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-

WALNUT PLACE LLC, et al.,

Intervenor-Respondents.

Index No. 651786/2011

Assigned to: Kapnick, J.

MEMORANDUM OF LAW IN SUPPORT OF ORDER TO SHOW CAUSE WHY THE COURT SHOULD NOT CONVERT THIS SPECIAL PROCEEDING TO A PLENARY ACTION

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For the better part of a century courts consistently have limited the application of Article 77 to a circumscribed set of cases that relate directly to the administration of and accounting for express trusts. Several courts have converted actions that were filed under Article 77 but exceeded its scope into plenary proceedings pursuant to CPLR 103(c). For at least three reasons,, that is precisely what intervenor-respondents and objectors (**the Intervenors**), through the Steering Committee,[1] respectfully request that the Court do in this case.

First, it is undisputed that this Court has the power to convert this case into a plenary action. (*See* Part I.) Second, this case falls under an express exception to Article 77 because the trusts at issue here are trusts created for the benefit of creditors. (*See* Part II.) Third, even if it is not expressly excluded from Article 77, this proceeding far exceeds the scope of Article 77. Indeed there is little, if anything, in this action that falls within the core subjects of Article 77, that is, accounting, administration, and construction of express trusts. To the contrary, the Bank of New York Mellon seeks relief of unprecedented complexity and size for an Article 77 proceeding. (*See* Part III.) For all of these reasons, and because a plenary action is necessary for the Court and certificateholders to develop a full and fair record upon which this Court may decide this action, the Intervenors and Objectors respectfully request that the Court convert this matter into a plenary action.

[1] The Steering Committee submits this motion on behalf of all Intervenors except: the Delaware Department of Justice; the New York State Office of the Attorney General; the Federal Housing Finance Agency; the National Credit Union Administration Board; the Maine State Retirement System; Pension Trust Fund for Operating Engineers; Vermont Pension Investment Committee; the Washington State Plumbing and Pipefitting Pension Trust; Ambac Assurance Corporation; and the Segregated Account of Ambac Assurance Corporation. In addition, the Knights of Columbus and the other clients represented by Talcott Franklin P.C., do not join in or oppose the order to show cause/motion at this time.

PROCEDURAL HISTORY

On June 29, 2011, after negotiating exclusively with 22 out of the hundreds of investors in the 530 trusts, BNYM announced an agreement with Countrywide and Bank of America Corporation to settle all potential claims belonging to the 530 trusts for which BNYM serves as trustee. As a condition precedent to the settlement, BNYM immediately filed this Article 77 proceeding to request judicial approval of the proposed settlement, which would release the claims of all 530 trusts against Countrywide and Bank of America. In exchange for the release of claims on all of the 530 trusts, Countrywide and Bank of America agreed to pay up to $8.5 billion for distribution among the trusts pursuant to a loss-based formula to be calculated by BNYM's expert after the settlement was approved, as well as various loss mitigation provisions and servicing improvements for the loans in the trusts.

After BNYM filed this proceeding, the 22 investors that it negotiated with intervened to support the settlement. Shortly thereafter, many different investors intervened as respondents or objected to the settlement as "objectors." These intervenors argued, among other things, (1) that the settlement was inadequate because Countrywide and Bank of America were liable for more than $100 billion; (2) that the Intervenors had not received enough information to adequately evaluate the settlement; (3) that the Settlement Agreement did not explain how much money each trust or each certificate would receive; and (4) that BNYM was conflicted because it received an expanded indemnification from Bank of America for claims arising from both its duties as trustee and its negotiation of the settlement. In addition to investors, the Attorneys General for the States of New York and Delaware also moved to intervene in the case. The New York Attorney General filed a counterclaim alleging that BNYM committed securities fraud under General Business Law § 352-c(1)(a), (c), committed persistent fraud and illegality in violation of Executive Law § 63(12), breached its fiduciary duties to the trust investors by misleading and failing to inform

investors about Countrywide's breaches of its obligations, and breached its fiduciary duties by negotiating the proposed settlement in the midst of a conflict of interest. Verified Pleading in Intervention at 15-16, *The Bank of New York Mellon, et al. v. The People of the State of New York, by Eric T. Schneiderman, Attorney General of the State of New York,* Index No. 651786/2011 (N.Y. Sup. Aug. 4, 2011).

On August 26, 2011, Walnut Place removed this matter to federal court and on August 30 BNYM moved to remand. The United States District Court for the Southern District of New York denied the motion to remand on October 19. The Southern District stated that it "ha[d] found no authority suggesting that a single Article 77 proceeding may evaluate the actions of 530 trustees with respect to 530 trusts." *Bank of New York Mellon v. Walnut Place LLC*, No. 11 Civ. 5988, 2011 WL 4953907, at *1, *5 n.4 (S.D.N.Y. Oct. 19, 2011), *rev'd on other grounds, BlackRock Financial Management Inc. v. Segregated Account of Ambac Assur. Corp.*, No. 11-5309, 2012 WL 611401, at *2 (2d Cir. Feb. 27, 2012). It remarked that "[i]n sharp contrast to the $8.5 billion Settlement Agreement at issue" in BNYM's Article 77 proceeding," proceedings under Article 77 are typically "uncontested" and present "garden-variety matters of trust administration." *Id.* at *3. On February 27, 2012, the Court of Appeals for the Second Circuit reversed that decision and remanded the case to this Court. In doing so, it noted that whether Article 77 permits a "New York court . . . to grant the relief sought in this case is an issue for the New York courts." *BlackRock Financial Management Inc.*, 2012 WL 611401, at *2. After this matter was remanded, at a March 19 telephone conference, the Court invited Intervenors, by Order to Show Cause, to seek the conversion of the Article 77 proceeding into a plenary action.

ARGUMENT

I. THE COURT HAS THE POWER TO CONVERT THIS PROCEEDING INTO A PLENARY ACTION.

Under New York CPLR § 103(c), "the courts are empowered and indeed directed to convert a civil proceeding not brought in the proper form into one which would be in the proper form, . . . making whatever order is necessary for its proper prosecution." *First National City Bank v. City of New York Finance Administration*, 36 N.Y.2d 87, 94 (N.Y. 1st Dep't 1975); *see also Stoffer v. Department of Public Safety of Town of Huntington*, 907 N.Y.S.2d 38, 47 (N.Y. 2d Dep't 2010) (a court "has the power, pursuant to CPLR 103(c), to convert a proceeding into an action").

II. THE TRUSTS AT ISSUE IN BNYM'S PETITION ARE TRUSTS FOR THE BENEFIT OF CREDITORS, WHICH ARE EXPRESSLY EXCLUDED FROM THE SCOPE OF ARTICLE 77.

A special proceeding may be brought under Article 77 to determine a matter relating to any express trust "except . . . a trust for the benefit of creditors." CPLR § 7701. Here, the certificateholders are the creditors of the trusts: they hold notes that were issued by the trusts, they are the beneficiaries, and therefore the trusts are "trust[s] for the benefit of creditors." On the same day that this brief was filed, the United States District Court for the Southern District of New York, in a class action against BNYM, held that 20 of the very certificates at issue in this action "are debt securities." *Retirement Board of the Policemen's Annuity & Benefit Fund of the City of Chicago v. The Bank of New York Mellon*, No. 11 Civ. 5459, slip op. 12 (S.D.N.Y. April 3, 2012) (attached to this memorandum in the appendix). The court found that the certificates issued by the trust were debt because among other things: (1) they entitle certificateholders to regular payments of principal and interest on fixed dates; (2) payments are not left to the payee's

discretion; (3) the certificates have a fixed maturity date; and (4) the certificateholders have no role to play in managing the trusts. *Id.* at 11-12.

Several other courts routinely have referred to certificates like those at issue in this action as debt securities. *See Greenwich Financial Services Distressed Mortgage Fund 3 LLC v. Countrywide Financial Corp.*, 603 F.3d 23, 29 (2d Cir. 2010) (stating that PSAs are "similar to bond indentures."); *see also LaSalle Bank National Association v. Nomura Asset Capital Corp.*, 424 F.3d 195, 200 (2d Cir. 2005) (referring to Certificates issued by similar trusts under PSAs as "bonds"); *MBIA Insurance Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d 287, 290 (N.Y. 1st Dep't 2011) ("Securitization involves packaging numerous mortgage loans into a trust, issuing debt securities in the trust and selling those notes, known residential mortgage-backed securities, to investors."). Because the certificates are debt securities, the holders of those certificates are, by definition, creditors. And because the 530 Trusts in this proceeding were created for the sole purpose of issuing those certificates, the Trusts must necessarily be "for the benefit of creditors," and therefore excluded from the scope of Article 77.

III. THIS PROCEEDING, AS DEFINED BY BNYM'S PETITION AND PROPOSED ORDER, FAR EXCEEDS THE SCOPE OF ARTICLE 77.

Given the size of the proposed settlement, Countrywide's potential liability, and the enormity of the interest at stake for hundreds if not thousands of beneficiaries, few (if any) cases would be less well-suited for an Article 77 proceeding and the "expedition and efficiency" that BNYM argues Article 77 was intended to provide. (BNYM March 12, 2012 letter, at 1.)

