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), BlackRock Financial Management Inc. (intervenor), Kore Advisors, L.P. (intervenor), Maiden Lane, LLC (intervenor), Metropolitan Life Insurance Company (intervenor), Trust Company of the West and affiliated companies controlled by The TCW Group, Inc. (intervenor), Neuberger Berman Europe Limited (intervenor), Pacific Investment Management Company LLC (intervenor), Goldman Sachs Asset Management, L.P. (intervenor), Teachers Insurance and Annuity Association of America (intervenor), Invesco Advisors, Inc. (intervenor), Thrivent Financial for Lutherans (intervenor), Landesbank Baden-Wuerttemberg (intervenor), LBBW Asset Management (Ireland) plc, Dublin (intervenor), ING Bank fsb (intervenor), ING Capital LLC (intervenor), ING Investment Management LLC (intervenor), Nationwide Mutual Insurance Company and its affiliated companies (intervenor), AEGON USA Investment Management LLC, authorized signatory for Transamerica Life Insurance Company, AEGON Financial Assurance Ireland Limited, Transamerica Life International (Bermuda) Ltd., Monumental Life Insurance Company, Transamerica Advisors Life Insurance Company, AEGON Global Institutional Markets, plc, LIICA Re II, Inc., Pine Falls Re, Inc., Transamerica Financial Life Insurance Company, Stonebridge Life Insurance Company, and Western Reserve Life Assurance Co. of Ohio (intervenor), Federal Home Loan Bank of Atlanta (intervenor), Bayerische Landesbank (intervenor), Prudential Investment Management, Inc. (intervenor), and Western Asset Management Company (intervenor),

Petitioners,

for an order, pursuant to C.P.L.R. § 7701, seeking judicial instructions and approval of a proposed settlement.

Index No. 651786-2011

Kapnick, J.

Motion Sequence No. 24

THE BANK OF NEW YORK MELLON'S REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF ITS MOTION REGARDING THE STANDARD OF REVIEW AND SCOPE OF DISCOVERY

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PRELIMINARY STATEMENT

The Objectors'[1] Opposition ("Opp.") does not dispute two critical points: first, that the Trustee has broad discretion to settle claims against Countrywide; and second, that this Court may reverse that decision only if the Trustee acted in bad faith or abused its discretion. That resolves the first question raised in the Trustee's motion.

The second question—what the scope of discovery should be in this special proceeding—is dictated by the answer to the first. It should be narrowly focused on the single issue before the Court: whether, in entering into the Settlement, the Trustee acted within the bounds of the discretion that all parties agree it possesses. The Objectors' demands for far-reaching discovery are based on meritless allegations of conflict that fail as a matter of both law and common sense. Their recycled theories all depend on alleged benefits to the Trustee that, if they exist at all, would be found in the Settlement Agreement. But the terms of the Settlement Agreement make clear that there is no conflict. No case cited allows such expansive discovery based on such flimsy allegations, and the Court should not indulge the Objectors here.

ARGUMENT

I. The Scope of the Proceeding Is the Only Threshold Issue.

Misconstruing the Trustee's Motion Regarding the Standard of Review and Scope of Discovery (the "Motion") and the law, the Objectors first argue that setting the standard of review at this juncture would "put[] the cart before the horse" because the Court cannot determine the standard of review until the completion of discovery. Opp. 1. But the legal

[1] We note that even more Objectors have dropped out of the Steering Committee's latest filing: specifically, Cranberry Park LLC and Cranberry Park II LLC, City of Grand Rapids General Retirement System, City of Grand Rapids Police and Fire Retirement System, Retirement Board of the Policeman's Annuity and Benefit Fund of the City of Chicago, and The Westmoreland County Employee Retirement System have not joined the filing.

standard governing judicial review of trustees' discretionary decisions is established by decades of New York jurisprudence and confirmed by the PSA; it is not a question that turns on the outcome of discovery. *See* Trustee Mem. at 7. Precisely the opposite is true: the scope of discovery turns on the standard of review. *See, e.g., Stephen-Leedom Carpet Co. v. Arkwright-Boston Mfr. Mut. Ins. Co.*, 101 A.D.2d 574, 577 (1st Dep't 1984) (Disclosure "must be relevant to the issue or issues in controversy.").

