# 13-661, 13-664

## United States Court Of Appeals
*for the*
## Second Circuit

RETIREMENT BOARD OF THE POLICEMEN'S ANNUITY AND BENEFIT FUND OF THE CITY OF CHICAGO, WESTMORELAND COUNTY EMPLOYEE RETIREMENT SYSTEM, CITY OF GRAND RAPIDS GENERAL RETIREMENT SYSTEM, AND CITY OF GRAND RAPIDS POLICE AND FIRE RETIREMENT SYSTEM (on Behalf of Themselves and Similarly Situated Certificate Holders),

*Plaintiffs-Petitioners-Cross-Respondent*,

v.

THE BANK OF NEW YORK MELLON (as Trustee Under Various Pooling and Servicing Agreements),

*Defendant-Respondent-Cross-Petitioner*.

On Petition for Interlocutory Appeal from an Order of the United States District Court for the Southern District of New York

William H. Pauley III, District Judge
Case No. 1:11-cv-5459

**REPLY IN SUPPORT OF BNYM'S PETITION FOR PERMISSION TO FILE INTERLOCUTORY APPEAL**


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## BNYM'S REPLY

Plaintiffs' response is unpersuasive in several respects. Most obviously, plaintiffs do not dispute the enormous practical importance of the question presented by our petition: whether the TIA applies to a trust governed by a PSA. As we demonstrated, the Order places the legal obligations of trusts worth hundreds of billions (if not trillions) of dollars in substantial jeopardy, and at least thirty-two new trusts, worth over $30 billion, have expressly rejected the district court's conclusion and declined to conform the offerings with the TIA. *See* Pet. 18-19 & A32-A33. The securitization market is closely watching this case for badly needed guidance. Indeed, the same day that we filed our petition, another issuer released a prospectus for a new trust that declined to conform with the TIA, while noting that "Judge Pauley recently granted a motion to certify his ruling for interlocutory appeal to the Second Circuit." Free Writing Prospectus, WFRBS Commercial Mortgage Trust 2013-C12, SEC File No. 333-17236606, at 261-62 (Feb. 25, 2013). The issuer explained that, if the Order "is affirmed on appeal," it would have to amend the PSA to comply with the TIA. *Id*. Regardless of the ultimate decision, it is imperative that the Court resolve this question to bring certainty to the marketplace.

To oppose our petition, plaintiffs recycle the same arguments they pressed before the district court. Although that court agreed with plaintiffs

on the merits, it nonetheless recognized that its conclusion was debatable and that immediate resolution of this question would materially aid the litigation. That decision was correct. Decades of contrary SEC guidance, the unanimous views of commentators, and historical practice of a massive industry—coupled with a textual reading of the TIA—adequately demonstrate that the Order is, at the very least, contestable. And the trial court's determination that interlocutory review of this issue would advance the litigation is not only deserving of substantial deference, but plainly correct. The Court accordingly should permit an interlocutory appeal.

### A. Whether the TIA applies to PSA-governed trusts is, at the very least, debatable.

Plaintiffs first contend that there is no basis for a difference of opinion on this issue. Judge Pauley disagreed, and for good reason—notwithstanding his view that plaintiffs are correct on the merits of the issue. As we demonstrated in our petition, the Order stands against decades of guidance from the SEC and commentators, was unprecedented, and is contrary to the plain text of the TIA. These points more than demonstrate that the application of the TIA to PSA-governed trusts is debatable within the meaning of Section 1292(b). Plaintiffs' policy arguments, even if correct, would not bear on whether the Order is contestable.

1. SEC guidance has long indicated that PSA-governed trusts are not subject to the TIA, and security issuers have relied on this guidance in de-

veloping the market. Pet. 9. Plaintiffs argue that this guidance is not entitled to deference (Resp. 16-18), but that misses the point for present purposes. That the agency charged with administration of the TIA has consistently advised issuers that the TIA does not apply to pass-through trusts itself demonstrates that the district court's contrary conclusion is contestable.[1]

Likewise *every* commentator of which we are aware has agreed with the SEC, concluding that the TIA does not apply in these circumstances. Pet. 9-10 & n.7. Plaintiffs denigrate these authorities by stating that they "parrot BNYM's shallow, self-serving reading of the TIA" (Resp. 18), but among the authors is Talcott Franklin, a leading *plaintiff*-side securities attorney who has sued BNYM. *See* Talcott J. Franklin & Thomas F. Nealon, *Mortgage & Asset Backed Securities Litigation Handbook* §§ 1:44, 4:36 (2012 update). The numerous treaties, many written several years prior to the recent wave of MBS litigation, confirm that, prior to the Order issued below, *every* stakeholder who gave thought to the question—from the SEC to securities issuers to attorneys representing investors—thought that the TIA did not apply in

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[1] Plaintiffs purport to find support in the SEC's complaint in *United States Securities and Exchange Commission v. Option One Mortgage Corp. n/k/a Canyon Corp.*, No. 12-cv-633 (C.D. Cal.), for the assertion that the "SEC also recently concluded that MBS certificates are debt." Resp. 10. This is incorrect. The SEC did not raise a TIA claim and did not there determine that trusts governed by PSAs are debt within the meaning of the TIA.

these circumstances. Though they suggest that this is a parochial view, plaintiffs offer absolutely nothing in response.