For at least four reasons, this case far exceeds the scope of Article 77. First, Article 77 is designed to govern questions of trust accounting, administration, and construction, but the relief that BNYM seeks is much different and far broader. Second, even if Article 77 were sufficient to determine the rights of a single trust, it has never been used to adjudicate the rights of 530 trusts

in a single proceeding, and this Court should not be the first dramatically to expand the scope of Article 77. Third, BNYM's serious conflicts of interest make the use of an Article 77 special proceeding even less appropriate in this case. Finally, there is no precedent for an Article 77 special proceeding of this nature and magnitude.

A. The Vast Majority Of The Relief That BNYM Is Seeking Is Not A Matter Of Trust Administration.

Article 77 was originally introduced into the CPLR as Article 79.[2] It was established to provide a more tailored procedure for resolving matters concerning trust administration, accounting, and construction, on the theory that such matters did not need the tools of the plenary adversarial litigation process. Article 77 was developed to address issues related to "trust accountings and administrations with incidental construction and enforcement relief," *Gregory v. Wilkes*, 205 N.Y.S.2d 405, 407 (N.Y. Sup. 1960), and to dispense with "details of a plenary action in regard to settlement of accounts and construction of the trust." *In re Bucherer's Trust*, 196 N.Y.S.2d 439, 440 (N.Y. Sup. 1959).[3] BNYM's argument that because it brought this *sui generis*

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[2] The language of Article 77 and former Article 79 are substantively identical. Former Article 79 of the Civil Practice Act provided that "[*a*]*ny matter involving or relating to any express trust* of which the supreme court has jurisdiction may be brought on for hearing and determination before the court . . . [and] [a]ny such proceeding is a special proceeding." *Application of Chase National Bank of City of New York*, 59 N.Y.S.2d 848, 853 (N.Y. Sup. 1946) (emphasis added). Article 77 now provides that "[a] special proceeding may be brought to determine *any matter relating to any express trust* . . ." CPLR § 7701 (emphasis added); *see also In re Spangenberg*, 41 Misc. 2d 584, 585 (N.Y. Sup. 1963) ("[T]he three trustees of an *inter vivos* trust . . . have applied for a settlement of their accounts pursuant to article 79 of the Civil Practice Act now article 77 of the Civil Practice Law and Rules.").

[3] *See also Norwood v. New York Trust Co., et al.*, 92 N.Y.S.2d 185, 186 (N.Y. Sup. 1949) ("[T]he purpose of . . . Article [79] was to authorize the settlement of the trustees' accounts, which in most cases present mere matters of administration, without the necessity of resorting to an action which contemplates adversary litigation."); *In re Fields' Trust*, 193 Misc. 781, 782 (N.Y. Sup. 1948) ("Article 79['s] . . . purpose, as stated in the report of the Judicial Council, was to simplify the procedure in matters of *inter vivos* trusts and make unnecessary in trust accountings resort to an equity action 'involving much cumbersome and expensive *(continued)*

case as an Article 77 proceeding it must be resolved with "expedition and efficiency" simply begs the question whether Article 77 should apply at all.

The vast majority of the relief that BNYM seeks here does not involve—and BNYM's requested relief certainly is not limited to—"trust accountings and administrations with incidental construction and enforcement relief." *Gregory*, 205 N.Y.S.2d at 407. BNYM stated in its letter to this Court of March 12, 2012 (at page 3), that "the only issue before this Court is whether the Trustee's decision to settle was within the bounds of a reasonable exercise of discretion by the Trustee." But this Court should be guided not by the characterizations that BNYM makes in correspondence but instead by the petition and proposed final order that it filed. In its petition and proposed order, BNYM seeks at least eighteen separate findings by this Court:

(1) **The "Jurisdiction" Finding:** "The Court has jurisdiction over the subject matter of this Article 77 proceeding." (Proposed Final Order and Judgment ¶ b.)

(2) **The "Adequate Notice" Finding:** "The form and the method of dissemination of the notice (the "Notice") . . . provided the best notice practicable under the circumstances . . . . The Notice provided due and adequate notice of these proceedings and the matters set forth herein, including the Settlement and the Court's consideration of the actions of the Trustee in entering into the Settlement Agreement . . . ." (*Id.* ¶¶ c-d.)

(3) **The "Trustee's Authority" Finding:** "The Trustee has the authority . . . to enter into the Settlement Agreement . . . . (*Id.* ¶ f.)

(4) **The "Within the Trustee's Discretion" Finding:** ". . . the decision whether to enter into the Settlement Agreement . . . is a matter within the Trustee's discretion." (*Id.* ¶ g.)

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practice.'") (quoting NINTH ANNUAL REPORT OF THE N.Y. JUDICIAL COUNCIL, at 309); NINTH ANNUAL REPORT OF THE N.Y. JUDICIAL COUNCIL, at 309 (explaining that special proceedings are necessary because "trust accountings by action involv[e] much cumbersome and expensive practice" but yet "[s]ettlement of a trustee's account partakes so little of the nature of adversary litigation, for which Supreme Court practice has primarily been formulated.") (quoting *In re Runk*, 200 N.Y. 447, 460-61 (N.Y. 1911)).

(5) **The "Full and Fair Opportunity" Finding:** "A full and fair opportunity has been offered to all Potentially Interested Persons, including the Trust Beneficiaries, to make their views known to the Court, to object to the Settlement and to the approval of the actions of the Trustee in entering into the Settlement Agreement, and to participate in the hearing thereon." (*Id.* ¶ e.)

(6) **The "Factual Investigation" Finding:** "The Settlement Agreement is the result of factual . . . investigation by the Trustee . . . ." (*Id.* ¶ h.)

(7) **The "Legal Investigation" Finding:** "The Settlement Agreement is the result of . . . legal investigation by the Trustee . . . ." (*Id.*)

(8) **The "Focus on Available Alternatives" Finding:** ". . . the Trustee's deliberations appropriately focused on . . . the alternatives available or potentially available to pursue remedies for the benefit of the Trust Beneficiaries . . . ." (*Id.* ¶ j.)

(9) **The "Appropriate Evaluation of the Underlying Claims" Finding:** "The Trustee appropriately evaluated . . . the strengths and weaknesses of the claims being settled." (*Id.* ¶ i.)

". . . the Trustee's deliberations appropriately focused on the strengths and weaknesses of the Trust Released Claims . . . ." (*Id.* ¶ j.)

(10) **The "Appropriate Evaluation of the Settlement" Finding:** "The Trustee appropriately evaluated the terms, benefits, and consequences of the Settlement . . . ." (*Id.* ¶ i.)

". . . the Trustee's deliberations appropriately focused on . . . the terms of the Settlement." (*Id.* ¶ j.)

(11) **The "Arms-Length Negotiations" Finding:** "The arms-length negotiations that led to the Settlement Agreement . . . appropriately focused on the strengths and weaknesses of the Trust Released Claims . . . ." (*Id.*)

(12) **The "Acted in Good Faith" Finding:** "The Trustee acted in good faith . . . in determining that the Settlement Agreement was in the best interests of the Covered Trusts." (*Id.* ¶ k.)

(13) **The "Acted Within its Discretion" Finding:** "The Trustee acted . . . within its discretion . . . in determining that the Settlement Agreement was in the best interests of the Covered Trusts." (*Id.*)

(14) **The "Acted Within the Bounds of Reasonableness" Finding:** "The Trustee acted . . . within the bounds of reasonableness in determining that

the Settlement Agreement was in the best interests of the Covered Trusts." (*Id.*)

(15) **The "Binding on all Parties" Finding:** "[T]he Parties [to the Settlement Agreement] are directed to consummate the Settlement" (*Id.* ¶ m.)

(16) **The "Extinguished Rights" Finding:** BNYM seeks to forever bar and enjoin all certificateholders—which includes the Intervenors—from ever seeking relief: (1) from BAC/CW for their conduct in originating, selling, delivering, servicing, and failing to maintain proper documentation for the mortgage loans held by the Covered Trusts, (*id.* ¶ n.); and (2) from BNYM for "any claims arising from or in connection with the Trustee's entry into the Settlement . . . ." (*Id.* ¶ p.)

(17) **Approval of the Trustee's Decision:** "[T]he Court hereby approves the actions of the Trustee in entering into the Settlement Agreement in all respects." (*Id.* ¶ l.)

(18) **Approval of the Settlement:** "The Settlement Agreement is hereby approved in all respects, and is fully enforceable in all respects." (*Id.* ¶ n.)