The Objectors also suggest that the Trustee is seeking to prevent the Court from "intervening" to determine whether the Trustee "operated under a conflict of interest, acted in bad faith, failed to exercise its discretion, or otherwise acted improperly or unreasonably." Opp. 1. That, too, is false. The motion seeks only to define the scope of the proceeding: "Under New York law, the sole issue before the Court is whether the Trustee's decision to settle was within the bounds of a reasonable exercise of discretion by the Trustee." Trustee Mem. at 3. The Trustee has *asked* the Court to intervene on this issue, and the Court is free to determine that the Trustee's decision to enter into the Settlement was not within the bounds of a reasonable exercise of its discretion, if that determination is warranted on the record.

That the Objectors have inserted baseless allegations of conflict into the case changes nothing. The Objectors effectively claim that any allegation of conflict, no matter how flimsy, suffices to redefine the scope of the proceeding and transform a summary proceeding intended to advance resolution with "expedition and economy" (Trustee Mem. at 5) into a searching review of the course of negotiations and the merits of the underlying settled claims. But "bald assertions of conflict of interest" —such as those made here—do not trigger a heightened level of scrutiny of a securitization trustee's actions. *Elliot Assocs. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 70 (2d Cir. 1988); *see also In re E.F. Hutton S.W. Props. II, Ltd. v. Union Planters Nat.*

Bank, 953 F.2d 963, 972 (5th Cir. 1992) (heightened scrutiny "not activated until a conflict arises where it is evident that the Indenture trustee may be sacrificing the interests of the beneficiaries in favor of its own financial position," *i.e.*, where a "clear possibility of [conflict] is evident from the facts of the case").

The Objectors seek to confuse the standard of review in this case by citing cases involving clear instances of self-dealing and structural conflicts of interest that were evident from the face of the transactions at issue. None applies here. For instance, *Birnbaum v. Birnbaum* evaluated a contract "pursuant to which certain estate assets were transferred *to*" *the trustee* and noted "the conflict *inherent* in such [a] transaction." 117 A.D.2d 409, 411, 416 (4th Dep't 1986) (emphasis added). *In re Bruches*, 67 A.D.2d 456, 462 (2d Dep't 1979), is a clearly distinguishable testamentary trust case where the trustee transferred the entire trust principal to a beneficiary whose pre-existing will stood to confer significant benefits to the trustee's immediate family. And apart from a futile attempt to distinguish *IBJ Schroder*, in which there was no indication that the court needed to go beyond the transaction documents to determine that the trustee was not "somehow interested in the transaction" (No. 101530/98, slip op. at 5), Objectors cite only one Article 77 case, in which, once again, there was clear evidence of self-dealing. *Milea v. Hugunin*, 24 Misc. 3d 1211(A), 2009 WL 1916400, *3-*4, *9 (Sup. Ct. Onondaga Cnty. June 1, 2009) (testamentary trust case involving "inherent conflict" of a "trustee who is also a beneficiary of the trust"; trustee acted with clear self-interest in sub-dividing trust real property).

II. The Objectors' Demonstrably False Allegations of Conflict Do Not Warrant Discovery.

The "Expanded Indemnity." There is no expanded indemnity. This contention has been repeatedly addressed and thoroughly rebutted by the Trustee in this proceeding, most recently in its opposition to the Objectors' motion to compel. Nor did the Trustee and Bank of America agree to "re-construe" a direction from the Institutional Investors to enter into the Settlement as a

"non-direction[]" in order to shift some liability from the Trustee to Bank of America. Opp. 6. This argument is built on a demonstrably false premise: the Institutional Investors never directed the Trustee to enter into the Settlement. *See* Ex. C to the Verified Petition, at Ex. B ("*Though this is not a binding instruction from our clients*, our clients believe the settlement is in the best interests of all of the Trusts included in the settlement, so they urge the Trustee to accept it.").

Two points require further discussion. First, the Objectors ignore that the absence of a binding direction actually was *disadvantageous* to the Trustee. Section 8.02(iii) of the PSA is clear: if the Trustee acts pursuant to a binding direction, it has no liability absent bad faith. Without a direction, the Trustee is offered *less* protection—it can be liable if it acted in bad faith *or* was negligent in ascertaining the facts.

