

BNY Mellon Dodges More Claims In MBS Trustee Action

By Kurt Orzeck

Law360, Los Angeles (December 23, 2014, 9:17 PM ET) -- The Second Circuit on Tuesday partially affirmed a judge's decision gutting most of a putative class action alleging the Bank of New York Mellon Corp. failed to properly oversee hundreds of mortgage-backed securities trusts battered by the housing collapse, along with tossing additional claims.

The appeals court agreed with U.S. District Judge William H. Pauley's April 2012 decision that the plaintiffs — four pension funds — could only bring claims under the Trustee Indenture Act in relation to 26 BNY Mellon-controlled trusts in which they invested. The original complaint, filed in August 2011, sought to recover losses on 530 trusts overseen by the bank.

"Plaintiffs claim that evidence of BNYM's policy of 'inaction' in the face of widespread defaults will be applicable to all of the trusts at issue," Tuesday's decision said. "But as plaintiffs recognize, even proof that BNYM always failed to act when it was required to do so would not prove their case, because they would still have to show which trusts actually had deficiencies that required BNYM to act in the first place."

Additionally, the Second Circuit on Tuesday reversed part of Judge Pauley's holding that said the Trustee Indenture Act applies to RMBS certificates governed by pooling and servicing agreements. The appeals court thus decided that the plaintiffs couldn't bring most of their Trustee Indenture Act claims over the remaining trusts.

A BNY Mellon spokesman told Law360 on Tuesday that the bank is pleased with the court's decision. Attorneys for the plaintiffs didn't immediately respond to requests for comment Tuesday.

The suit relates to pools of mortgages that Bank of America Corp. unit Countrywide sold into trusts, which received the flow of interest and principal from the mortgage payments. The rights to that cash flow were distributed to investors through trust certificates or securities.

As trustee of the trusts, BNY Mellon had an obligation to step in if Countrywide failed to perform its duties as the loan servicer, according to the complaint. Those included reviewing the loan files, substituting or repurchasing bad loans and transferring mortgage notes to BNY Mellon, according to the suit.

The bank breached its contractual and fiduciary duties to investors by not compelling Countrywide to

meet those requirements, the suit claimed.

On Tuesday, Judge Pauley said the 26 trusts could give rise to some claims under the Trust Indenture Act, which governs the responsibilities of a trustee for debt securities distributed to investors. The judge rejected BNY Mellon's allegation that securities from 25 of the trusts resembled equity, not debt, and were therefore exempt from the law.

Beth A. Kaswan of Scott and Scott LLP, which is representing the plaintiffs, told Law360 in April 2012 that Judge Pauley's ruling marked the first time a federal court had sustained a Trust Indenture Act claim against a trustee over investor losses allegedly caused by poor loan underwriting standards.

The 530 trusts had an original principal balance of \$424 billion. By comparison, the 26 trusts remaining in the suit after Judge Pauley's decision had a balance of about \$30 billion, according to Kaswan. The plaintiffs had been seeking more than \$3 billion in losses on those trusts, Kaswan said.

Martin Seidel, a partner at Cadwalader Wickersham & Taft LLP, which represented amici curiae Securities Industry and Financial Markets Association in the appeal, told Law360 on Tuesday that "the lower court's decision upended three decades of settled practice, and the appeals court's decision righted the ship and allows the parties to return to settled practice in securities transactions."

Of those 26 trusts, the plaintiffs hold certificates issued by 25 pooling and service agreement-governed trusts and one sale and servicing agreements and indenture-governed trust, according to court papers.

Circuit Judges Dennis Jacobs, Jose A. Cabranes and Debra Ann Livingston sat on the panel for the Second Circuit.

Plaintiffs are represented by William C. Fredericks, Beth A. Kaswan, Max R. Schwartz and Deborah Clark-Weintraub of Scott and Scott LLP.

BNY Mellon is represented by Charles A. Rothfeld, Christopher J. Houpt, Paul W. Hughes, Matthew D. Ingber and James F. Tierney of Mayer Brown LLP.

The cases are Retirement Board of the Policemen's Annuity and Benefit Fund of the City of Chicago et al. v. the Bank of New York Mellon, case numbers 13-1776 and 13-1777, in the U.S. Court of Appeals for the Second Circuit.

--Additional reporting by Max Stendahl. Editing by Christine Chun.