The most important aspects of the relief that BNYM is seeking—approval of the substantive fairness of the settlement and the propriety of BNYM's actions in negotiating it—are neither matters of trust administration nor based on or even related to the trust agreements. Similarly, the question whether BNYM acted in good faith and free of conflicts of interest that are prohibited by New York common law is far from an administrative matter and well outside the bound of any trust documents.[4]

[4] Even if BNYM could somehow convince the Court that substantive legal rulings on the fairness of the multi-trust settlement, the propriety of BNYM's conduct in negotiating that settlement, and the alleged conflicts of interest somehow fall within the technical definition of "trust administration," they are certainly not the kind of internal administrative matters that courts have previously addressed in Article 77 proceedings, such as whether a co-trustee has disclaimed his role as trustee, *Sankel v. Spector*, 819 N.Y.S.2d 520, 525 (N.Y. 1st Dep't 2006), whether the situs of the trust may be removed out of state, *In re Hudson's Trust*, 286 N.Y.S.2d 327, 329 (N.Y. 3d Dept 1968), or which portion of the trust principal should be charged for money owed to counsel for the trust, *In re Osborn's Trust*, 238 N.Y.S.2d 152, 154-55 (N.Y. 1st Dep't 1963).

Moreover, while there may be some matters of trust construction at issue, such as those concerning BNYM's authority to enter into settlement agreements on behalf of the trusts, the substantive fairness of the settlement and the propriety of BNYM's conduct in negotiating the settlement have nothing to do with the terms of the trust agreements. Finally, none of these requests for relief, nor any other part of BNYM's Petition, seeks an accounting.

B. Article 77 Does Not Contemplate Adjudicating The Rights Of 530 Separate Trusts In A Single Proceeding.

The existence of 530 trusts makes the present proceeding different in kind, not just in degree, from other Article 77 proceedings for two reasons. First, because each trust exists as a separate legal entity, under a separate trust agreement, BNYM must necessarily reach beyond the terms of the trust agreements to justify settling all 530 trusts in one proceeding, and to develop the method for dividing and distributing the settlement funds among the trusts. Second, the mortgage loans that back the trusts are not homogeneous, and the vague allocation of the settlement amount that BNYM proposes does not account for that fact. Article 77 is inappropriate because the court must consider these differences, which are not part of the trust agreements, in deciding if the settlement allocates the settlement amount fairly.

Under CPLR § 7701, a "special proceeding may be brought to determine a matter relating to *any* express *trust*." (emphasis added). This action does not seek to determine an action relating to a single trust, but rather to 530 different trusts, each operating under a separate trust agreement. BNYM's decision to conflate the interests of 530 separate legal entities into one undifferentiated settlement goes well beyond the scope of "judicial instructions" that this Court has the authority to issue under Article 77.[5] This settlement, if it is permitted at all, is not

[5] While it is true that a few cases under Article 77, and its predecessor Article 79, have adjudicated issues with regard to more than one trust, none of these cases have concerned *(continued)*

therefore a matter of mere trust administration, but rather of inter-trust coordination and positioning.

The conclusion that BNYM is not concerned with mere trust administration is highlighted by the fact that its role in negotiating the settlement agreement was not that of a single trustee, representing 530 trusts, but rather as 530 different entities, each a trustee of a distinct trust. It is undisputed that under New York law, an entity acting as the trustee of a trust, is acting in a separate legal capacity. Courts in New York have held for more than a century that "a judgment against the same person in one capacity is not a judgment against him in another." *In re Webster's Estate*, 151 Misc. 572, 575 (N.Y. Surr. 1934); *see also Collins v. Hydorn*, 135 N.Y. 320, 324 (1892) ("The same person may in law be considered another person, and consequently another party, by suing in another capacity."); *Purvin v. Grey*, 64 N.Y.S.2d 266, 267 (N.Y. Sup. 1946). This rule was recently underscored by the Fourth Department Appellate Division in *Tuper v. Tuper*: "[P]ersons suing or being sued in their official or representative capacity are, in contemplation of law, distinct persons, and strangers to any right or liability as an individual." 34 A.D.3d 1280, 1281 (N.Y. App. Div. 2006) (quoting *Leonard v. Pierce*, 182 N.Y. 431, 432 (1905)). This unbroken line of cases establishes that a trustee suing solely in its capacity as trustee is a unique legal entity. Judge Pauley adopted this reasoning and held in his decision on BNYM's motion to remand that "BNYM is trustee for 530 separate and unique trusts and seeks approval for its decision to settle the claims of each individual trust. Under New York law, trustees are separate legal entities with respect to each trust that they administer." *Bank of New York Mellon v. Walnut Place LLC*, 2011 WL 4953907, at *5.

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anywhere near the number or complexity of the trusts here. Moreover, those cases involved straightforward matters of trust accounting or administration for each trust, arising from the separate duties and powers provided by each trust agreement.

Indeed, if the Court were to approve the settlement, the existence in this proceeding of multiple trusts, multiple trustees (BNYM acting in a separate capacity as trustee for each trust), and multiple groups of beneficiaries, would transform Article 77 from a proceeding designed to resolve issues related to a single trust into a vehicle for distributing the settlement proceeds among the 530 trusts and their hundreds, if not thousands of beneficiaries, without any single trust agreement to govern that distribution. That is necessarily outside of the scope of Article 77.

The settlement agreement is deliberately vague about how the settlement amount will be distributed to the 530 trusts. Under the settlement agreement, which stands separate from and above the individual trusts and trust agreements, the money is to be distributed among the trusts according to an undisclosed loss-based formula calculated by an expert retained by BNYM. (Settlement Agreement, at § 3(c)). The difficulties that this vague formula poses for fairly distributing the funds are worsened by the fact that the loans in the trusts are not identical. Article 77 was not designed and has never before been used to resolve such inter-trust issues that are inherently external to any single trust agreement, and therefore are not merely matters of a trust's accounting or administration. *See In re Reilly*, 17 Misc. 2d 1077, 1079 (N.Y. Sup. 1956) ("[A]rticle 79 [was] promulgated for expeditious accounting and determination of issues strictly of construction. Matters of mental capacity, finances and motive are not the proper concern of a proceeding instituted under that article.").

C. BNYM's Conflicts of Interest Render Article 77 An Inappropriate Vehicle For Resolution of This Action.

There are at least three tangible conflicts of interest that the proposed settlement has raised. First, BNYM's evaluation of the fairness of the proposed settlement is inherently conflicted, because it is obviously in BNYM's own interest to "settle" the claims of all 530 trusts at the same time on substantially identical terms. Otherwise, BNYM could be liable to

certificateholders that believe they were treated less favorably than others. But not all of the trusts are identically situated. For example, Walnut Place conducted an investigation into three trusts that revealed the certificateholders in those trusts had distinct potential recoveries from other certificateholders of the 530 trusts at issue. Presumably these types of distinctions would manifest themselves in other trusts as well. BNYM should have insisted that the proposed settlement take into account any material differences between the trusts and the certificateholders in those trusts.

Second, under the Pooling and Servicing Agreements, BNYM is indemnified by the Master Servicer of each trust, Countrywide Home Loans Servicing, LP (now BAC Home Loans Servicing, Inc.), for costs and liabilities that arise out of certain duties that BNYM is to perform for the trusts. As part of the proposed settlement, BNYM negotiated for itself an indemnity from Countrywide that goes well beyond the scope of the indemnity that BNYM is otherwise entitled to under the PSAs. In particular, Countrywide agreed to indemnify BNYM for all costs and liabilities that BNYM may incur as a result of its participation in the negotiation of the proposed settlement. This expanded indemnity is embodied in a "side letter" to the Settlement Agreement. It is very unusual, to say the least, for a trustee that says it is representing the interests of the beneficiaries of a trust, to demand and obtain an indemnity from the very party that is adverse to that trust and its beneficiaries (in this case, the certificateholders). BNYM concedes in its petition that it was concerned about its liability for the way in which it was handling (or, more accurately, ignoring) the demands of its beneficiaries that it take legal action for their benefit against Countrywide and Bank of America. For example, BNYM referred to "reports that a group of Certificateholders has considered taking action against BNY Mellon for its participation in the Settlement process." (BNYM Petition ¶ 13.) BNYM also states that "the Trustee also may be

subject to claims by individual Certificateholders who believe that the Settlement, though benefiting thousands of Trust Beneficiaries now and in the future, may not be in their individual best interests." (BNYM Petition ¶ 15.) The proposed settlement protects BNYM from these liabilities by means of an indemnity from the party from which it was supposed to protect the interests of its beneficiaries. BNYM now anticipates that it may be liable for its failure to do so.

Finally, under the PSAs, BNYM is indemnified solely by Countrywide Home Loans Servicing, yet the parent of the successor of that entity, Bank of America Corporation, guaranteed that indemnity to BNYM. The guarantee does nothing for the trusts or the certificateholders, but it provides a great benefit to BNYM. Indeed, BNYM states expressly in its petition that it doubts the solvency of Countrywide, so much so that it argues that Countrywide's supposed inability to pay a large judgment is a reason to accept the proposed settlement. (Id. ¶¶ 78-81.) Thus, the guarantee from Bank of America puts BNYM in a substantially better position than it was in before negotiating the proposed settlement, at the direct expense of the certificateholders whose interests BNYM purports to protect.