Second, the Objectors claim, again, that the guaranty from Bank of America was a "significant financial benefit to BNYM" because the Countrywide entities are nearly insolvent. Opp. 6. As we have said before, this is simply wrong. The Objectors imagine that a hypothetical Countrywide indemnitor was "insolvent," when, for years before the Settlement, the PSA indemnitor has been BAC Home Loans Servicing LP (a direct subsidiary of Bank of America, whose solvency has never been questioned). The guaranty from Bank of America therefore was "belt and suspenders"; it was not a "significant financial benefit" to the Trustee. In any event, the PSAs expressly permit the Trustee to seek "*adequate* indemnity," and the cases say the same. *See CFIP Master Fund, Ltd. v. Citibank, N.A.*, 738 F. Supp. 2d 450, 475 (S.D.N.Y. 2010).

The "Event of Default." The Objectors' next theory of Trustee benefit is that the Settlement Agreement improperly cured an Event of Default. This, too, relies on a false assumption—namely, that it is the *Trustee's* obligation to cure defaults. Opp. 7. In fact, the Event of Default provision at issue here relates solely to "any failure by the Master Servicer to

observe or perform in any material respect," and the 60-day cure period runs from when "written notice" of the non-performance "has been given to the Master Servicer." PSA § 7.01(ii). As we have explained (Opp. to Mot. to Compel 21), the Institutional Investors alleged in October 2011 that the Master Servicer—not the Trustee—had breached the PSAs, and they demanded that the Master Servicer—not the Trustee—cure those breaches. The Trustee has no obligation to supervise the Master Servicer and is not liable for its performance. *See* PSA § 3.03.

In any event, the post-default "prudent person" standard (*see* PSA § 8.02) requires only that the trustee *exercise* its powers as a prudent person would.[2] It is hardly credible to argue, in support of expansive discovery, that the Trustee spent months participating in the negotiation of the Settlement Agreement, engaged and consulted with multiple experts to consider the legal, contractual and valuation issues presented by the Settlement, decided to enter into the Settlement, filed this Article 77 proceeding, implemented a robust, global notice program, and invited all trust beneficiaries to participate in support of or in opposition to the Settlement, all so that it could avoid having to exercise its powers—the very powers that it did exercise in negotiating and entering into the Settlement. Moreover, the prudent-person standard does not narrow a trustee's *discretion* when it chooses to act, meaning that the standard of review that applies to the Trustee's decision is the same regardless of whether an Event of Default has occurred.

The "Release of Liability." The third theory of conflict is that the Settlement Agreement somehow "secure[s] protection from [the Trustee's] own potential liability to certificateholders."

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[2] *See Beck v. Mfrs. Hanover Trust Co.*, 218 A.D.2d 1, 13 (1st Dep't 1995) ("The trustee must in the post-default context act prudently, but only in the exercise of those rights and powers granted in the indenture. The scope of the trustee's obligation then is still circumscribed by the indenture, albeit less narrowly. The trustee is not required to act beyond his contractually conferred rights and powers, but must, as prudence dictates, exercise those singularly conferred prerogatives").

Opp. 7. This was refuted in the Trustee's October 31, 2011 Consolidated Response to Objections (at 18-19), in which it explained that nothing in the Settlement Agreement releases claims against the Trustee: rather, such protection would derive from the Court's action should it find that the Trustee acted within its proper discretion and adopt the injunctive provision in the proposed final order and judgment (which the Objectors continue to mischaracterize as a release). Moreover, the protection that would be afforded by the injunctive provision is limited to the Trustee's conduct relating to the Settlement. If the Trustee really wanted to avoid liability from entering into the Settlement, it would not have entered into the Settlement.

Even more fundamentally, there is no need for discovery about conflicts of interest: if the Trustee received any benefit from the Settlement Agreement, it necessarily would be stated in the Agreement. Indeed, the Objectors themselves have argued from the beginning that the Agreement itself establishes a conflict. They are wrong, as just explained, but the more pertinent point here is that, even on their own theories, the broad discovery sought by the Objectors is wholly unnecessary.