2. Plaintiffs are wrong in contending that "numerous courts have found that Certificates are debt." Resp. 9. In fact, *no* court, prior to the Order here, had held that PSA-governed certificates are debt, much less subject to the TIA. As we noted (Pet. 12-13), some opinions loosely characterized PSA-governed certificates as being like "bonds," but not one of those cases involved a situation where the parties disputed, and the court had to resolve, whether a PSA trust certificate was debt or equity.

Plaintiffs are correct to observe that another district court has followed the Order below and held that certain pass-through trust agreements are subject to the TIA. *See Policemen's Annuity & Benefit Fund v. Bank of Am., NA*, 2012 WL 6062544, at *16 (S.D.N.Y. 2012). But this only underscores the importance of resolving the TIA question now, as it will have significant repercussions for other pending litigation.

3. Plaintiffs assert that the district court properly applied the TIA to PSA-governed certificates because they "provide a sum certain" (Resp. 10-15), but plaintiffs do not cite any provision of the PSAs that actually creates such an entitlement. As we explained (Pet. 11-12), the amounts that investors in a PSA are *entitled to* (not only the amounts that they are *paid*) are not fixed and depend completely on loan collections. Plaintiffs show only that

they are entitled to those variable amounts on specific *dates*. Contrary to plaintiffs' repeated assertion (*e.g.*, Resp. 12), there is no obligation to pay investors anything other than whatever variable amount the trust collects; thus, by definition, there is never a circumstance in which a sum certain obligation cannot be met—because there is no such obligation. It is telling that plaintiffs rely on a prospectus supplement and certain quarterly reports (Resp. 11 & n.3) in lieu of any provision within the PSA itself.

Plaintiffs note that investors in PSA-governed trusts face a risk of nonpayment, and they contend that this somehow supports characterization of the PSA-governed trusts as debt. Resp. 12-13. But the risk of loss is inherent in *every* investment, debt *or* equity, and thus provides no basis to characterize this instrument as a form of debt.

Moreover, plaintiffs overlook the importance of the Section 304(a)(2) exception. *See* Pet. 15.[2] The TIA recognizes that certain forms of trusts are "certificate[s] of interest or participation" in debt. 15 U.S.C. § 77ddd(a)(1)(B). The Act thus contemplates that participations in a single debt instrument are susceptible to similar remedial provisions as actual debt securities. The TIA crafted a further carve-out for these certificates, however: when, as here, the underlying assets are "two or more securities having substantially differ-

[2] As plaintiffs themselves recognize in their argument heading (Resp. 15), the court below ruled on this issue.

ent rights and privileges," the TIA does not apply. *Id.* § 77ddd(a)(2). Although this kind of security may have certain features of debt—because the underlying assets are debt instruments—the security is nonetheless a form of equity expressly exempt from the TIA. Indeed, it is for this reason that the SEC has found PSA-governed trusts exempt from the TIA. Pet. 9. Plaintiffs make no attempt to demonstrate how their counter-argument can be squared with the TIA's plain terms.

Finally, we recognize that some mortgage securitizations—those that issue debt—are subject to the TIA, and their indentures say as much. Pet. 4 n.2. But this does not suggest, as plaintiffs would have it, that *all* mortgage-backed securities must be construed as debt. Resp. 13. We do not argue, as plaintiffs contend, "that the title affixed to a security determines whether it is debt, irrespective of the security's substance." *Id*. We argue the reverse: it is not the difference in title that matters, but the substantial difference in legal entitlements. Unlike PSA-governed trusts, trusts governed by indentures *do* create sum-certain amounts due.

4. Much of plaintiffs' response is wholly off point. Plaintiffs devote four pages to demonstrating that Congress enacted the TIA to protect "investors in debt securities." Resp. 5-8. That proposition, while doubtless true, is immaterial here: The TIA concededly does *not* apply to most equity securities and the question here is whether the PSA certificates constitute debt. Plain-

tiffs' discussion of the TIA's general legislative purpose says nothing at all about that issue.