It strains plausibility to argue that BNYM's undertaking, which potentially conflicts with its duties under the individual trust agreements and New York law, and certainly does not derive its authority from the individual trust agreements, is somehow a matter of mere trust administration. *In re Roberts v. Galbraeth*, 18 Misc. 2d 599, 601-02 (N.Y. Sup. 1959) ("Article 79 was intended to deal with matters that *directly* involve administration of a trust.") (emphasis added); *id*. at 601 ("in light of [the] history" as set forth the Ninth Annual Report of the N.Y. Judicial Council, "the courts have consistently declined to permit article 79 to be used for matters beyond those indicated by the [ ] report"). None of these conflicts is merely a matter of trust

administration, and therefore this case is inappropriate for resolution by an Article 77 proceeding.

D. There Is No Precedent For An Article 77 Special Proceeding Of This Nature And Magnitude.

Throughout this proceeding, including in its most recent letter briefs to the Court, BNYM has not been able to find a single case in New York that used Article 77 to decide a case of the size and complexity that is before the Court here.

BNYM relies on a single sentence that it lifts out of context from *Greene v. Greene*, 88 A.D.2d 547, 548 (1st Dep't 1982), to support its argument that Article 77 is "broadly construed to cover any matter of interest to trustees, beneficiaries or adverse claimants concerning the trust." That sentence does not change the numerous decisions of New York courts holding that many issues that indirectly touch upon trusts nevertheless do not "relate to any express trust" under Articles 77 or 79. *See Gregory*, 205 N.Y.S.2d at 407; *In re Roberts v. Galbreath*, 18 Misc. 2d at 600-602 (choice of counsel for a pension committee in charge of a trustee's disbursement of pension funds from a trust was not matter for Article 79 proceeding); *In re Reilly*, 21 Misc. 2d 597, 598 (N.Y. Sup. 1959) (revocation or partial modification of a trust on the basis of a settlement agreement resolving cross claims brought against the trustee was not a matter for Article 79 proceeding); *In re Reilly*, 17 Misc. 2d at 1079 (issue of trust settlor's mental capacity as it relates to the validity of the trust agreement was not a matter for an Article 79 proceeding).

BNYM also relies heavily on *IBJ Schroder Bank & Trust Company*, Index No. 101530/1998, 6 (N.Y. Sup. Aug. 16, 2000) (attached to this memorandum in the appendix), in which a trustee sought and received court approval of a settlement of claims against a third party on behalf of 186 trust beneficiaries. But neither the trial court nor the appellate division opinion in *Schroder* directly considered the question whether Article 77 may properly be used to approve

a settlement of the claims of a trust against a third party. *See Wellbilt Equipment Corp. v. Fireman*, 719 N.Y.S.2d 213, 217 (N.Y. 1st Dep't 2000) ("[A] case is precedent only as to those questions presented, considered and squarely decided.") (internal quotation omitted). That question, which is now squarely before this Court, is a matter of first impression.

Moreover, *Schroder* did not involve 530 trusts with the unprecedented complexity of claims and the unprecedented size of damages that are at issue here. Nor did it concern a request to order approval of an inter-trust settlement and the distributions of proceeds from that settlement, neither of which is connected to the provisions of any individual trust agreement. There were also no allegations in the *Schroder* case that the trustee had engaged in serious conflicts while negotiating the settlement, thus necessitating extensive adversarial proceedings that go beyond the scope intended by the drafters of Article 79. Finally, *Schroder* did not concern the expanded indemnification of the trustee for claims which themselves would have been outside the scope of Article 77.[6] *See In re Houston's Trust,* 294 N.Y.S.2d 225, 227 (N.Y. 3d Dep't 1968) (claims of fraud and conversion against trustee were not properly joined with special proceeding brought by trustee for accounting); *Gregory*, 26 Misc. 2d at 642 (allegations of trustee's fraud and undue influence was not the proper subject of Article 79 proceeding); *In re Reilly*, 21 Misc. 2d at 598 ("Cross claims or counterclaims are not authorized in the special proceeding under article 79."). Despite BNYM's assertions to the contrary, New York courts have simply never used Article 77 to resolve issues of this magnitude and complexity, involving the extensive and multiple forms of relief sought here. Indeed, in its decision on BNYM's motion

[6] Notably, the *Schroder* court acknowledged that "the objecting beneficiaries have not submitted any evidence to show that the trustee's action may have been based on some ulterior motive or that the trustee is somehow itself interested in the transaction other than in its fiduciary capacity." *IBJ Schroder Bank & Trust Company*, Index No. 101530/1998, at 5 (N.Y. Sup. Aug. 16, 2000).

to remand, the Southern District noted that it "ha[d] found no authority suggesting that a single Article 77 proceeding may evaluate the actions of 530 trustees with respect to 530 trusts," and suggested that "[c]ertification of this question to the New York Court of Appeals may be warranted." *Bank of New York Mellon v. Walnut Place LLC*, 2011 WL 4953907, at *5 n.4. If the Court were to maintain BNYM's action as an Article 77 proceeding, it would not only represent an extraordinary and unprecedented expansion of such proceedings, it would turn on its head Article 77's intended purpose of providing a simple and efficient means of resolving straightforward issues of trust accounting administration.

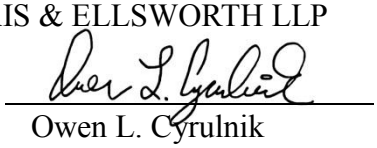
CONCLUSION

For all of the reasons argued above, the Court should convert this action from an Article 77 proceeding into a plenary action.

Dated: New York, New York
April 3, 2012

Respectfully submitted,

GRAIS & ELLSWORTH LLP

By: 
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Appendix

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

RETIREMENT BOARD OF THE POLICEMEN'S ANNUITY AND BENEFIT FUND OF THE CITY OF CHICAGO, *et al.*,

Plaintiffs,

-against-

THE BANK OF NEW YORK MELLON,

Defendant.

11 Civ. 5459 (WHP)

MEMORANDUM & ORDER

WILLIAM H. PAULEY III, District Judge:

Plaintiffs—suing individually, on behalf of a putative class, and derivatively—own mortgage-backed securities issued by trusts for which Defendant, The Bank of New York Mellon ("BNYM"), serves as trustee. They allege that BNYM violated several provisions of the Trust Indenture Act of 1939, 15 U.S.C. § 77aaa, et seq. (the "TIA"), and breached its contractual and fiduciary duties. BNYM moves to dismiss the Class Action and Derivative Complaint in its entirety. For the following reasons, BNYM's motion to dismiss is granted in part and denied in part.

BACKGROUND

This case is another installment in litigation over BNYM's obligations as trustee for hundreds of securitization trusts. The structure of the underlying residential mortgage securitization transactions is familiar: "To raise funds for new mortgages, a mortgage lender

sells pools of mortgages into trusts created to receive the stream of interest and principal payments from the mortgage borrowers. The right to receive trust income is parceled into certificates and sold to investors, called certificateholders." BlackRock Fin. Mgmt. Inc. v. Segregated Account of Ambac Assurance Corp., ---F.3d----, 2012 WL 611401, at *1 (2d Cir. 2012). Here, the mortgage lenders are Countrywide Home Loans, Inc. and various affiliates ("Countrywide"). (Class Action and Derivative Complaint, dated Aug. 31, 2011 ("Compl." or the "Complaint") ¶ 35.) Bank of America Corporation ("Bank of America") now owns Countrywide. (Compl. ¶ 15.)

Plaintiffs hold securities issued by twenty-five New York trusts and one Delaware trust. (Compl. Ex. B.) BNYM is trustee for the New York trusts, and Countrywide (now Bank of America) is the "master servicer." (Compl. ¶¶ 1, 15, 96 n.2.) As in BlackRock, 2012 WL 611401, at *1, the terms of the New York trusts as well as the rights, duties, and obligations of the trustee and the master servicer are set forth in Pooling and Servicing Agreements ("PSAs"). (Compl. ¶ 2; Compl. Ex. C: Pooling and Servicing Agreement dated Sept. 1, 2006 ("PSA").)[1] The PSAs also govern the trustee's distribution of money to certificateholders. (Compl. ¶¶ 1, 2.) The Delaware trust operates similarly, with a few key differences. The Delaware trust issued notes, subject to an indenture, for which BNYM serves as indenture trustee. (Declaration of Matthew D. Ingber, dated Dec. 16, 2011 ("Ingber Decl.") Ex A: Indenture, dated Mar. 30, 2006 ("Indenture") § 3.04, Annex 1 (Glossary).) Concurrently, the Delaware trust entered into a Sale and Servicing Agreement ("SSA") governing the sale of the underlying mortgage loans and the

[1] The parties do not dispute that the PSA attached as Exhibit C to the Complaint is representative of the PSAs governing all of the New York trusts at issue. See BlackRock, 2012 WL 611401, at *1 n.2 ("[T]he agreements are sufficiently similar for the Court to rely on a representative PSA[.]").

master servicer's responsibilities. (Ingber Decl. Ex. B: Sale and Servicing Agreement, dated Mar. 30, 2006 ("SSA").)[2]

The PSAs, Indenture, and SSA governing the trusts contain representations and warranties concerning the quality of the underlying mortgages, the duties of BNYM as trustee, and the structure of the securities issued by the trusts. (Compl. ¶¶ 33-48; Ingber Decl. Exs. A, B.) Plaintiffs allege that BNYM's duties include perfecting the assignment of the mortgages to the trusts, reviewing each of the loan files for the mortgages, certifying that the documentation for each of the mortgages is accurate and complete, creating a Document Exception Report listing any incomplete loan files, and ensuring that the master servicer cures, substitutes, or repurchases all mortgages listed on that Report. (Compl. ¶¶ 35-47.)