The cases cited by the Objectors overwhelmingly involve transactions that unquestionably involved self-dealing. *See, e.g., In re Garrasi*, 33 Misc. 3d 1224(A), 2011 WL 5843028, at *11 (Sur. Ct. Schenectady Cnty. Nov. 10, 2011) (case involving family trust, in which trustee "loan[ed] Trust assets to himself without prior court approval"); *City Bank Farmers Trust Co. v. Cannon*, 291 N.Y. 125, 132 (1943) (case involving inter vivos trust in which corporate trustee invested trust funds in its own stock). Curiously, Objectors also cite a pair of ERISA benefit cases concerning whether the scope of discovery should be limited to the administrative record. Opp. 8 (citing *Parker v. Hartford Life & Accident Ins. Co.*, No. 08-60034-cv, 2008 WL 2025326 (S.D. Fla. May 9, 2008), and *Mergel v. Prudential Life Ins. Co. of Am.*,

No. 09-cv-0039, 2009 WL 2849084 (S.D.N.Y. Sept 1, 2009)). These cases are inapposite. In *Mergel*, the court authorized additional discovery in light of, among other things, a "structural conflict" of interest by a plan administrator that both determined an employee's eligibility for benefits and paid those benefits. 2009 WL 2849084, at *1-*2. The court allowed discovery to determine "the role that the conflict may have played in the outcome" (*id.* at *1), not whether there was a conflict in the first place. The other case, *Parker*, said nothing about any conflict in its discussion of a test for reviewing denial of an ERISA claim; that test requires, as a first step, that the court "determine whether the claim administrator's benefits-denial decision is 'wrong.'" *Doyle v. Liberty Life Assur. Co. of Boston*, 511 F.3d 1336, 1340 (11th Cir. 2008). Because *Doyle* first requires a fact-intensive "full consideration of Defendant's decision"—that is, whether the decision was "wrong"—*Parker* held that determination of the standard of review must await summary judgment. 2008 WL 2025326, at *1 (S.D. Fla. May 9, 2008). Here, the Court does not determine whether the decision was "right" or "wrong"; as the objectors agree, the review is only whether the decision was within the Trustee's discretion.

III. The Other Grounds for Expanding the Scope of Discovery Are Equally Meritless.

The Trustee exercised discretion. The next argument is that discovery is necessary to determine whether it was really the Trustee who decided to enter into the Settlement, or whether it "abandon[ed] its discretion" to the Institutional Investors. Opp. 9. The answer here is simple: the Trustee, and no one else, made the decision to enter into the Settlement on behalf of the Trusts. Verified Pet. ¶¶ 1, 58-96. If the Trustee wanted to abandon its discretion, it could have refused to enter into the Settlement unless the Institutional Investors gave it a direction, and that direction unquestionably would have immunized the Trustee from liability absent bad faith. Instead, the Trustee is here, stating in a Verified Petition that it participated actively in a process of negotiating the Settlement, that it was represented by its own counsel throughout the process,

that it retained and received the opinions of experts in residential mortgage-backed securities and commercial finance, mortgage servicing, accounting, valuation, and that *it* decided that the Settlement was in the best interest of the Trusts. *Id.* The best the Objectors can do is argue that the Trustee "abandon[ed] its discretion" because the Institutional Investors *also* played an active and important role in the settlement process. In fact, the support of the Institutional Investors, whose holdings in the Trusts are in the tens of *billions* of dollars, serves principally to confirm the reasonableness of the Trustee's decision. This case is wholly unlike *In re Osborn*, in which one of the beneficiaries wrote checks on the trust account with "no supervision by the trustee," who was obliged to consider the interests of all beneficiaries. 252 A.D. 438, 443 (2d Dep't 1937). There is no basis for the allegation that the Trustee determined that the Settlement is proper solely *because* the Institutional Investors support it; rather, the Trustee *agreed* with and took into account the assessment of the Institutional Investors, and the Trustee commenced this proceeding. That should end the inquiry on this point. Verified Pet. ¶¶ 10, 58-96.