Indeed, to the extent that plaintiffs' discussion has any bearing on the question presented, it supports our position. Plaintiffs assert that the SEC's views were instrumental in the enactment of the TIA (Resp. 6-8)—but the SEC consistently has expressed the view that the TIA is not applicable to PSA certificates. Although Congress has amended the TIA in recent years (*e.g.*, Trust Indenture Reform Act of 1990, tit. IV, Pub. L. No. 101-550), it has *not* chosen to make the TIA expressly applicable to PSA-governed certificates in response either to SEC guidance that such instruments are outside the statute's scope or to the uniform industry practice reflecting that view. This history confirms that current practice is consistent with the congressional intent underlying the TIA. *Cf. Lindahl v. Office of Personnel Mgmt.*, 470 U.S. 768, 782 n.15 (1985) ("'Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it reenacts a statute without change.'" (quotation omitted)).

Additionally, in our petition, we described the confounding effects if the TIA suddenly were applied to PSA-governed certificates. Pet. 16-18. Plaintiffs offer no substantive response and instead simply point the Court to their argument below. Resp. 18-19. But that brief did not demonstrate *how* PSA-governed trusts that presently exist may be reconciled with the TIA; it

simply offered a series of arguments as to why Congress *should have* drafted the TIA so as to apply to PSA trusts. And our position (and that of numerous amici) is not that applying the TIA would be "inconvenien[t]" (Resp. 18); rather, it is that the logical impossibility of applying many of the TIA's substantive provisions to these trusts shows that these are not the kind of securities that Congress intended the TIA to cover.

**B. This appeal would materially advance the litigation.**

Plaintiffs assert that an appeal would not materially further this proceeding because resolution of the TIA question would leave some elements of the case before the district court. Resp. 19-20. But there is no disputing that certification is appropriate where an interlocutory appeal would "speed the District Court's consideration of the merits of the parties' claims or defenses," even if it does not resolve the whole case. *In re City of New York*, 607 F.3d 923, 933 (2d Cir. 2010).[3] Here, the district court found that dismissal of the TIA claims against the PSA trusts *would* "considerably streamline[]" this litigation. A29. That case-management decision of the district court deserves substantial deference. Pet. 8 n.5.

The district court's determination was for good reason: the size of this case will determine its character going forward. Whether the case involves

[3] Plaintiffs make this argument in their own petition for interlocutory review. Pls. Pet. 18.

one Delaware trust only, the Delaware trust and the 25 PSA trusts in which plaintiffs invested, or more than 500 other Countrywide trusts will fundamentally shape future proceedings. Not only was this recognized by the district court, but it is the underpinning of plaintiffs' *own* petition asking this Court to accept an interlocutory appeal. Pls. Pet. 17-18.

Plaintiffs suggest that state-law claims against the New York trusts would remain regardless of the TIA's application and that they can pursue "the same relief" based on those claims. But plaintiffs plainly believe that the TIA imposes duties that differ from those in the contracts; this is the gravamen of their policy arguments—that the contracts the plaintiffs agreed to are inadequate and superseded by legislation. Resp. 5-8. Even the potential of eliminating only the TIA claims against the PSA-governed trusts is thus enough to support the district court's view that an interlocutory appeal is warranted.

Plaintiffs' contention is wrong for an additional reason: if the TIA claims are dismissed, the district court would lack subject-matter jurisdiction over the state-law claims asserted against the PSA-governed trusts. Plaintiffs now point to diversity jurisdiction, but they did not plead diversity in their complaint or identify the citizenship or corporate status of their members. Supplemental jurisdiction would not permit these claims to proceed, either, as dismissal of the federal claims, in the "usual case," also ne-

cessitates dismissal of the supplemental state law claims. *Kolari v. N.Y.-Presbyterian Hosp.*, 455 F.3d 118, 123-24 (2d Cir. 2006).

* * *

Finally, we note that, although plaintiffs vigorously oppose our request that the Court accept jurisdiction of the certified Order, their opposition fails to mention that they have *themselves* petitioned the Court to accept an interlocutory appeal of the *same* Order. In that petition (at 1 n.1), plaintiffs correctly explain that if the Court accepts jurisdiction over the Order, it will have "jurisdiction over the entirety of the [Order]." Plaintiffs' petition is peculiar in a number of respects, among them that plaintiffs opposed certification below and now seek review of an issue not presented to the district court as a basis for certification of the Order. But given that the entire case will be before the Court if review is granted, it is especially odd that plaintiffs here oppose the very same relief that they have asked the Court to grant.

## CONCLUSION

The petition for interlocutory review should be granted.

Respectfully submitted,

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Dated: March 14, 2013

## CERTIFICATE OF SERVICE

I certify that on March 14, 2013, I served the foregoing BNYM's Reply in Support of Petition for Permission for Leave to File Interlocutory Appeal on all counsel via the Court's ECF system.

Dated: March 14, 2013

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