Plaintiffs claim that Countrywide breached its obligations as master servicer by failing "to provide mortgage loan files in their possession, to cure defects in the mortgage loan files and/or to substitute the defective loans with conforming loans." (Compl. ¶ 87.) They further allege that BNYM did nothing to remedy the inadequate servicing of the mortgages undergirding the trusts. Specifically, they contend that BNYM failed to take possession of the loan files, review the loan files adequately, and require Countrywide and Bank of America to cure, substitute, or repurchase the defective loans. To support these allegations, Plaintiffs cite the bankruptcy court testimony of a Countrywide employee, who stated that it was Countrywide's standard business practice to retain the original mortgage notes and other documentation, rather than delivering them to BNYM as trustee. (Compl. ¶¶ 55-58.) Plaintiffs also cite a 2011 Joint Report by the Federal Reserve and other agencies flagging "concerns about the prevalence of

[2] The parties do not dispute that the Indenture and SSA attached to the Declaration of Matthew D. Ingber govern the Delaware trust in which Plaintiffs allege holdings.

irregularities in the documentation of ownership [that] may cause uncertainties for investors of securitized mortgages." (Compl. ¶ 60.) Similarly, the New York Attorney General alleged that BNYM failed to ensure the complete transfer of mortgages and loan files from Countrywide to the trusts. (Compl. ¶ 61.)

The gravamen of the Complaint is that a prudent trustee would have remedied these failures by requiring the master servicer to cure or repurchase the defective loans in the trusts, and would have compelled the master servicer to comply with its servicing duties. Yet BNYM allegedly took no action to protect investors.[3] Rather, on June 28, 2011, BNYM entered into an agreement with Countrywide and Bank of America to settle all potential claims belonging to the trusts for which it is trustee for $8.5 billion. See BlackRock, 2012 WL 611401, at *2. Plaintiffs contend that—regardless of the settlement's fairness—BNYM caused them significant losses. They allege that the value of their mortgage-backed securities plummeted as a consequence of the underwriting defects and inadequate servicing of the underlying mortgages. (Compl. ¶¶ 74-76.)

DISCUSSION

I. Legal Standard

To survive a motion to dismiss, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" Ashcroft v. Iqbal, 556 U.S. 662, 129 S. Ct 1937, 1949 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S.

[3] In Walnut Place LLC v. Countrywide Home Loans, Inc., Justice Barbara R. Kapnick concluded that BNYM "did, in fact, act upon plaintiffs' complaints, as demonstrated by the settlement agreement reached with the defendants[.]" Index No. 650497/11, at *15 (N.Y. Sup. Ct. Mar. 28, 2012). At this preliminary stage, this Court expresses no opinion regarding BNYM's diligence.

544, 570 (2007)). To determine plausibility, courts follow a "two pronged approach." Iqbal, 129 S. Ct. at 1950. "First, although a court must accept as true all of the allegations contained in a complaint, that tenet is inapplicable to legal conclusions, and threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." Harris v. Mills, 572 F.3d 66, 72 (2d Cir. 2009) (internal punctuation omitted). Second, a court determines "whether the 'well-pleaded factual allegations,' assumed to be true, 'plausibly give rise to an entitlement to relief.'" Hayden v. Paterson, 594 F.3d 150, 161 (2d Cir. 2010) (quoting Iqbal, 129 S. Ct. at 1950). On a motion to dismiss, courts may consider "facts stated on the face of the complaint, in the documents appended to the complaint or incorporated in the complaint by reference, and . . . matters of which judicial notice may be taken." Allen v. WestPoint–Pepperell, Inc., 945 F.2d 40, 44 (2d Cir. 1991).

II. Standing

A. Trusts in which No Named Plaintiff Invested

Plaintiffs allege current or former ownership of certificates relating to only twenty-six of the trusts referenced in the Complaint. (Compl. ¶ 1; Compl. Ex. B (listing holdings).) BNYM argues that Plaintiffs lack standing to bring claims based on the trusts in which no named plaintiff invested. Although this Court afforded Plaintiffs an opportunity to amend the Complaint to add additional certificateholders, they declined to do so. (Hr'g Tr. dated Feb. 10, 2012 at 39-40.)

Standing under Article III of the Constitution is "the threshold question in every federal case, determining the power of the court to entertain suit." Denney v. Deutsche Bank AG, 443 F.3d 253, 263 (2d Cir. 2006) (quoting Warth v. Seldin, 422 U.S. 490, 498 (1975))

(internal quotation marks omitted). To establish standing, "a plaintiff must have suffered an 'injury in fact' that is 'distinct and palpable'; the injury must be fairly traceable to the challenged action; and the injury must be likely redressable by a favorable decision." Denney, 443 F.3d at 263 (quoting Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-61 (1992)).

In accord with these principles, Plaintiffs may not pursue claims relating to securities in which they never invested. In re Smith Barney Transfer Agent Litig., 765 F. Supp. 2d 391, 400 (S.D.N.Y. 2011); see also In re Salomon Smith Barney Mut. Fund Fees Litig., 441 F. Supp. 2d 579, 607 (S.D.N.Y.2006) ("With regard to the sixty-eight funds of which Plaintiffs own no shares, Plaintiffs do not have standing to assert any claims because Plaintiffs cannot satisfy the standing requirements."). Accordingly, Plaintiffs lack standing to assert claims regarding the trusts referenced in the Complaint in which they never invested, and those claims are dismissed with prejudice. Plaintiffs may pursue claims relating only to the twenty-six trusts in which they allege current or former holdings.

B. "Fully Wrapped" Delaware Trust

Plaintiffs hold notes issued by a single Delaware trust. (Compl. Ex. B.) BNYM challenges Plaintiffs' standing to sue regarding this trust because the trust is fully guaranteed—or "wrapped" —by a monoline insurer, and Plaintiffs do not allege that the insurer failed to perform. (Indenture § 8.03.)

Monoline insurers provide "a guarantee to protect against credit risk, i.e. the risk of default." In re Ambac Fin. Grp., Inc. Sec. Litig., 693 F. Supp. 2d 241, 248 (S.D.N.Y. 2010). For "fully wrapped" trusts, then, "the risk of a litigation outcome that impairs the loans in a securitization rests solely with the insurer, not with the security holders." David Reiss, Subprime

Standardization, 33 Fla. St. U. L. Rev. 985, 1030 n.288 (2006). BNYM contends that this economic reality undermines Plaintiffs' standing because where a "plaintiff suffered no injury, it does not have standing to pursue its TIA claim." Bluebird Partners, L.P. v. First Fid. Bank, 896 F. Supp. 152, 157 (S.D.N.Y. 1995). As the monoline guarantee is evident on the face of the Indenture, and the Indenture is integral to the Complaint, BNYM argues that this Court may consider the guarantee on a motion to dismiss. See United Magazine Co. v. Murdoch Magazines Distrib., Inc., 146 F. Supp. 2d 385, 408 (S.D.N.Y. 2001) ("Although this is a motion under Rule 12(b)(6), the Court may consider the Purchase Agreement because several of plaintiffs[']claims, including this one, are founded upon that contract.").

Ultimately, the presence of the monoline guarantee may preclude Plaintiffs from proving any damages resulting from their ownership of notes issued by the Delaware trust. Nevertheless, Plaintiffs contend that BNYM's alleged conduct caused the value of their notes to drop, and they claim to have sold notes issued by the Delaware trust at a significant loss. (Compl. ¶ 64; Compl. Ex. B.) As such, Plaintiffs have alleged damages beyond those covered by the guarantee. And whether the monoline insurer performed its obligations is a question of fact better resolved on a more fully developed record. See Fair Hous. In Huntington Comm. Inc. v. Town of Huntington, N.Y., 316 F.3d 357, 361 (2d Cir. 2003) ("To the degree that defendants challenge the factual underpinnings of the allegations made by plaintiffs in support of their standing to bring suit, the argument is premature."). Thus, Plaintiffs' damages allegations are sufficient to confer standing, and BNYM's motion to dismiss is denied in this respect.

III. Trust Indenture Act Claims

A. Applicability of the Trust Indenture Act

The parties agree that the TIA applies to the mortgage-backed notes issued by the Delaware trust, but they dispute whether the TIA applies to the certificates issued by the twenty-five New York trusts. The TIA covers only debt securities, and does not apply to equity securities. See 15 U.S.C. § 77ddd ("The provisions of this title shall not apply to . . . any security other than . . . a note, bond, debenture, or evidence or indebtedness[.]"). BNYM argues that certificates issued by the New York trusts are equity securities, not debt.

