

<b>Bluebird Partners, L.P. v Bank of N.Y.</b>
2010 NY Slip Op 31407(U)
June 7, 2010
Sup Ct, NY County
Docket Number: 601016/96
Judge: Eileen Bransten
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT

PART 3

Index Number : 601016/1996

BLUEBIRD PARTNERS, L.P.

vs

BANK OF NEW YORK

Sequence Number : 012

SUMMARY JUDGMENT

INDEX NO. 601016/1996

MOTION DATE 5/4/10

MOTION SEQ. NO. 012

MOTION CAL. NO. \_\_\_\_\_

The following papers, numbered 1 to \_\_\_\_\_ were read on this motion to/for \_\_\_\_\_

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits \_\_\_\_\_

Replying Affidavits \_\_\_\_\_

PAPERS NUMBERED

1

2

3

Cross-Motion:  Yes  No

Upon the foregoing papers, it is ordered that this motion

IS DECIDED

IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

**UNFILED JUDGMENT**  
This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 141B).

Dated: 6-7-10

*Eileen Bransten*  
J.S.C.

**HON. EILEEN BRANSTEN**

Check one:  FINAL DISPOSITION  NON-FINAL DISPOSITION

Check if appropriate:  DO NOT POST  REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: PART 3

-----X

BLUEBIRD PARTNERS, L.P.,  
Plaintiff,  
-against-

Index No.: 601016/96  
Motion Date: 5/4/10  
Motion Seq. No.: 012

THE BANK OF NEW YORK; FIRST FIDELITY BANK,  
N.A., NEW JERSEY; MIDATLANTIC NATIONAL  
BANK; UNITED JERSEY BANK; NATIONSBANK OF  
TENNESSEE, N.A.; CONSTELLATION BANK;  
CORESTATES NEW JERSEY NATIONAL BANK;  
RIKER DANZIG SCHERER HYLAND & PERRETTI;  
VECCHIONE, P.C.; WOLF & SAMSON,  
KELLEY DRYE & WARREN; and WILENTZ  
GOLDMAN & SPITZER, P.C.,  
Defendants.

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appear in person at the Judgment Clerk's Desk (Room  
141B).

-----X

EILEEN BRANSTEN, J.:

Defendant Bank of New York ("BNY") moves, pursuant to CPLR 3212, for summary judgment dismissing the complaint on the ground that BNY acted in a reasonable and prudent manner in establishing and administering the litigation reserve that is the subject of this lawsuit.

**BACKGROUND**

In 1987, Continental Airlines, Inc. ("Continental") issued \$350 million in bonds that were secured by over \$400 million in aircraft and airplane parts (the "Collateral"). These bonds were termed the First, Second and Third Priority Secured Equipment Certificates. Investors who acquired the Certificates are referred to herein as Certificateholders. Former defendant First Fidelity Bank was the Collateral Trustee under a Secured Equipment Indenture and Lease Agreement (the "Indenture")(Affidavit of Loretta A. Lundberg ["Lundberg Aff."],

Ex. 4). Under the Indenture, as amended and modified by a partial settlement agreement (Lundberg Aff., Ex. 5) and a liquidating trust agreement (the "Trust") (Lundberg Aff., Ex. 6), the Collateral Trustee had the authority to reserve funds in its possession "sufficient to pay reasonably anticipated fees and expenses of each Series Trustee and its own fees and expenses incurred in its capacity as Collateral Trustee . . ." (the "Litigation Reserve")(Lundberg Aff., Ex. 7). Section 3.09 (a) of the Indenture defines the priority of payments that the Collateral Trustee must make from the Trust's proceeds in the event of default.

The first priority payments are "all proper charges, expenses or advances made or incurred by the Collateral Trustee or any Series Trustee in accordance with the provisions of this Agreement . . ." The second priority payment is "the principal then due and payable, of premium (if any) and interest . . . on all the Outstanding First Certificates" (Lundberg Aff., Ex. 4). In addition, Sections 9.06 (c) and (f) provide that, in the event of a default, the trustees are to be indemnified out of the trust's proceeds for all of the expenses, including attorneys' fees, they incur, in performing their duties (Lundberg Aff., Ex. 4; Affirmation of Howard B. Schub ["Schub Aff."], Ex. 5).

Section 9.02 of the Indenture defines the standard of care governing the Collateral Trustee in the event of default, stating that the "Collateral Trustee and each of the Series Trustees shall exercise such of the rights and powers vested in it by this agreement, and use the same degree of care and skill in their exercise as a prudent man would exercise or use under the circumstances in the conduct of his own affairs" (Lundberg Aff., Ex. 4).

Former defendant NationsBank was the successor Collateral Trustee to First Fidelity Bank under the Indenture. In December 1990, Continental filed a bankruptcy petition and ceased making payments on the bonds. At that time, approximately \$180 million of the bonds remained outstanding, secured by collateral worth approximately \$175 million. During the course of the bankruptcy proceeding the Collateral declined in value by over \$100 million.

In February 1994, Bluebird, an owner of more than \$71 million in First Series Certificates issued by Continental, commenced a federal court action against a number of the indenture trustees alleging various forms of breach based on the indenture trustees' alleged failure to protect the Certificateholders' interest in the collateral during Continental's bankruptcy. In December 1995, BNY replaced NationsBank as Collateral Trustee. At that time, the Trust held approximately \$34 million (Lundberg Aff., Ex. 13). By letter dated December 15, 1995, NationsBank informed BNY that the amount of the litigation reserve it had established, based on amounts incurred through April 30, 1995, was approximately \$25.6 million (Lundberg Aff., Ex. 11). According to NationsBank, the amount in the litigation reserve represented the indemnification claims of banks and law firms that were sued by Bluebird for allegedly failing to protect Bluebird's interests in the collateral securing the indenture during Continental's bankruptcy.