In any event, the Objectors can find no cases that support their contention. Two of their cases hold that the trustee, *rather than the court*, must exercise discretion. *See In re Hagymas*, 46 Misc. 2d 492, 495 (Sur. Ct. Rensselaer Cnty. 1965) ("the trustee chosen to make the decisions should do so," not the court, in the guise of interpreting the trust document); *In re Shiels' Will*, 120 N.Y.S.2d 632, 636 (Sur. Ct. Westchester Cnty. 1953) ("It is well settled that the exercise of a discretionary power in trustees to invade principal *is not subject to the control of the courts* except that their acts . . . may be reviewed to prevent an abuse of discretion, bad faith, arbitrary action or fraud. . . . The court may not substitute its judgment for that of the trustees.") (citations omitted and emphasis added). And *In re Stillman* held that the trustees abused their discretion by

refusing to follow the trust instrument. 107 Misc. 2d 102, 108-09 (Sur. Ct. N.Y. Cnty. 1980). None of these cases holds that a trustee is prohibited from considering the views of beneficiaries.

The Trustee did not violate the duty of impartiality. Finally, the Objectors suggest that the Trustee might have violated the duty of impartiality because it shares a common interest privilege with the Institutional Investors. Opp. 11. That a trustee and a group of its beneficiaries share a common interest is hardly evidence of impropriety on either side. The standard for the common interest privilege, which the Objectors never cite, requires only that two parties have "an interlocking relationship or a limited common purpose." *GUS Consulting GMBH v. Chadbourne & Parke LLP*, 20 Misc. 3d 539, 542 (Sup. Ct. N.Y. Cnty. 2008) ("a total identity of interest among the participants is not required under New York law"). That does not mean that two parties sharing a common interest must share privileged communications with anyone who might also share that interest, and the Objectors cite no case suggesting otherwise.

In addition, the argument that "the Institutional Investors do not have to pay their own attorney's fees, while all other certificateholders do" (Opp. 11), fails to raise a colorable claim that the Trustee violated a duty of "impartiality." As the authority cited by the Objectors recognizes, "[i]t would be overly simplistic, and therefore misleading, to equate impartiality with some concept of 'equality' of treatment or concern." Restatement (Third) of Trusts § 79 cmt. b. Yet that is precisely what the Objectors argue. The Objectors also neglect to acknowledge that if the Settlement is approved, all Certificateholders will receive its benefits without needing to incur any cost whatsoever. Any payment made by a third party to counsel for the Institutional Investors simply puts the Institutional Investors in the same position as all other beneficiaries, who did not take the initiative or incur the expense of participating in settlement negotiations along with the Trustee and securing the settlement. The Objectors' flimsy assertions do not

change the standard of review and the Objectors' cited cases simply underscore the weakness of these allegations.

IV. There Is No Need for Discovery Beyond the Trustee's Decision-Making Process.

The Objectors further argue that they are entitled to a wide range of documents, even without any prima facie showing of collusion or conflict of interest. They are wrong.[3] Objectors "should not be allowed to use pre-trial discovery as a fishing expedition when they cannot set forth a reliable factual basis for their suspicions." *Orix Credit Alliance v. R.E. Hable Co.*, 256 A.D.2d 114, 116 (1st Dep't 1998).

Settlement communications. The Objectors assert that "New York courts routinely allow discovery into settlement materials." Opp. 14. That is not so, and the cases cited by the Objectors are completely inapposite. When *Geltzer v. Andersen Worldwide, S.C.* noted that "*more* searching judicial scrutiny of a proposed settlement is required" where the plaintiff acts as a fiduciary (No. 05-cv-3339, 2007 WL 273526, at *1 (S.D.N.Y. Jan. 30, 2007) (emphasis added)), the court was comparing that situation to settlements that receive no review at all. *Id.* ("Just as individuals or companies may settle their disputes without going to court at all, a plaintiff generally is free to dismiss a complaint for any reason or none . . . without judicial approval or public notice."). The court rejected a settlement by a court-appointed bankruptcy trustee who did "not disclose the amount of the settlement." *Id.* at *2. That is hardly analogous to this proceeding, and the court did not authorize discovery into unsubstantiated conflicts, negotiations, or privileged documents.