While it cites no case law for the proposition that some mortgage-backed securities are exempt from the TIA, BNYM marshals several treatises in support of its position. BNYM also argues that the structure of the New York certificates closely resembles equity. For example, the Delaware Indenture provides that "[a]ll Notes . . . shall be valid obligations of the Issuer, evidencing the same debt[.]" (Indenture § 2.03(d).) In contrast, the PSAs governing the New York trusts clarify that certificates "represent[] a beneficial ownership interest in the Trust Fund created by the Agreement." (PSA, Ex. E.) Similarly, whereas the Delaware Indenture defines the issuer's failure to pay interest or principal to noteholders as an "event of default," the New York PSAs do not. (Compare Indenture §§ 5.01(i)-(ii), with PSA §§ 7.01(i)-(ii).) BNYM asserts that these differences are dispositive because, by definition, a certificate that evidences ownership must be equity, not debt. See Black's Law Dictionary 541 (6th ed. 1990) (defining "equity security" as "[a] security that represents an equity ownership interest in a corporation, rather than debt"). BNYM also contends that the PSAs' lack of language regarding payment default or acceleration proves that the New York certificates are equity. Cf. Gilbert v. Comm'r,

248 F.2d 399, 402 (2d Cir. 1957) ("The classic debt is an unqualified obligation to pay a sum certain at a reasonably close maturity date along with a fixed percentage in interest payable regardless of the debtor's income or lack thereof.").

Finally, BNYM relies on interpretative guidance published on the Securities and Exchange Commission's website. According to the SEC website, "[c]ertificates representing a beneficial ownership interest in a trust . . . . are treated as exempt from the Trust Indenture Act under Section 304(a)(2) thereof." Trust Indenture Act of 1939, Questions and Answers of General Applicability, http://www.sec.gov/divisions/corpfin/guidance/tiainterp.htm (last visited Apr. 3, 2012). BNYM contends that this Court should give "some deference" to the SEC's determination. United States v. Mead Corp., 533 U.S. 218, 234 (2001) ("[A]n agency's interpretation may merit some deference whatever its form[.]").

Yet, despite BNYM's arguments, many courts suggest that certificates similar to those issued by the New York trusts are debt, not equity. To begin with, "as many courts have observed, pass-through certificates are structurally similar in form and function to bonds issued under an indenture." Ellington Credit Fund, Ltd. v. Select Portfolio Servicing, Inc., ---F. Supp. 2d----, 2011 WL 6034310, at *7 (S.D.N.Y. 2011). The Second Circuit has explained that "[i]t is these stakes—the 'bonds' or 'certificates'—that are ordinarily referred to as commercial mortgage-backed securities." LaSalle Bank Nat'l Ass'n v. Nomura Asset Capital Corp., 424 F.3d 195, 200 (2d Cir. 2005); see also CWCapital Asset Mgmt., LLC v. Chi. Props., LLC, 610 F.3d 497, 499 (7th Cir. 2010) (Posner, J.) (describing mortgage-backed securities governed by PSAs as "giant bond[s]"). Indeed, the Second Circuit has characterized PSAs governing securitization trusts as "similar to bond indentures in many respects." Greenwich Fin. Servs.

Distressed Mortg. Fund 3 LLC v. Countrywide Fin. Corp., 603 F.3d 23, 29 (2d Cir. 2010). Unsurprisingly, several courts in this district have equated mortgage-backed securities governed by PSAs with debt securities. See Ellington, 2011 WL 6034310, at *7 (holding that a New York statute applying to "bonds" covers pass-through certificates governed by a PSA); see also Trust for Certificate Holders of Merrill Lynch Mortg. Passthrough Certificates Series 1999-C1 v. Love Funding Corp., No. 04 Civ. 9890 (SAS), 2005 WL 2582177, at *1 (S.D.N.Y. Oct. 11, 2005) ("These certificates are essentially bonds secured by a pool of commercial mortgages that the Trust has purchased from lenders.").

These decisions reflect the fact that "[t]he shareholder is an adventurer in the corporate business; he takes the risk, and profits from success. The creditor, in compensation for not sharing the profits, is to be paid independently of the risk of success, and gets a right to dip into the capital when the payment date arrives." Comm'r v. O.P.P. Holding Corp., 76 F.2d 11, 12 (2d Cir. 1935). It is well established that, in evaluating whether a security is debt or equity for tax purposes, "the test cannot be merely the name given to the security." Jewel Tea Co. v. United States, 90 F.2d 451, 452-32 (2d Cir. 1937) (L. Hand, J.). Rather, under the tax laws, courts delineate "the vital difference between the shareholder and the creditor," O.P.P., 76 F.2d at 12, by evaluating, inter alia, the factors set forth in IRS Notice 94-47, 1994-19 I.R.B. 9 (Apr. 18, 1994):

> (a) whether there is an unconditional promise on the part of the issuer to pay a sum certain on demand or at a fixed maturity date that is in the reasonably foreseeable future; (b) whether holders of the instruments possess the right to enforce the payment of principal and interest; (c) whether the rights of the holders of the instruments are subordinate to rights of general creditors; (d) whether the instruments give the holders the right to participate in the management of the issuer; (e) whether the issuer is thinly capitalized; (f) whether there is identity between holders of the

> instruments and stockholders of the issuer; (g) the label placed upon the instruments by the parties; and (h) whether the instruments are intended to be treated as debt or equity for non-tax purposes, including regulatory, rating agency, or financial accounting purposes.
>
> TIFD III-E, Inc. v. United States, 459 F.3d 220, 235 n.13 (2d Cir. 2006).

Consistent with the case law and the IRS factors, the New York certificates resemble debt. Unlike equity securities, the certificates entitle their holders to regular payments of principal and interest on fixed "Distribution Date[s]." (PSA Preliminary Statement, PSA §§ 1.01, 3.08.) While BNYM observes that corporations typically pay dividends to stockholders on a regular basis as well, the payment of dividends is typically "left to the discretion of the board." eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 12 (Del. Ch. 2010). Here, by contrast, the PSAs grant certificateholders a contractual right to receive distributions. Moreover, the New York certificates have a fixed maturity date, further evidencing their status as debt rather than equity. See TIFD III-E, 459 F.3d at 235 n.13. And the certificateholders have no role in managing the trusts. Thus, the New York certificates are debt securities, not equity.

The statements on the SEC website do not compel a different conclusion. These statements do not warrant controlling deference because "interpretations contained in policy statements, agency manuals, and enforcement guidelines . . . [are] beyond the Chevron pale." Mead, 533 U.S. at 234 (quoting Christensen v. Harris County, 529 U.S. 576, 587 (2000)) (internal quotation marks omitted). Rather, courts afford such informal agency opinions "respect proportional to [their] 'power to persuade[.]'" Mead, 533 U.S. at 235 (quoting Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944)). More specifically, courts grant Skidmore deference to an agency's interpretation based on "its writer's thoroughness, logic, and expertness, its fit with prior interpretations, and any other sources of weight." Mead, 533 U.S. at 235.

Here, the conclusory statements on the SEC website are unsupported, contrary to the case law, and unpersuasive. Therefore, they do not merit Skidmore deference. See Walker v. Eggleston, No. 04 Civ. 0369 (WHP), 2006 WL 2482619, at *5 (S.D.N.Y. Aug. 29, 2006) (declining to grant Skidmore deference where agency "offered nothing more than its ipse dixit"). According to the website, "[c]ertificates representing a beneficial ownership interest in a trust . . . are treated as exempt from the Trust Indenture Act under Section 304(a)(2) thereof." Section 304(a)(2) of the TIA exempts "any certificate of interest or participation in two or more securities having substantially different rights and privileges, or a temporary certificate for any such certificate[.]" 15 U.S.C. § 77ddd(a)(2). Unfortunately, the SEC supplies no analysis supporting its conclusion that § 304(a)(2) covers mortgage-backed securities such as the New York certificates. And the structure of the New York certificates suggests that this section does not apply. They do not evidence "participation" in the underlying mortgage loans because the certificateholders' rights are not wholly contingent on the performance of those loans. If, for example, the mortgage loans generate "Excess Proceeds," the master servicer—and not the certificateholders—receives those funds. (PSA § 3.14.) And the master servicer—not the certificateholders—is entitled to all profits generated from investing the funds contained in the Distribution and Certificate Accounts, but must repay any losses. (PSA § 3.05(e).) Because the New York certificates are debt securities, the TIA applies.

B. Trust Indenture Act Section 315(a)

Apart from arguing that the New York certificates are exempt from the TIA, BNYM contends that various provisions of the TIA are inapplicable.

1. Breach of the PSAs, Indenture, and SSA

BNYM challenges Plaintiffs' reliance on § 315(a) of the TIA, which provides in relevant part that an indenture "shall be deemed to provide" that "the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in such indenture." 15 U.S.C. § 77ooo(a)(1). Relying on this language, Plaintiffs contend that BNYM violated the TIA whenever it failed to perform its duties under the PSAs, Indenture, or SSA. BNYM responds that § 315(a) merely limits a trustee's duties to those performed in the indenture, and does not impose any actionable federal duties on trustees.

