Blackrock Balanced Capital Portfolio (FI) v U.S. Bank N.A.
2018 NY Slip Op 31388(U)
January 12, 2018
Supreme Court, New York County
Docket Number: 652204/2015
Judge: Saliann Scarpulla

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 39

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BLACKROCK BALANCED CAPITAL PORTFOLIO (FI), ET AL.,

Plaintiffs,

Index No.: 652204/2015

-against-

U.S. BANK NATIONAL ASSOCIATION,

DECISION AND ORDER

Defendant.

-and-

THE TRUSTS IDENTIFIED IN EXHIBIT 1,

Nominal Defendants.

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SALIANN SCARPULLA, J.:

In this action, *inter alia*, to recover damages for breach of contract, defendant U.S. Bank National Association ("U.S. Bank") moves to dismiss the amended complaint.

This action involves 770 mortgage backed securitization trusts, of which U.S. Bank was trustee. The 770 trusts were each governed by a pooling and servicing agreement ("PSA"). In 2008, during the financial and housing market crisis, many mortgages foreclosed, and resulted in losses for investors, including plaintiffs. Plaintiffs commenced this action alleging that U.S. Bank breached its duties as trustee.

In their complaint, plaintiffs allege breach of contract, setting forth the following alleged breaches: (1) failure to ensure delivery of mortgage loan files; (2) failure to provide written notice of breaches of sellers' mortgage loan representations and

warranties; (3) failure to enforce the sellers' obligation to repurchase, substitute or cure the defective mortgage loans; (4) knowledge of the servicer's failure to provide notice of any such breach of duties as specified in the PSAs; and (5) failure to provide required notice to trigger the events of default ("EOD") to the servicers, to exercise prudence following the EODs, and to provide notice of all uncured EODs to certificateholders.

Plaintiffs next allege that U.S. Bank breached its fiduciary duties to the trust and certificateholders prior and post-EOD. Specifically, they claimed that U.S. Bank (1) failed promptly to enforce the sellers' obligation to cure, repurchase, or substitute mortgage loans that had defective mortgage files or were affected by breaches of the sponsors' and originators' representations and warranties; (2) failed to provide notice to the certificateholders of those breaches or of its intention not to enforce the sellers' obligation to cure, repurchase, or substitute the loans with defective mortgage files and breaches of representations and warranties; (3) failed to enforce the servicers' obligations to observe and perform agreements as set forth in the PSAs; and (4) failed to provide notice to the certificateholders of the servicing violations or of its intention not to enforce the servicers' obligations to observe and perform agreements set forth in the PSAs.

Additionally, plaintiffs claim that U.S. Bank breached its fiduciary duty by failing to avoid conflicts of interest. Specifically, U.S. Bank knew that sellers were breaching representations and warranties, and servicers were engaging in activities outside of customary and usual standards of practice of prudent mortgage servicers. However, U.S. Bank refused to take any action against the sellers or servicers, or even notify the certificateholders of seller or servicer defaults because U.S. Bank was economically

obligated to the sellers, could be held liable for its own servicing violations, and faced repurchase liability for the sale and securitization of its own loans.

Plaintiffs also assert a cause of action for breach of the implied covenant of good faith and fair dealing, in the alternative to the breach of contract claim. According to plaintiffs, U.S. Bank breached its duty to give written notice to the servicer after U.S. Bank gained actual knowledge of the servicers' failure to observe and perform pursuant to the PSAs, so as to facilitate the occurrence of an EOD.

Finally, plaintiffs assert a claim for negligence in the alternative to the breach of contract claim. Plaintiffs claim that U.S. Bank owed certificateholders an extra-contractual, common law duty to perform all basic, non-discretionary, ministerial tasks with due care. U.S. Bank breached its common law duty of due care to certificateholders by negligently failing to provide written notices to the responsible servicers, which prevented the occurrence of EODs.

U.S. Bank now moves to dismiss the amended complaint.