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[3] The Trustee will not respond to the curious suggestion that it has prevented the Objectors from taking depositions (Opp. 13), except to note that Judge Pauley denied their emergency motion to compel a Federal Rule 30(b)(6) deposition on the grounds that (a) he had not entered a protective order, (b) the Objectors were disorganized and had not agreed on who would take the deposition, and (c) there were enormous disputes concerning the scope of discovery that he was unprepared to resolve when his jurisdiction was in doubt.

In *Masterwear Corp. v. Bernard*, the court permitted discovery of the *terms* of a settlement agreement, because, in the unique circumstances of that case, the amount paid and "admissions" in the agreement were "material and necessary to the non-settling defendant's case." 298 A.D.2d 249, 250 (1st Dep't 2002). The court said nothing about negotiations (contrary to Objectors' description), and the later First Department decision referred only to the agreement and "additional documents such as affidavits." 3 A.D.3d 305, 307 (1st Dep't 2004). *NYP Holdings* is off-point for the reasons explained by the Institutional Investors' Opposition to the Motion to Compel (at 7): An indemnitee does not have discretion to act on behalf of the indemnitor and must prove the reasonableness of the settlement amount, whereas a trustee that is contractually vested with discretion must prove only that its actions were within that discretion.

Even some Objectors recognize this point. Two groups of Objectors, in defending their maintenance of copycat cases in other courts, have argued that this proceeding "is not even concerned with whether Countrywide breached the PSAs, given that the sole determination in the Article 77 proceeding is whether BNYM's entry into the settlement was reasonable—***not whether the settlement itself is reasonable*** in light of Countrywide's breaches." *Bankers Ins. v. BNYM*, M.D. Fla. No. 11-cv-1630, Doc. 34, at 8; *Sterling F.S.B. v. Countrywide Fin. Corp.*, N.D. Ill. No. 11-cv-2012, Doc. 84, at 8 (emphasis added).

The Objectors also contend that the Trustee's argument against the disclosure of settlement communications is based on "limited federal law." Opp. 15. That, too, is wrong. It is "well established that objectors are not entitled to discovery concerning settlement negotiations between the parties without evidence indicating that there was collusion." 2 McLaughlin on Class Actions § 6:11 (8th ed. updated 2011). And the supporting case law is hardly "limited."

See Institutional Investors' Opp. to Motion to Compel Discovery 4 n.13 (cataloguing eleven state and federal cases); *see also* Trustee Mem. at 14-16 & n.6.

The Objectors suggest that more discovery is necessary here than for class action settlements, because class members can opt out. Opp. 15. Setting aside that this is not true for many class actions (*see* Fed. R. Civ. P. 23(b)(1), (b)(2), (c)(3) (describing non-opt-out classes)), it is doubtful that investors who voluntarily purchased securities subject to contracts that vest title and enforcement rights in a trustee have any less "opportunity to preserve their claims and rights" (Opp. 15) than class members do. Unlike class counsel, the Trustee does not rely on authority granted by a court; every objector here opted *in* to the Covered Trusts and agreed to contracts that empower the Trustee to settle claims like these. *See ASR Levensversekering NV v. Breithorn ABS Funding P.L.C.*, Index No. 650557/09, op. at 7 (Sup. Ct. N.Y. Cnty. Oct. 17, 2011) (parties, "each highly sophisticated commercial entities, chose . . . to interpose . . . the Trustee between them. . . . Plaintiffs are bound by the agreements that they made.").

Loan Files: For the reasons explained in the Trustee's Opposition to the Motion to Compel Discovery (Dkt. No. 263 at 4-5), discovery is not needed into loan files, because the Trustee did not consider them. It is welcome news that the Objectors no longer want 530,000 loan files, but they have yet to make a concrete proposal for "a manageable sampling." Opp. 15. And it is illogical to assert that the Court cannot evaluate what the Trustee *did* do unless the Court itself engages in a massive fact-finding that the Trustee consciously did *not* undertake. *Id.* at 16. This attempt to dramatically broaden discovery without any principled connection to the scope of this proceeding must be denied.

CONCLUSION

For all of the foregoing reasons, the Court should grant the Motion.

Dated: April 19, 2012
New York, New York

Respectfully submitted,

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