By its plain language, § 315(a) requires that indentures contain language limiting a trustee's duties to those set forth in the indenture. It does not suggest that every violation of an indenture is a per se violation of the TIA. In 1990, Congress amended the TIA to make such limiting language mandatory in all indentures. See Semi-Tech Litig., LLC v. Bankers Trust Co., 353 F. Supp. 2d 460, 474 n.69 (S.D.N.Y. 2005), aff'd sub nom., In re Bankers Trust Co., 450 F.3d 121 (2d Cir. 2006) (per curiam). Thus, "prior to default . . . a trustee's duties are limited to what is set forth in the indenture and the statute." Semi-Tech, 353 F. Supp. 2d at 471. But the 1990 TIA amendments did not change the fact that § 315(a) limits a trustee's responsibilities to those enumerated in the indenture, rather than imposing additional federal obligations. See 15 U.S.C. § 77ooo(a)(1). Accordingly, Plaintiffs' § 315(a) claims based on this theory are dismissed with prejudice.

2. Duty to "Examine the Evidence"

Plaintiffs also contend that BNYM violated § 315(a) of the TIA by failing to examine the evidence provided by the master servicer certifying compliance with the PSAs and SSA. (Compl. ¶ 86.) They rely on the final clause of § 315(a), which imposes a pre-default duty on a trustee to "examine the evidence furnished to it pursuant to section 77nnn of this title to determine whether or not such evidence conforms to the requirements of the indenture." 15 U.S.C. § 77ooo(a).

Importantly, § 315(a) does not require a trustee to examine all evidence it might receive. Rather, the trustee's duty is limited to examining evidence furnished under § 77nnn, which requires "[e]ach person who . . . is or is to be an obligor" to provide certain information to the trustee. 15 U.S.C. § 77nnn(a). The TIA defines an "obligor," when the term is "used with respect to any indenture security," as "every person (including a guarantor) who is liable thereon, and, if such security is a certificate of interest or participation, such term means also every person (including a guarantor) who is liable upon the security or securities in which such certificate evidence an interest or participation[.]" 15 U.S.C. § 77ccc(12). Taking these provisions together, § 315(a) requires trustees to examine evidence provided by "obligors," but not evidence supplied by others.

BNYM contends that the "examine the evidence" provision does not apply here because Countrywide and its successor Bank of America are not "obligors," and because its duty to examine evidence extends only to form, not substance. Plaintiffs offer no rejoinder to this argument. Accordingly, Plaintiffs are deemed to have abandoned this claim, and it is dismissed with prejudice. See Lipton v. Cnty. of Orange, N.Y., 315 F. Supp. 2d 434, 446 (S.D.N.Y. 2004)

("This Court may, and generally will, deem a claim abandoned when a plaintiff fails to respond to a defendant's arguments that the claim should be dismissed.").

C. Trust Indenture Act §§ 315(b)-(c)

Section 315(b) of the TIA requires trustees to provide security holders with notice of defaults. See 15 U.S.C. § 77ooo(b). Section 315(c) imposes heightened duties on trustees following an "event of default." See Semi-Tech, 353 F. Supp. 2d at 478-80 (citing 15 U.S.C. § 77ooo(c)). The term "default" as used in TIA derives its meaning from the indenture. See 15 U.S.C. § 77ooo(c). Plaintiffs allege that BNYM violated these requirements by failing to give notice of Countrywide's and Bank of America's repeated breaches of their duties as master servicer, and by failing to act prudently after these alleged defaults.

BNYM does not dispute that the TIA imposes a duty to provide notice of defaults, nor does it disagree that "after default (as such term is defined in the indenture) a trustee is held to a prudent person standard." Semi-Tech, 353 F. Supp. 2d at 471-72 (quoting 15 U.S.C. §77ooo(c)) (internal punctuation omitted). Rather, BNYM counters that the Indenture governing the Delaware trust limits "defaults" to breaches by the issuer, and Plaintiffs only allege breaches by the master servicer. BNYM further argues that the TIA's focus on "indenture[s]" dictates that the Delaware Indenture, and not the SSA, must provide the controlling definition of "default."

1. Events of Default Under the PSAs

The PSAs governing the New York trusts define an "event of default" to include "any failure by the Master Servicer to deposit in the Certificate Account or remit to the Trustee any payment required to be made under the terms of this Agreement[.]" (PSA § 7.01(i).) The PSAs' definition of "event of default" also encompasses "any failure by the Master Servicer to

observe or perform in any material respect any other of the covenants or agreements on the part of the Master Servicer contained in this Agreement[.]" (PSA § 7.01(ii).)

As these provisions make clear, a "default" occurs under the PSAs when the master servicer—here, Countrywide—fails to perform certain contractual obligations. Under the TIA, such master servicer defaults trigger the trustee's duty to give notice, and subject the trustee to the "prudent person" standard. See 15 U.S.C. §§77ooo(b)-(c). Plaintiffs allege that Countrywide and Bank of America breached the PSAs by failing "to provide mortgage loan files in their possession, to cure defects in the mortgage loan files and/or to substitute the defective loans with conforming loans." (Compl. ¶ 87.) As such, Plaintiffs plead "defaults" of the PSAs sufficient to trigger BNYM's duties under §§ 315(b) and (c) of the TIA. Accordingly, BNYM's motion to dismiss these claims is denied.

2. Events of Default Under the Delaware Indenture

In contrast to the PSAs, the Indenture underlying the Delaware notes defines an "event of default" to include certain failures of the issuer, rather than the master servicer. The Indenture provides that an "event of default" occurs when the issuer fails to pay interest or principal to the noteholders. (Indenture §§ 5.01(i)-(ii).) More broadly, an "event of default" occurs under the Indenture if there is a "default in the performance of any obligation of the Issuer under this Indenture . . . or [if] any representation or warranty of the Issuer made in this Indenture or in any certificate or other writing delivered in connection with this Indenture proves to have been materially incorrect as of the time when it was made[.]" (Indenture § 5.01(iii).) Under §§ 3.05(iv) and 3.05(v) of the Indenture, the issuer—i.e., the trust—is obligated to "enforce any rights with respect to any of the Collateral, [i.e., the underlying mortgages]" and is

required to "preserve and defend title to the Collateral and the rights of the Indenture Trustee, the Credit Enhancer, and the Noteholders in the Collateral against all adverse claims."

Together with the Indenture, the Delaware trust entered into an SSA—a contract with Countrywide—whereby Countrywide, as master servicer, agreed to "service and administer the Mortgage Loans[.]" (SSA § 3.01(a).) As in the PSAs, Countrywide also assumed the responsibility of curing or repurchasing defective loans. (SSA § 3.06.) Plaintiffs allege that Countrywide and Bank of America failed to furnish mortgage loan files to the trustee, failed to cure any defects in those mortgage loan files, and failed to replace defective loans with conforming loans. (Compl. ¶ 87.) While these alleged failures constituted direct breaches of the SSA, they also violated the issuer's duties under the Indenture. After all, if Countrywide and Bank of America failed to cure or repurchase defective mortgages, the issuer similarly failed to "enforce any rights with respect to any of the Collateral," as the Indenture required it to do. (Indenture § 3.05(iv).) Under the Indenture, an "event of default" occurs when there is a "default in the performance of any obligation of the Issuer under this Indenture." (Indenture § 5.01(iii).) Thus, Plaintiffs allege "defaults" of the Indenture sufficient to impose heightened duties on BNYM under TIA §§ 315(b) and (c). BNYM's motion to dismiss these claims is denied.

D. Trust Indenture Act § 316(b)

BNYM also attacks Plaintiffs' reliance on § 316(b) of the TIA, which provides that "the right of any indenture security to receive payment of the principal . . . and interest . . . shall not be impaired or affected without the consent of such holder." 15 U.S.C. § 77ppp(b). According to BNYM, § 316(b) only prevents non-consensual impairments to certificateholders' right to demand payment of interest and principal. See In re Nw. Corp., 313 B.R. 595, 600

(Bankr. D. Del. 2004) ("[Section 316(b)] applies to the holder's legal rights and not the holder's practical rights to the principal and interest itself.") (emphasis in original).

Plaintiffs do not respond to BNYM's arguments. Accordingly, the § 316(b) claim is deemed abandoned, and it is dismissed with prejudice. See Lipton, 315 F. Supp. 2d at 446.

IV. Supplemental Jurisdiction

This Court may exercise supplemental jurisdiction over Plaintiffs' state law claims if they "form part of the same case or controversy" as the remaining TIA claims. 28 U.S.C. § 1367(a). Exercising supplemental jurisdiction is appropriate where state and federal claims "derive from a common nucleus of operative fact." Shahriar v. Smith & Wollensky Restaurant Grp., Inc., 659 F.3d 234, 245 (2d Cir. 2011) (quoting Briarpatch Ltd. v. Phoenix Pictures, Inc., 373 F.3d 296, 208 (2d Cir. 2004)) (internal quotation marks omitted). Here, Plaintiffs' state law claims are based on the same alleged failures of BNYM and Countrywide underlying the remaining TIA claims. As such, this Court retains supplemental jurisdiction over the state law claims.

