestionably was within the bounds of reasonableness. Accordingly, it is entitled to judicial deference. *See In re Application of IBJ Schroder Bank & Trust Co.*, 101530/1998, at 6; *see also In re Roberts*, 61 N.Y.2d 782, 783-84 (1984) (denying petitioner's application to compel trustees to exercise their discretion and invade the trust's principal because the "trustees did not abuse their discretion as a matter of law by refusing to pay over the trust corpus"); *In re Rath's Estate*, 58 Misc. 2d 184, 186 (Sur. Ct. Nassau County 1968) (notwithstanding the court's finding that the trustee's position was without support, denying petitioner's application to compel trustee to act because it did "not find that the fiduciary here has abused his discretion").

IV. THE SETTLEMENT, IF APPROVED, SHOULD BE BINDING ON ALL TRUST BENEFICIARIES

Under New York law, a judicial instruction, including approval of a settlement, is subject to the usual rules of *res judicata*. *See* CPLR § 411 commentary ("A judgment in a special proceeding is, for all purposes, the same as a judgment in an action."). Consistent with those longstanding rules, a judgment in a special proceeding is binding on all beneficiaries who are joined as parties to the action, who are otherwise adequately represented, or over whom the court obtains jurisdiction. *See In re Hunter*, 6 A.D.3d 117, 121-22 (2d Dep't 2004), *aff'd*, 4 N.Y. 3d 260 (2005) ("every decree whether upon an accounting or otherwise is binding upon all persons over whom jurisdiction was obtained"); Restatement (Third) of Trusts § 71 comment b (2007).

This Court will have jurisdiction over – and can bind – the Trust Beneficiaries if they received adequate notice of this Article 77 proceeding (the "Article 77 Proceeding"). *See In re*

Judicial Settlement of the First Intermediate Accounts of Proceedings of Cent. Hanover Bank and Trust Co., 2008 NY Slip Op 50342U, at 7 (Sup. Ct. N.Y County 2008) [hereinafter *In re Matter of De Sanchez*] (jurisdiction established where trustee submitted unrebutted proof that it mailed notice of proceedings to petitioners); *O'Hagan v. Kracke*, 165 Misc. 4, 14 (Sup. Ct. Westchester County 1937), *aff'd,* 253 A.D. 632 (2d Dep't 1938) (holding that a judgment granting an accounting to a trustee was *res judicata* to a beneficiary who "was duly served with a summons and verified complaint, but did not appear"); *see also Steves & Sons, Inc. v Pottish*, 2011 NY Slip Op 50864U, at 4 (Sup. Ct. Suffolk County May 11, 2011) (personal jurisdiction exists where defendant received adequate notice of lawsuit); *Dornberger v. Metro. Life Ins. Co.*, 203 F.R.D. 118, 148 (S.D.N.Y. 2001) (personal jurisdiction exists where adequate notice was disseminated to all potential class members); *Bradford Trust Co. v. Wright*, 70 F.R.D. 323, 325 (E.D.N.Y. 1976) (in an Article 77 proceeding under New York law, "[j]urisdiction over all beneficiaries in such an action could be obtained by mail").

Due process, however, does not require that Trust Beneficiaries *actually* receive notice. Rather, it mandates only "'notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.'" *In re Matter of De Sanchez*, 2008 NY Slip Op 50342U, at 5 (quoting *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950)).

The Trustee's proposed notice program is more than adequate. As described more fully in the Ingber Affirmation (at ¶ 5), the Trustee has proposed an extremely robust notice program that is a combination of individual notice, notice through the Depository Trust Company ("DTC"), notice by publication in specified written and on-line publications, and notice through a website created and maintained by the Trustee. It includes:

- Mailing a copy of the notice that is attached to the Ingber Affirmation as Exhibit B ("Notice"), along with the Verified Petition, the Order to Show Cause, and this Memorandum of Law, by first class, registered mail to Potentially Interested Persons for whom the Trustee has addresses (*id.* ¶ 5(a)-(b));

- Providing the Notice to DTC, which will post the Notice in accordance with DTC's established procedures (*id.* ¶ 5(c));

- Publishing the Notice, and translated versions of the Notice, in seventeen different newspapers and periodicals with worldwide distribution (*id.* ¶ 5(d)-(e));

- Issuing the Notice through three media distribution wire services (*id.* ¶ 5(f));

- Establishing a website, www.cwrmbssettlement.com, that will post a copy of the Notice, the Verified Petition, the Order to Show Cause, this Memorandum of Law, and all papers subsequently filed in connection with the Article 77 Proceeding (*id.* ¶ 5(g));

- Creating a hyperlink on BNY Mellon's investor reporting website, https://gctinvestorreporting.bnymellon.com/Home.jsp, to www.cwrmbssettlement.com, for information about the Settlement and the Article 77 Proceeding (*id.* ¶ 5(h)); and

- Seeking to purchase banner advertisements announcing the Settlement, with a hyperlink to www.cwrmbssettlement.com, on various websites (*id.* ¶ 5(i)).

The form and method of dissemination of the Notice is reasonably calculated to provide notice to Trust Beneficiaries, and therefore fully satisfies New York and federal due process requirements. *See Mullane*, 339 U.S. at 314 (finding that notice by publication satisfied due process requirements); *Congregation Yetev Lev D'Satmar, Inc. v. Cnty. of Sullivan*, 59 N.Y.2d 418, 423 (1983) ("Those whose names or whereabouts are unknown and cannot be learned with due diligence or those whose interests are uncertain may be notified by publication even though it is reasonably certain that such notice will prove futile,") (citing *Mullane*, 339 U.S. at 316); *Harkness v. Doe*, 261 A.D.2d 846, 847 (4th Dep't 1999) (notice by publication satisfied due process because "'in the case of persons missing or unknown, employment of an indirect and

even a probably futile means of notification is all that the situation permits'"); *In re Matter of De Sanchez*, 2008 NY Slip Op 50342U, at 7 (notice by mail satisfies due process requirements).

In short, it is difficult to conceive of any scenario in which Trust Beneficiaries could argue that they lacked actual or constructive notice of the Settlement. Accordingly, the Court will have jurisdiction over the Trust Beneficiaries and, if approved, the Settlement should be binding on all of them. *See In re Hunter*, 6 A.D.3d at 121-22; *In re Matter of De Sanchez*, 2008 NY Slip Op 50342U, at 7; *O'Hagan v. Kracke*,165 Misc. at 14.

CONCLUSION

For all the foregoing reasons, BNY Mellon, as Trustee, respectfully requests that the Court grant the relief requested in the Verified Petition.

Dated: New York, New York
June 28, 2011

Respectfully submitted,

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