Discussion

Breach of Contract

U.S. Bank first argues that plaintiffs have failed adequately to plead its three categories of breach-of-contract claims, which are: (i) post-EOD claims, (ii) pre-EOD claims concerning alleged seller and originator breaches of representation and warranties and servicer failures, and (iii) pre-EOD claims concerning loan documentation.

U.S. Bank argues that, according to the applicable PSAs, an EOD occurs when there is a breach by a servicer or master servicer (depending on the relevant PSA) of its

obligations, written notice is given to the servicer or master servicer by a designated deal party or the certificateholders themselves, and there is a failure to cure within a specified time. U.S. Bank contends that it was not obligated to provide the written notice, and in any event, plaintiffs did not plead that U.S. Bank itself obtained notice of any servicing breach, and did not plead any specific servicing breach sufficient to constitute an EOD.

Plaintiffs allege that the PSAs obligated U.S. Bank to provide the written notice to the servicer after U.S. Bank gained notice of a servicing breach. They claim that U.S. Bank had knowledge of the servicer's failure to perform its duties and obligations, and failed to provide the written notice sufficient to trigger an EOD. Plaintiffs contend that U.S. Bank knew of loan specific servicer breaches, through receipt of servicing data and preparation of remittance reports for the trust, and through specific notices.

Plaintiffs submit two September 2012 letters from Gibbs and Bruns, referring to several of the trusts, and referencing multiple servicing failures. One letter provides, "each of these failures to perform Wells Fargo's covenants and agreements violated the prudent servicing and/or master servicing obligations imposed on Wells Fargo by PSA §3.01 and §9.01. Each of these failures to perform Wells Fargo's covenants and agreements has also materially affected the rights of the Certificateholders. Each of these failures to perform constitutes a continuing Event of Default."

U.S. Bank notes that plaintiffs have not pled that it provided notice to the servicer of the alleged breach. According to U.S. Bank, plaintiffs' failure to plead its notice to the servicer or the servicer's failure to cure—both of which must occur before an EOD —is fatal to its post-EOD duty claim. Plaintiffs maintain that allegations regarding U.S.

Bank's notice of breach and the servicers' failure to cure are missing from the complaint because U.S. Bank did nothing despite allegedly knowing—or having reason to know—about the breaches.

Plaintiffs argue that U.S. Bank cannot now rely on its failure to give notice to prevent an EOD from occurring, to argue a pleading deficiency. This "prevention doctrine," provides that "a party may not insist upon performance of a condition precedent when its nonperformance has been caused by the party [it]self." *Commerzbank AG v. United States Bank N.A.,* 2017 U.S. Dist. LEXIS 159069, *11 (S.D.N.Y., September 27, 2017). Plaintiffs argue that even though U.S. Bank was not obligated pursuant to the PSAs to give notice to the servicers, it had the power to do so, and cannot now evade potential liability because it was not obligated to do so and because other deal parties could have provided notice. Plaintiffs contend that U.S. Bank cannot rely on its own failure to give notice as a shield from liability. *See Phoenix Light SF Ltd. v. Bank of N.Y. Mellon*, 2015 U.S. Dist. LEXIS 131206 (S.D.N.Y. September 29, 2015).

Based on the September 2012 letters, I find that plaintiffs have sufficiently pled that U.S. Bank had notice of facts regarding certain specific violations by servicers, constituting EODs. *Cf. Commerce Bank v Bank of N.Y. Mellon*, 141 A.D.3d 413 (1st Dept. 2016). Those letters only refer to a limited number of trusts at issue, however, but for those specific trusts referenced in the two September 2012 letters, plaintiffs have sufficiently stated a claim for breach of contract based on a failure to provide required notice to trigger an EOD to the servicers and failing to make prudent decisions concerning EODs.

