

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,

-against-

AMERICAN INTERNATIONAL GROUP, INC., AMERICAN GENERAL ASSURANCE COMPANY, AMERICAN GENERAL LIFE AND ACCIDENT INSURANCE COMPANY, AMERICAN GENERAL LIFE INSURANCE COMPANY, AMERICAN GENERAL LIFE INSURANCE COMPANY OF DELAWARE, AMERICAN HOME ASSURANCE COMPANY, AMERICAN INTERNATIONAL LIFE ASSURANCE COMPANY OF NEW YORK, CHARTIS PROPERTY CASUALTY COMPANY, CHARTIS SELECT INSURANCE COMPANY, COMMERCE AND INDUSTRY INSURANCE COMPANY, FIRST SUNAMERICA LIFE INSURANCE COMPANY, LEXINGTON INSURANCE COMPANY, NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, NEW HAMPSHIRE INSURANCE COMPANY, SUNAMERICA ANNUITY AND LIFE ASSURANCE COMPANY, SUNAMERICA LIFE INSURANCE COMPANY, THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA, THE UNITED STATES LIFE INSURANCE COMPANY IN THE CITY OF NEW YORK, THE VARIABLE ANNUITY LIFE INSURANCE COMPANY, and WESTERN NATIONAL LIFE INSURANCE COMPANY (collectively "AIG") (proposed intervenors),

Respondents,

for an order pursuant to CPLR § 7701 seeking judicial instructions and approval of a proposed settlement.

Index No. 651786/2011

Assigned to: Kapnick, J.

MEMORANDUM OF
LAW IN SUPPORT OF
VERIFIED PETITION TO
INTERVENE

Proposed intervenors American International Group, Inc., American General Assurance Company, American General Life and Accident Insurance Company, American General Life Insurance Company, American General Life Insurance Company of Delaware, American Home Assurance Company, American International Life Assurance Company of New York, Chartis Property Casualty Company, Chartis Select Insurance Company, Commerce and Industry

Insurance Company, First SunAmerica Life Insurance Company, Lexington Insurance Company, National Union Fire Insurance Company of Pittsburgh, PA, New Hampshire Insurance Company, SunAmerica Annuity and Life Assurance Company, SunAmerica Life Insurance Company, The Insurance Company of The State of Pennsylvania, The United States Life Insurance Company in The City of New York, The Variable Annuity Life Insurance Company, and Western National Life Insurance Company (collectively referred to herein as "AIG"), by their attorneys Reilly Pozner LLP, submit this memorandum of law in support of their verified petition to intervene under CPLR 401, 1012, and 1013 in the above-captioned proceeding.

PROCEDURAL BACKGROUND

The Bank of New York Mellon ("BoNY") is trustee for 530 trusts created by Countrywide Home Loans, Inc., and its affiliates ("Countrywide"). The trusts own hundreds of thousands of mortgage loans created or acquired by Countrywide and have and are projected to suffer financial losses totaling nearly \$108 billion, according to estimates relied upon by a group of investors who have intervened in this action. AIG owns certificates in 97 of these trusts. Countrywide and its successor, Bank of America (collectively, "BAC"), have significant liability to the trusts and their beneficiaries in connection with the projected losses.

Beginning in November, 2010, BoNY and BAC, along with a group of Institutional Investors (referred to in AIG's Petition as the "Inside Institutional Investors"), negotiated a proposed settlement agreement concerning the losses sustained by the trusts. AIG, along with thousands of other trust beneficiaries, were not included in the settlement negotiations. The proposed settlement agreement provides that BoNY as trustee will release BAC from any liability in connection with losses sustained by the trusts in exchange for a payment equal to a small percentage of the projected \$108 billion in losses.

BoNY then initiated this Article 77 proceeding to obtain judicial approval of the proposed settlement agreement, along with releases and indemnification for BoNY itself. Both the substance of the agreement and the procedure by which it was made raise numerous questions as to the reasonableness of the agreement. The factors that call into question the proposed agreement's reasonableness are discussed in depth in AIG's Petition, but include:

- (a) The proposed settlement is the product of a highly conflicted process
- BoNY admits that it “finds itself squarely in the middle of conflicts among Certificateholders” who have directed the trustee to take different actions and who do not support the proposed settlement and are “looking to remedy alleged breaches in different ways.”
 - Despite this admitted conflict of interest, BoNY has chosen to support the proposed settlement which is supported only by the Inside Institutional Investors.
 - As part of the proposed settlement BoNY has obtained a release from certain claims the trust beneficiaries may bring as well as expanded indemnification from BAC.
 - Counsel for the Inside Institutional Investors will be paid \$85 million in legal fees from BAC upon approval of the settlement.
- (b) The proposed settlement is a fraction of the \$108 billion in losses assumed by the Inside Institutional Investors
- Based upon certain assumptions, the Inside Institutional Investors assumed that the various trusts have and would suffer losses in an amount of \$108 billion.
 - Accepting for present purposes the Inside Institutional Investors' loss assumption, the \$8.5 billion proposed settlement is a dramatic reduction from the \$108 billion in losses that the Inside Institutional Investors believe the trusts have or will incur.
 - BoNY appears to have accepted, without challenge, BAC's assumptions – including breach rates, success rates, and predictions on successor liability – to drive down the settlement value to a mere \$8.5 billion.