CONCLUSION

For the foregoing reasons, BNYM's motion to dismiss the Complaint is granted in part and denied in part. Because Plaintiffs lack standing to pursue claims regarding trusts in which they never invested, all such claims are dismissed with prejudice. Further, BNYM's motion to dismiss Plaintiffs' claims under TIA §§ 315(a) and 316(b) is granted, and those claims are also dismissed with prejudice. BNYM's motion to dismiss Plaintiffs' claims under TIA §§ 315(b) and 315(c) is denied. This Court exercises supplemental jurisdiction over Plaintiffs' state law claims.

The Clerk of the Court is directed to terminate the motion pending at ECF No. 18.

Dated: April 3, 2012
New York, New York

SO ORDERED:

WILLIAM H. PAULEY III
U.S.D.J.

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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY : IAS PART 10

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In the Matter of the Application of

Index No. 101530/98

IBJ SCHRODER BANK & TRUST COMPANY (not in its individual capacity but in its capacity as Trustee under a Trust Agreement dated as of December 21, 1985 among Resources Satellite Corp., J. Henry Schroder Bank & Trust Company and the Beneficiaries thereunder),
Petitioner,

for an order, pursuant to CPLR § 7701, for a Construction of an Indenture and Approval of a Settlement.

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SHAINSWIT, J.:

In this special proceeding, brought pursuant to CPLR Article 77, petitioner-trustee seeks a declaratory judgment concerning the construction of an Investor Trust Agreement, together with approval of the trustee's proposed settlement of another action presently pending in this Court, involving assets of the Trust, entitled IBJ Schroder Bank & Trust Co. v GE Capital Spacenet Services, Inc., Index No. 601299/96 (the "Spacenet" action).

The Trust was established in 1985 to facilitate investments by more than 400 beneficiaries in a project involving the launching and operation of a communications satellite during the years 1985 through 1994. The Trust involved a complex series of financial transactions involving the development and placement in space of the communications satellite.

The Spacenet action involves a certain master lease relating to the lease of 24 satellite transponders carried on a satellite which was launched into orbit in 1985.

The satellite earned money for the Trust through receipt of sums from television and radio broadcasters for the use of electronic signals transmitted for television and radio broadcasting by the satellite's "transponders." A transponder automatically transmits a broadcasting signal upon reception of such a signal from another transmitter.

Because adequate supply of fuel was crucial to the operation of the satellite, the trustee and the satellite owner executed the Agreement Regarding Fuel ("Fuel Agreement"), whereby the satellite owner agreed to make certain stipulated fuel shortfall payments, entitled "Stipulated Loss Value" payments, in the event of a fuel shortage. It is alleged that such a fuel shortage occurred, thereby triggering the trustee's rights to demand payment from the satellite owner under the terms of the Fuel Agreement. Accordingly, in the Spacenet action, the trustee seeks to recover from the satellite owner the sum of $40,785,455, representing a "Stipulated Loss Value" payment set forth for in the Fuel Agreement.

The satellite owner served its answer in the Spacenet action, denying all liability and pleading defenses and counterclaims, including, among other things, that: (a) the provision in the Fuel Agreement as to Stipulated Loss Value was an unenforceable penalty under New York law; (b) the satellite's failure resulted from a catastrophic event or mechanical failure and not from a lack of fuel; and (c) the satellite in fact had sufficient fuel on the applicable date.

In September 1997, the trustee and the defendants in the Spacenet litigation conditionally agreed to a proposed settlement which provides for the satellite owner to pay $8.5 million, of which $6.97 million would be paid to the Trust.

The trustee thereupon commenced this action by "Verified Petition For Construction of Trust and Approval of Proposed Settlement," seeking, among other things: (a) a declaration that it had the authority to commence the Spacenet action; (b) a declaration that it had the authority to settle the Spacenet action; and (c) judicial approval of the proposed settlement of the Spacenet action. 186 trust beneficiaries, jointly represented by one law firm, have submitted opposition to the trustee's application for a declaratory judgment and approval of the proposed settlement.

The trustee predicates his commencement of the Spacenet action, vis-a-vis the beneficiaries of the Trust, upon section 5.02 of the Investor Trust Agreement. That section provides that, in the event of an event of a default under the master lease:

> the Trustee shall give prompt written notice of such event of default to the Lessee, the Grantor and the Beneficiaries by certified mail, postage prepaid. In the event that such event of default has not been cured within 30 days after mailing of such notice, the Trustee shall take such action or shall refrain from taking such action, not inconsistent with the provisions of the Agreements, with respect to such event of default as the Trustee shall be directed in writing by all of the Beneficiaries, or, if no such direction has been received from all of the Beneficiaries within 30 days after the mailing of such notice to the Beneficiaries, the Trustee shall, in its sole discretion ... take such action as shall be necessary to terminate the Master Lease, to obtain the benefits of the Master Collateral Assignment Agreement and to cause the Lessee thereunder to perform all of its obligations upon such termination.

(emphasis supplied).

Prior to commencing the Spacenet action, the trustee sent the requisite notice under Section 5.02 of the Investor Trust Agreement to the proper parties, including the beneficiaries, and did not, in return, receive any "directions" from the beneficiaries.

By decision and judgment dated October 21, 1998, this Court held that the Trust Agreement did not confer upon the trustee authority to settle the action in question.[1] Having decided that such authority to settle the Spacenet action was lacking, the Court never reached the trustee's further request for judicial approval of the proposed settlement. The trustee appealed from the October 21, 1998 decision and judgment.

The Appellate Division reversed (__ AD2d __ , 706 NYS2d 114 [First Dept 2000]). The Appellate Division held that the trustee was, in fact, vested with the authority to settle the Spacenet action, stating that:

> It is settled that the duties and powers of a trustee are defined by the terms of the trust agreement and are tempered only by the fiduciary obligation of loyalty to the beneficiaries (see, United States Trust Co. of N. Y. v First Nat. City Bank, 57 AD2d 285, 295-296 affd 45 NY2d 869; Restatement [Second] of Trusts § 186, comments a, d). In this matter, the same provision of the trust agreement which, the parties do not dispute, gave the trustee the power to commence the underlying action, also vests the trustee with the power to "take such action as shall be necessary" with respect to the subject matter of the underlying action. We now find that this provision includes the power to settle that action. We take no position on whether the settlement agreement, in its present form, should be approved and remand the matter to the IAS court to consider all relevant factors in determining whether such approval is warranted.

(Id.).

Thus, this matter is now before this Court on remand to determine

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[1] On a motion seeking, inter alia, reargument and clarification of the October 21, 1998 decision and judgment, this Court held that the trustee had the authority, pursuant to section 5.02 of the Investor Trust Agreement, to "take such action" as might be necessary under the circumstances, including commencing the Spacenet action (Decision and Order dated April 12, 1999).

whether or not approval of the proposed settlement is warranted.

As set forth in the Petition, the trustee maintains that the proposed settlement of the Spacenet action is reasonable and prudent, and the best way to conserve and protect the Trust's assets. In support, the trustee argues that: (a) there is a serious risk that the Spacenet defendants may prevail on one or more of the defenses asserted by them in the Spacenet action, thereby precluding any recovery by the trustee in the Spacenet action; and (b) prosecution of the Spacenet action would be very costly and time consuming, because such cases are extremely expert-intensive and technically complex.

The opposition offered by the 186 trust beneficiaries goes primarily to their belief that the settlement amount is too low. They claim that the proposed settlement is unreasonable and contrary to their best interests, arguing that: (a) the plain terms of the Fuel Agreement require payment of the "Stipulated Loss Value" of approximately $40 million (now over $60 million with interest); (b) the proposed settlement would substantially compromise that amount to $8.5 million; and (c) the trustee has not in any way tested any of the defenses raised in the Spacenet litigation, but rather agreed to that substantial compromise despite having failed to take any discovery or to file any dispositive motions in the Spacenet litigation.

Since the objecting beneficiaries have not submitted any evidence to show that the trustee's actions may have been based on some ulterior motive or that the trustee is somehow itself interested in the transaction other than in its fiduciary capacity, the trustee submits that the dispute comes down to whose view as to the

wisdom of the proposed settlement should prevail - - that of the trustee or that of the objecting beneficiaries.

Here, the trustee is the entity to whom the Investor Trust Agreement gives sole power to "take such action as shall be necessary" with respect to the subject matter of the underlying action. While there is some question as to whether the applicable standard of review here is the business judgment rule or the prudent man standard, the conclusion is the same under either standard - - the trustee's decision to compromise the Spacenet action is within the scope of the trustee's powers, is reasonable and prudent, and is entitled to judicial deference. Thus, in view of the trustee's showing of the reasonableness of the proposed settlement herein, and in the absence of any evidence tending to show a breach by the trustee of its fiduciary duties, the trustee's view must prevail. The Court will not invalidate the proposed settlement merely because certain beneficiaries believe a greater recovery might be obtained if the Spacenet action is submitted to an expensive and unpredictable litigation.

CONCLUSION

Accordingly, on remand, the Court holds that approval of the proposed settlement of the Spacenet action is warranted, and grants the trustee's motion to that extent. Settle order/judgment.

Dated: August 16, 2000

ENTER:

J.S.C.