As to pre-EOD claims, Plaintiffs maintain that U.S. Bank breached its duty to identify in final certifications and exception reports, mortgage files that were missing documentation required to be delivered under the PSAs, which included documents to prove ownership of the note and mortgage. U.S. Bank argues that the pre-EOD loan documentation claims are based on duties that terminated soon after a trust's closing and are time barred, and in any event, U.S. Bank did not have a contractual obligation to deliver the loan files, review mortgage files, prepare exception reports, or oversee servicers and master servicers. I agree that claims for document delivery failures and creating certifications and exception reports are time-barred by the six-year statute of limitations.[1] *See Royal Park Invs. SA/NV v. HSBC Bank USA, N.A.*, 109 F. Supp. 3d 587 (S.D.N.Y. 2015); *Fixed Income Shares: Series M v. Citibank, N.A.*, 56 Misc.3d 1205(A) (Sup. Ct. N.Y. Co. June 26, 2017).

U.S Bank next argues that plaintiffs fail to allege facts to support an inference that U.S. Bank discovered or received written notice of loan specific breaches of representations and warranties, and fail to allege breaches by many of the sponsors and for the trusts. Plaintiffs argue that U.S. Bank discovered seller representation and warranty breaches and plaintiffs properly pled the specific representations and warranties breached – regarding the mortgage loan files, originators' compliance with underwriting standards and practices, owner occupancy statistics, appraisal procedures, LTV and combined loan-to-value ratios, and U.S. Bank's discovery of those breaches. Further,

[1] U.S. Bank concedes that this claim regarding one of the trusts (SASCO 2007-BC4), which closed in January 2008, is not time barred and may proceed.

U.S. Bank received written notice from monoline insurers and investors concerning breaches by these same sellers in its capacity as trustee to other trusts. In addition, discovery was based on information from certificateholders themselves, internal documents, remittance reports, and "document exception reports," which identified many incomplete mortgage loans that were not timely cured. Plaintiffs maintain that U.S. Bank failed to see that the defects were cured or that the defective loans were repurchased, and did nothing while servicers engaged in "robosigning" even though the missing documents were needed to foreclose on the properties.

The complaint sufficiently states that there were breaches of the sellers' representations and warranties with respect to the loans included in the trusts at issue and that U.S. Bank had actual knowledge of these breaches and failed to take appropriate action. *See Fixed Income Shares: Series M v. Citibank, N.A.*, 56 Misc.3d 1205(A) (Sup. Ct. N.Y. Co. June 26, 2017). The factual allegations are sufficient at this pleading stage, where the pleadings are afforded a liberal construction and the plaintiffs are given the benefit of every favorable inference. *See Warberg Opportunistic Trading Fund, L.P. v GeoResources, Inc.*, 112 A.D.3d 78 (1st Dept. 2013).

Breach of Implied Covenant of Good Faith and Fair Dealing

Plaintiffs contend that U.S. Bank breached its implied duty of good faith and fair dealing by not giving notice to the servicers, and thus preventing an EOD from being triggered. U.S. Bank argues that this claim must be dismissed because the trusts' governing agreements prohibit the imposition of implied covenant claims. As properly noted by U.S. Bank, the applicable agreements expressly disclaim implied obligations.

Specifically, "no implied covenants or obligations shall be read into this Agreement against the Trustee" prior to the occurrence of an EOD of which trustee shall have actual knowledge, and this disclaimer is binding. *See Nat'l Credit Union Admin. Bd. v. U.S. Bank Nat'l Ass'n*, No. 14-cv-9928(KBF), 2016 WL 796850 (S.D.N.Y. Feb. 25, 2016).[2]

In any event, plaintiffs essentially argue that U.S. Bank breached this covenant by failing to fulfill its contractual obligations. The breach of contract and breach of implied covenant claims are based on the same alleged facts, and as such, this claim must be dismissed. *See Blackrock Allocation Target Shares: Series S Portfolio v. Wells Fargo Bank,* 247 F. Supp. 3d 377 (S.D.N.Y. 2017); *Commerzbank AG v. HSBC Bank USA, N.A.,* No. 15 Civ. 10032 (LGS), 2016 U.S. Dist. LEXIS 75028 (S.D.N.Y. June 8, 2016); *Policemen's Annuity & Benefit Fund of City of Chicago v. Bank of Am., NA, 907 F. Supp. 2d 536* (S.D.N.Y. 2012); *Netologic, Inc. v Goldman Sachs Group, Inc.*, 110 A.D.3d 433 (1st Dept. 2013).

