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Judge to solve puzzle over BoFA mortgage removal

By Grant McCool – September 15, 2011

Bank of America Corp's \$8.5 billion proposed mortgage-backed securities settlement is now in the hands of a New York federal judge. But it could end up back before state court in a legal tug-of-war over who should decide whether the pact passes muster.

The stakes are high for Bank of America, which had hoped the agreement would resolve uncertainty over potential liabilities tied to pools of soured loans sold to investors by Countrywide Financial Corp, the mortgage lender it bought in 2008.

While the proposed settlement was filed in state court in June as a special proceeding and not as a class action, an investor group called Walnut Place LLC removed the case to federal court in late August, arguing it should be treated as a "mass action" under a federal law.

The case is now before U.S. District Judge William Pauley, who may have reasons under class-action law to return the case to New York State Supreme Court, according to some experts.

Or, as sometimes happens in removals, the federal judge keeps the case and the state action ceases unless there are developments later that cause it to be remanded to state court for different reasons.

The settlement was negotiated by Bank of New York Mellon, the trustee for mortgage backed securities in Countrywide, with 22 institutional investors such as BlackRock Inc and Allianz SE's Pimco. Countrywide was the largest U.S. mortgage lender before being taken over by BofA. The agreement also calls for the biggest U.S. bank by assets to improve its mortgage servicing practices.

On September 21, Pauley will hear oral arguments for the bid by Walnut Place for the case to be resolved under the Class Action Fairness Act of 2005 that requires big-money class actions to be supervised by a federal judge.

HIGH STANDARD FOR REMOVAL

"There have been various ways in which the federal court has managed to kick removals out without giving it much of a review but I prefer to think judges see it as part of their job," said Eugene Beckham of Beckham and Beckham PA in Miami, who has written about removal procedures but is not involved in the mortgage settlement case.

"However, the federal courts can be very unforgiving and if you don't follow the rules or you don't have the right allegations they will usually remand it," Beckham said.

He said that can lead to an attorney fee award or sanctions against lawyers deemed to have incorrectly removed a case.

Lawyers for law firm Grais & Ellsworth are leading the challenge for Walnut Place against the Bank of New York Mellon (BNYM) settlement.

Walnut Place owns certificates in three of the 530 trusts that are part of the proposed agreement. It argues that the negotiations were held in secret, but BNYM says that BofA said in a December 2010 press release

it was in talks with the trustee and institutional investors over trusts, including one in which Walnut Place holds certificates.

BNYM, and some lawyers who are not involved in the litigation said that under the class-action law cited by Walnut, a party needs to be a defendant and there needs to be a claim for monetary relief to have standing to remove the case.

But Walnut's lawyers said in court papers on Wednesday night that neither of those arguments are plausible.

"Walnut Place intervened as an adverse respondent in the state court proceeding, and BNYM did not oppose the petition to intervene or disagree with its characterization of Walnut Place as an adverse party," its memorandum said. It said monetary relief "surely" was the \$8.5 billion that the trustee had asked the court to direct Bank of America and Countrywide to pay.

MONTHS OF NEGOTIATIONS

Another CAFA requirement is that there must be 100 or more plaintiffs who have filed lawsuits seeking monetary damages. In this case, there is only one plaintiff, the trustee, BNYM.

"It doesn't immediately appear obvious to me what the tactical benefits would be of removal," said Chris Keller, partner at Labaton Sucharow, whose two New York pension fund clients were part of a \$624 million settlement in Countrywide securities litigation in February.

The proposed BofA settlement was made in New York State Supreme Court under Article 77, a provision that usually covers family trust matters. The agreement covers 530 mortgage pools with \$174 billion of unpaid principal balances. BNYM said it took months of negotiations to reach a deal.

New York State Supreme Court Justice Barbara Kapnick rejected Walnut's efforts to change the case to a class action and to add an "opt-out" provision typical in class actions but not in Article 77 proceedings.

Sara Shanahan, a litigation partner with law firm Sherin and Lodgen in Boston, said BNYM could argue that "if you're going to remove, you do it early on the proceedings, you don't get to remove once you think things are going badly for you in the state court proceedings."

Pauley's job is to determine whether the case was properly removed and properly pending in federal court, she said.

"If he's wrong, then that issue can be challenged later on appeal after a lot of additional work," Shanahan said.

The cases are In re: The Bank of New York Mellon, New York State Supreme Court, New York County, No. 651786/2011; and The Bank of New York Mellon et al v. Walnut Place LLC et al, U.S. District Court, Southern District of New York, No. 11-05988.