

Alison Frankel's **ON THE CASE**

Grais fights to keep \$8.5 billion BofA case in fed. court

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On Wednesday night, **Grais & Ellsworth** filed a [29-page brief](#) laying out its arguments for why Bank of America's proposed \$8.5 billion settlement with Countrywide mortgage-backed securities investors belongs in federal court, not in New York state court, where Bank of New York Mellon, as Countrywide MBS trustee, filed it. I'll talk about Grais's assertions in a moment, but first, I want to explain why the jurisdictional question is so crucial to the ultimate fate of BofA's proposed deal. Two transcripts tell that tale.

BNY Mellon, you'll recall, used a highly unusual device when it asked for court approval of the proposed \$8.5 billion settlement in late June. The bank filed the case as an Article 77 proceeding in New York state supreme court, taking advantage of a state law that permits trustees to seek a judge's endorsement of their decisions. Using Article 77 was a deliberate tactic by BNY Mellon, BofA, and the 22 institutional investors who support the settlement. The lawyers who put together [the deal](#) considered and rejected other possible vehicles for court approval, but decided that Article 77 was the fastest, cleanest way to resolve claims involving 530 separate trusts. The provision, which is usually invoked in garden-variety trust cases, gives broad discretion to trustees, who are generally assumed to be acting in the best interests of trust beneficiaries.

The Article 77 strategy looked brilliant at the first hearing on the settlement before New York state supreme court judge **Barbara Kapnick**. According to a [transcript](#) of the August 5 hearing, Judge Kapnick shot down objectors to the deal who, in her view, wanted to proceed with discovery as if the case were a class action. "It's important to remember that this petition was brought as an Article 77 petition," the judge said. "It's not a class action. There aren't provisions in there to opt out that you are talking about. That's not what this is. If you started it, maybe that's what you would have done, but they started it and that's what they did. I have to work, at least now, within the confines of the proceeding that is before me."

But then **David Grais** of Grais & Ellsworth, in a move as bold and novel as the banks' use of Article 77, [removed the case to federal court](#), arguing that the settlement is a mass action under the federal Class Action Fairness Act. And there, BNY Mellon met with quite a different reception. At a Sept. 1 hearing, Manhattan federal judge **William Pauley** gave BNY Mellon's counsel, **Matthew Ingber** of **Mayer Brown**, pretty rough treatment. "Isn't it unusual to use an Article 77 proceeding to seek approval for a settlement of this type," the judge demanded, according to a [transcript](#) of the hearing. "Isn't it odd that the trustee appears to have chosen such a proceeding whose main benefit appears to be to limit the rights of the trust beneficiaries to opt out of the settlement? You don't think that is in any way at odds with the trustee's fiduciary duty to the beneficiaries of the trust?" Judge Pauley went on to grill Ingber on the experts BNY Mellon engaged to determine the fairness of the settlement and the controversial side letter to the [settlement agreement](#) in which BofA affirms indemnity for BNY Mellon as trustee.

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These are the same issues Grais & Ellsworth and other objectors to the settlement have raised and Judge Pauley is clearly listening to their arguments. It's dangerous to read too much into how judges behave at preliminary hearings, but if I were BofA, BNY Mellon, or any other supporter of the settlement, I'd prefer my chances before Judge Kapnick a lot more than another hearing in front of Judge Pauley.

That's why BNY Mellon argued strenuously in a [Sept. 1](#) brief in federal court that the case should be sent back to state court. Calling Grais's attempt to move the proceeding to federal court "frivolous," the bank made four key arguments. First, BNY's counsel at Mayer Brown and Dechert argued, the case isn't a mass action under the Class Action Fairness Act. There's only one plaintiff in the Article 77 proceeding—BNY Mellon as trustee—not the 100 plaintiffs that define a mass action under the federal law. The Article 77 proceeding doesn't seek money damages, as CAFA requires, but simply judicial approval of the trustee's action; and Grais's client, a coalition of Countrywide MBS investors acting under the name Walnut Place, can't remove the Article 77 case to federal court because it's not a defendant in the proceeding.

Finally, the bank's lawyers pointed to [a ruling](#) by the U.S. Court of Appeals for the Second Circuit that holds claims under MBS pooling and servicing agreements fall into an exception to CAFA's removal provisions. As the bank's brief noted, Grais & Ellsworth knows the Second Circuit ruling, in a case called *Greenwich Financial Services v. Countrywide*, quite well: It was counsel to the MBS investors who sought, successfully, to send their case against Countrywide back to state court. To put an exclamation point on its assertion that Grais shouldn't have removed the case to federal court, the BNY Mellon brief asked Judge Pauley to award attorneys fees for the cost of litigating the removal petition.

In Wednesday's filing, Grais & Ellsworth addressed all of the bank's arguments in a brief that essentially asked Judge Pauley to look beyond the technicalities of the Article 77 proceeding and treat the proposed settlement as a de facto class action. Picking up on the judge's own skepticism at the Sept. 1 hearing, the Grais brief asserted: "BNYM chose to file an Article 77 proceeding because it thought it could use the special proceeding to cherry-pick the aspects of class action settlements that it finds useful (court approval, global releases of the rights of all class members, 'objections' rather than interventions as of right, etc.), but to cast aside the aspects that it finds inconvenient (mainly the right to opt out)."

Grais asserted that even though BNY Mellon says it's the only plaintiff in the Article 77 proceeding and claims that the case doesn't seek money damages, there are in fact 530 trusts and \$8.5 billion at issue. And even though the bank says Walnut Place isn't a defendant, the Grais brief said, Walnut has intervened in opposition to the proposed settlement, which makes it an adverse party in the state case—a defendant in fact, if not in name. As for BNY Mellon's demand for attorneys fees, the brief said, "despite BNYM's repeated and reckless description of this removal as 'frivolous,' there is no doubt that Walnut Place had an objectively reasonable basis for removing this action to federal court."

The Grais brief also distinguishes between the *Greenwich Financial* case that led to the Second Circuit's holding and the Article 77 proceeding. *Greenwich* was a case between an MBS investor and Countrywide as the MBS issuer, the brief said. The Second Circuit's finding related to the rights of an MBS investor. But BNY Mellon isn't an MBS investor, so the appellate court's holding does not apply.

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In an interview, Grais explained the distinction. The Second Circuit, he said, found that the CAFA exception that sent the Greenwich case back to state court applies to rights an investor has as the owner of a security (as opposed to an investor's rights as the purchaser of stocks and bonds). BNY Mellon's rights as securitization trustee, on the other hand, derive from the Countrywide MBS pooling and servicing agreements and from New York trust law. Because the trustee does not own any securities and derives its rights from contract and state law, Grais said, the CAFA securities exception at the heart of the Greenwich ruling is not relevant in the BNY Mellon case.

Bank of New York Mellon has until tomorrow to respond to the Grais & Ellsworth brief. Judge Pauley has scheduled a hearing on the remand motion for next Wednesday. If he's as outspoken as he was at the first hearing, we should get a pretty good idea of whose going to be overseeing this case and whether the Article 77 gambit backfires on the banks.

(Reporting by Alison Frankel)

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