Negligence and Breach of Fiduciary Duty

Plaintiffs argue that prior to an EOD, a trustee's duty is governed solely by the terms of the PSA, with two exceptions: a trustee must still "(1) avoid conflicts of interest, and (2) perform all basic, non-discretionary, ministerial tasks with due care." *Ellington Credit Fund, Ltd. v. Select Portfolio Servicing Inc.*, 837 F. Supp. 2d 162, 191-92 (S.D.N.Y. 2011). Plaintiffs allege that U.S. Bank is liable in tort for both. Plaintiffs further allege that post-EOD, U.S. Bank's conflict of interest prevented it from enforcing

[2] *Cf. Fixed Income Shares: Series M v. Citibank, N.A.*, 56 Misc.3d 1205(A) (Sup. Ct. N.Y. Co. June 26, 2017).

rights against sellers and servicers, as a prudent trustee would have done. Plaintiffs also argue that U.S. Bank breached its duty of care to certificateholders by knowing of the servicers' failure to observe and perform covenants set forth in the PSAs and then negligently failing to provide written notices to the responsible servicers.

In *AG Capital Funding Partners, L.P. v. State St. Bank & Trust Co.*, (11 N.Y.3d 146, 157 [2008]), the Court of Appeals agreed with other courts that had "held that prior to default, indenture trustees owe note holders an extracontractual duty to perform basic, nondiscretionary, ministerial functions." In *Commerce Bank v. Bank of N.Y. Mellon*, (141 A.D.3d 413 [1st Dept. 2016]), the plaintiffs alleged that the defendant had the duty to notify them that other parties to the PSA had failed to perform their obligations. The First Department held that to give plaintiffs such notice, defendant would have had to monitor other parties, and a failure to monitor other parties does not involve the performance of basic non-discretionary ministerial tasks. In addition, the court explained that a trustee does not owe a duty to "nose to the source" *Id.* at 416. Similarly, here, plaintiffs' negligence claim is deficient because it contains allegations that do not involve the performance of basic non-discretionary ministerial tasks.

U.S. Bank maintains that the breach of fiduciary duty claims must be dismissed because (1) the economic loss doctrine bars them; (2) they are duplicative of the breach of contract claims; (3) plaintiffs fails to allege an EOD in connection with their post-EOD fiduciary duty claim. Plaintiffs allege that U.S. Bank failed to protect the trusts and certificateholders by (1) not exercising its rights to enforce sellers' repurchase obligations, and servicers' prudent servicing obligations; (2) not recovering payment of

the underlying obligations owed to the trusts; and (3) avoiding conflicts of interest. They maintain that these claims are distinct from the contractual duties.

A trustee under a corporate indenture has its rights and duties defined by the terms of the agreement, not by any fiduciary relationship. *See AMBAC Indem. Corp. v. Bankers Trust Co.*, 151 Misc. 2d 334 (Sup. Ct. N.Y. Co. 1991); *Hazzard v. Chase Nat'l Bank*, 159 Misc. 57 (Sup. Ct. N.Y. Co. 1936). "The duties of an indenture trustee can be limited to those set forth in the indenture and, as a result, the trustee does not owe the broad fiduciary duties of an ordinary trustee prior to an event of default, except that the trustee is at all times obligated to avoid conflicts of interest with the beneficiaries." *AMBAC Indem. Corp. v. Bankers Trust Co.*, 151 Misc. 2d 334, 338-339 (Sup. Ct. N.Y. Co., 1991). Prior to an event of default, an indenture trustee owes a duty to perform its non-discretionary, ministerial functions with due care, and if this duty is breached the trustee will be subjected to tort liability. However, such action does not give rise to a claim for breach of fiduciary duty. *AG Capital Funding Partners, L.P. v. State St. Bank & Trust Co.*, 11 N.Y.3d 146 (2008). After an event of default, the indenture trustee's obligations come more closely to resemble those of an ordinary fiduciary. *See LNC Invs., Inc. v. First Fid. Bank, N.A.*, 935 F. Supp. 1333 (S.D.N.Y. 1996).