- BoNY also adopted loss assumptions much smaller and much more favorable to BAC than the Inside Institutional Investors' assumption of \$108 billion.
 - The negotiation process by which BoNY got to \$8.5 billion is entirely opaque.
 - There has been no allocation of the \$8.5 billion across the 530 trusts, so neither the trusts nor the trust beneficiaries have any understanding of what they would receive.
- (c) The proposed approval process deprives individual trusts and trust beneficiaries of their due process rights and is fundamentally unfair
- The proposed settlement suffers from a serious structural defect in that it provides no opt-out mechanism for either individual trusts or individual trust beneficiaries.
 - There is no precedent for using Article 77 to approve a settlement in the RMBS trust context and BoNY/BAC's attempted use of Article 77 may be improper.

AIG thus has serious and legitimate concerns that neither BoNY nor the proposed settlement adequately protects its interests. Permitting AIG to intervene and conduct discovery will provide a sound basis upon which AIG, other certificateholders, and the Court can evaluate the fairness of the proposed settlement. Therefore, as a certificateholder in a substantial number of the trusts at issue, AIG should be permitted to intervene to conduct discovery and determine for itself whether the proposed settlement affords a fair resolution of the claims against BAC.

ARGUMENT

“Intervention is liberally allowed by courts, permitting persons to intervene in actions where they have a bona fide interest in an issue involved in that action.” *Yuppie Puppy Pet Prods., Inc. v. Street Smart Realty, LLC*, 77 A.D.3d 197, 201 (1st Dep’t 2010). CPLR 1012 sets forth the standard for a party to intervene as of right, and CPLR 1013 establishes the standard for permissive intervention. “As a practical matter, however, under liberal rules of construction the

distinctions between the two forms of intervention are not important.” *Plantech Housing, Inc. v. Conlan*, 74 A.D.2d 920, 921 (2d Dep’t 1980); *accord Yuppie Puppy Pet Prods.*, 77 A.D.3d at 201 (“Distinctions between intervention as of right and discretionary intervention are no longer sharply applied.”).¹ Under either standard, “intervention should be allowed” when “the intervenor has a real and substantial interest in the outcome of the proceeding.” *Plantech Housing*, 74 A.D.2d at 921. AIG’s ownership of certificates in 97 of the trusts at issue constitutes a real and substantial interest in this proceeding, and so AIG should be permitted to intervene.

I. AIG should be allowed to intervene under CPLR 1012(a) because its interests in the trusts may not be adequately represented in the Article 77 proceeding and may, in fact, be adversely affected

A party can intervene as of right “[w]hen the representation of the person’s interest by the parties is or may be inadequate and the person is or may be bound by the judgment.” CPLR 1012(a)(2). This standard is easily met here. As set forth more fully in AIG’s Petition, incorporated herein by reference, numerous factors demonstrate that BoNY is not adequately representing AIG’s and other outsider trust beneficiaries’ interests.

First, BoNY admitted that “real and substantial conflicts” exist among trust beneficiaries and that BoNY would be placed in the middle of such conflicts. Doc. 1 ¶¶ 13 – 16. But, rather than resolve those conflicts before negotiating the proposed settlement (for example, by initiating an Article 77 proceeding), BoNY proceeded to negotiate with only a select group of Inside Institutional Investors notwithstanding its admitted conflicts.

Second, BoNY seeks Court approval of a proposed settlement agreement in which it has an interest. Rather than negotiating strictly for the benefit of trust beneficiaries, BoNY as trustee

¹ In a special proceeding, leave of the court is required for any party to intervene, *see* CPLR 401, further eroding the distinction between CPLR 1012 and CPLR 1013 for purposes of AIG’s petition to intervene.

negotiated releases and indemnity for its own benefit. This raises serious concerns under New York trust law. *See City Bank Farmers Trust Co. v. Cannon*, 291 N.Y. 125, 132 (1943) (“Under New York law, a trustee’s self-dealing will not be enforced: rather, a court “stops the inquiry when the relation is disclosed and sets aside the transaction or refuses to enforce it”). At a minimum, BoNY is entitled to no deference, as even its Petition acknowledges that a trustee acting in furtherance of his own interests acts with improper motive. Doc. 12 at 15 (citing Restatement (Second) of Trusts, § 187, cmt g (1959)).

Third, BoNY, BAC, and the Inside Institutional Investors have entered into a three-party confidentiality agreement that shields important information related to the good faith and reasonableness of the settlement from trust beneficiaries like AIG. As a trust beneficiary, particularly under the circumstances presented here, AIG is entitled to information in the trustee’s possession that is necessary for AIG to protect its own interests. *See* Restatement (Second) of Trusts § 173 (1959) (“The trustee is under a duty to the beneficiary to give him upon his request at reasonable times complete and accurate information as to the nature and amount of the trust property, and to permit him or a person duly authorized by him to inspect the subject matter of the trust and the accounts and vouchers and other documents relating to the trust.”). Even if the trust agreements limited the amount of information BoNY was required to provide to the trust beneficiaries, AIG is entitled to the information it seeks here to protect its interests. *See id.* cmt. c (“Although the terms of the trust may regulate the amount of information which the trustee must give and the frequency with which it must be given, *the beneficiary is always entitled to such information as is reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of trust.*”) (emphasis added).

Fourth, the reasonableness of the proposed settlement agreement is in question.

According to the Inside Institutional Investors, the trusts lost and are projected to lose nearly \$108 billion. Analyses of publicly available information show that 50-75% of loans in the trust breached the representations and warranties given by Countrywide Home Loans, Inc. and its affiliates (now BAC). But the settlement payment amounts about eight percent. As justification for such a low percentage recovery, BoNY submits five expert reports. These reports should be subjected to the same scrutiny as any other opinion in judicial proceedings. Several key concerns are identified in AIG's Petition.

Nor can the Inside Institutional Investors adequately protect AIG's interests. Like BoNY, the Inside Institutional Investors have shielded AIG and the other outsider investors from information relating to the proposed settlement by entering into a confidentiality agreement. In addition, BAC will pay counsel for the Inside Institutional Investors \$85 million in legal fees if the proposed settlement is approved, calling into doubt any claims of objectivity by the Inside Institutional Investors in evaluating the proposed settlement. Further, BAC and the Inside Institutional Investors have substantial ongoing business ties that may encourage the Inside Institutional Investors to be less aggressive in protecting the interests of certificateholders in the present dispute.

Pursuant to CPLR 1012(a)(2), intervention is appropriate where the interests of the proposed intervenor and the party to the proceeding are "not identical" in order "to insure complete litigation of [the intervenor's] interests in the judicial forum." *See N.Y. State Pub. Emp't Relations Bd. v. Bd. of Ed. of Buffalo*, 46 A.D.2d 509, 513 (4th Dep't 1975). Neither BoNY nor the Inside Institutional Investors have identical interests to AIG and other outside investors, but BoNY and the Inside Institutional Investors nevertheless seek to bind them to their settlement with BAC and the releases built into the proposed agreement. As shown above,

AIG's interests are not only "not identical" to BoNY's and the Inside Institutional Investors' interests, but differ in material respects. AIG should be permitted to intervene.

A party must also be permitted to intervene "[w]hen the action involves the disposition or distribution of, or the title or a claim for damages for injury to, property and the person may be affected adversely by the judgment." CPLR 1012(a)(3). This action concerns the distribution of, and claims for damages to, trust property due to breaches committed by BAC. As a certificateholder in 97 trusts, AIG owns beneficial interests in this trust property. *See George v. Grand Bay Assocs. Enter. Inc.*, 45 A.D.3d 451, 452 (1st Dep't 2007) (granting motion to intervene pursuant to CPLR 1012(a)(3) where action sought cancellation and reformation of a deed owned by intervenors because "[a]s purchasers of the subject property, intervenors had a real and substantial interest in the outcome of the litigation warranting their intervention"). Additionally, there can be no question that AIG "may be affected adversely by the judgment," CPLR 1012(a)(3), as the proposed settlement may result in AIG receiving less for its certificates than it would receive in the absence of the settlement and may block AIG from recovery against BoNY through BoNY's self-release of certain trust beneficiary claims. Intervention is thus appropriate under CPLR 1012(a)(3).

II. AIG should be allowed to intervene under CPLR 1013 because common issues of fact and law between the Article 77 proceeding and AIG's petition to intervene abound

Finally, a party may be permitted to intervene when its "claim or defense and the main action have a common question of law or fact" so long as the intervention does not "unduly delay the determination of the action or prejudice the substantial rights of any party." CPLR 1013. Here, AIG's interests will be directly impacted by the proposed settlement because its right to payment as a certificateholder is contingent upon the size of the recovery from BAC.

Accordingly, AIG's interest in ensuring that the settlement is fair and reasonable presents identical factual and legal questions that the Court will need to address in ruling on this Article 77 petition. Further, AIG's intervention will not cause undue delay or prejudice the substantial rights of any party. AIG is particularly well-positioned to develop the factual and legal record for the Court in a streamlined and targeted fashion. AIG has a stake in a large number of the trusts, has closely examined the issues, and has significant residential mortgage-backed securities litigation experience. Far from prejudicing the substantial rights of other parties, AIG's involvement will help the Court make an *informed* decision in the best interests of the trust and trust beneficiaries.

RELIEF REQUESTED

WHEREFORE, AIG respectfully requests that this Court issue an order permitting AIG to intervene as respondents in the above-captioned proceeding.

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