Any claim that U.S. Bank breached a fiduciary duty in failing to act as it was contractually required to do is barred by the economic loss doctrine. *See Nat'l Credit Union Admin. Bd. v. U.S. Bank Nat'l Ass'n*, No. 14-cv-9928 (KBF), 2016 WL 796850 (S.D.N.Y. Feb. 25, 2016); *Fixed Income Shares: Series M v. Citibank, N.A.*, 56 Misc.3d 1205(A) (Sup. Ct. N.Y. Co. June 26, 2017). Pursuant to the economic loss doctrine, "a

contracting party seeking only a benefit of the bargain recovery may not sue in tort notwithstanding the use of familiar tort language in its pleadings." *17 Vista Fee Associates v. Teachers Ins. & Annuity Ass'n of Am.*, 259 A.D.2d 75, 83 (1999). The damages that the plaintiffs seek on the breach of fiduciary duty claims flow from U.S. Bank's obligations under the PSAs. The alleged injury, the way in which the injury occurred, and the damages sought indicate that plaintiffs' actual remedy is found in the enforcement of contractual obligations. *See Blackrock Core Bond Portfolio v. U.S. Bank N.A.*, 165 F. Supp. 3d 80 (S.D.N.Y. 2016). As such, the breach of fiduciary duty claim is barred by the economic loss doctrine.

Further, to properly plead a conflict-of-interest claim, a plaintiff must allege more than the existence of a relationship between an issuer and an indenture trustee that is mutually beneficial and increasingly lucrative. Plaintiff must allege that a trustee personally benefitted from the alleged misconduct. *See Blackrock Allocation Target Shares: Series S Portfolio v. Wells Fargo Bank*, 247 F. Supp. 3d 377, 397 (S.D.N.Y. 2017). Here, plaintiffs allege that U.S. Bank failed and unreasonably refused to act to protect the trusts and certificateholders against seller breaches and servicer violations, because it would have revealed that U.S. Bank itself was engaged in the same servicing misconduct in its role as servicer for other mortgages and RMBS trusts.

Plaintiffs also claim that U.S. Bank was incentivized to prevent servicers from taking necessary and prudent action because the servicers were affiliated with the sponsors that provided U.S. Bank with valuable trustee appointments. Nevertheless, the damages that plaintiffs allege on this claim arise entirely from U.S. Bank's contractual

obligations. Because plaintiffs' allegations for damages arising from a conflict of interest come from U.S. Bank's alleged failure to take contractual actions – for example, its failure to prevent the servicers from engaging in activities outside of customary and usual standards of practice of prudent mortgage service - the claim is barred by the economic loss doctrine. *Blackrock Core Bond Portfolio v. U.S. Bank N.A.*, 165 F. Supp. 3d 80 (S.D.N.Y. 2016).

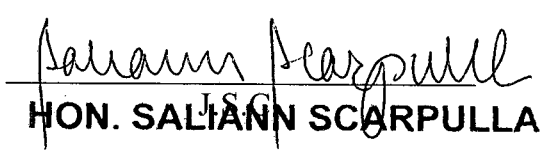
In accordance with the foregoing, it is hereby

ORDERED that defendant U.S. Bank National Association's motion to dismiss the complaint is granted to the extent that the cause of action for breach of fiduciary duty, the cause of action for negligence, the cause of action for breach of the implied covenant of good faith and fair dealing, and the cause of action for breach of contract insofar as it is premised on pre-Event of Default issues concerning loan documentation, and as otherwise set forth above, are dismissed, and the remaining causes are severed and shall continue; and it is further

ORDERED that defendants answer the complaint within twenty days of this decision.

This constitutes the decision and order of the court.

Dated: January 12, 2018
New York, New York



J.S.C.
HON. SALIANN SCARPULLA