In February 1996, Bluebird filed this lawsuit. Bluebird claims that under the controlling documents, BNY had no right to establish a litigation reserve in the Trust.

Bluebird asserts that BNY was wrongfully withholding Trust funds by not distributing them to the Certificateholders (Lundberg Aff., Ex. 1).

BNY moved to dismiss all causes of action in the complaint but for the fifth which was for a declaratory judgment and the eighth alleging breach of fiduciary duty. BNY argued that it could not immediately distribute all of the Trust's proceeds to the beneficiaries because the Indenture, as amended, required it to first indemnify the various trustees for the expenses they had incurred, and expected to incur, in defending themselves against Bluebird's lawsuits.

In an opinion and order entered on December 23, 1996, this court granted the motion to dismiss, in part, stating that "the Controlling Documents . . . require that the collateral trustee reserve adequate funds for the defendants' expenses including litigation expenses, which the defendants are entitled to" (Lundberg Aff., Ex. 15). After the First Department, on appeal, dismissed Bluebird's cause of action for breach of contract, two causes of action remained.

In those remaining two causes of action, Bluebird claims that BNY breached its fiduciary duty "[b]y failing to release all of the remaining funds held in trust for the Certificateholders, other than those funds reasonably necessary to satisfy the justifiable and necessary expenses of the Trust" (Lundberg Aff., Ex. 1, ¶ 123). Bluebird also seeks a declaration "limiting defendants' purported lien on the trust funds to an amount determined to be reasonably necessary to satisfy defendants' indemnity rights, if any, (not in excess of \$5

million) and that BNY must make immediate distribution of all remaining funds and not unduly prolong the duration of the Trust” (Lundberg Aff., Ex. 1, ¶ 110).

### CONTENTIONS

In support of its motion for summary judgment, BNY argues that, as a matter of law, it acted as a “prudent man” in establishing and maintaining the trust. BNY contends that in March 1996, acting in accordance with controlling documents, it: 1) wrote to the trustee-defendants in the various Bluebird litigations asking them for the amount of fees they had incurred to date and expected to incur in the future defending against Bluebird’s claims; 2) reviewed the trustee-defendants responses that, inter alia, emphasized the difficulty in estimating future litigation expenses; and 3) accepted the recommendation of its Default Advisory Committee in consultation with counsel to establish a fund of \$28.6 million, an amount it reached by totaling the legal fee estimates provided by the trustee-defendants and adding a 10% contingency cushion.

BNY states that the methodology it used to establish the reserve fund was based on the logical, common-sense reasoning of BNY’s trust officers. BNY also states that, throughout the life of the trust, it solicited updated fee estimates and that, whenever there was an adequate amount of money in excess of the litigation reserve, BNY distributed that excess money to the Certificateholders.

In opposition to BNY’s motion, Bluebird argues that the litigation reserve was excessive and that there are material facts in dispute about whether BNY acted prudently in

establishing and maintaining the litigation reserve. In particular, Bluebird claims that BNY: 1) failed to assess the reasonableness of estimates provided by the banks and their law firms and 2) did not secure an outside opinion about how to establish the reserve or whether the reserve was reasonable. Moreover, Bluebird contends that there is a question of fact about whether BNY unreasonably favored the interests of its fellow banks over those of the bondholders by maintaining an unnecessarily large litigation reserve.

### DISCUSSION

Summary judgment will be granted if it is clear that no triable issue of fact exists (*Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986]). The burden is on the moving party to make a prima facie showing of entitlement to summary judgment as a matter of law (*Zuckerman v City of New York*, 49 NY2d 557, 562 [1980]; *Friends of Animals v Associated Fur Mfrs.*, 46 NY2d 1065, 1067 [1979]). If a prima facie showing has been made, the burden shifts to the opposing party to produce evidentiary proof sufficient to establish the existence of a triable issue of fact (*Alvarez v Prospect Hosp.*, 68 NY2d at 324; *Zuckerman v City of New York*, 49 NY2d at 562). Mere conclusions, unsubstantiated allegations or expressions of hope are insufficient to defeat a summary judgment motion (*Zuckerman v City of New York*, 49 NY2d at 562).

In this case, BNY has established a prima facie case that it is entitled to judgment as a matter of law by producing the Indenture as amended by the partial settlement agreement and the liquidating trust agreement. The documents demonstrate that BNY had an obligation to

create and maintain a litigation reserve and also show that payment of reasonable expenses, including attorneys' fees, of the Collateral Trustee and the Series Trustees was the first priority.

Moreover, BNY has produced correspondence, deposition testimony and the notes of BNY's Default Advisory Committee to demonstrate that it acted in accordance with the "prudent man" standard articulated under New York law and in the Trust Indenture Act, as well as the relevant documents, in determining the amount money to place in the litigation reserve. In *Beck v. Manufacturers Hanover Trust Co.*, (218 AD2d 1, 11-13 [1st Dept 1995]), the First Department stated that in the event of default, the trustee must act with undivided loyalty to the trust's beneficiaries and must exercise its rights and powers under the indenture using the same degree of care and skill as a prudent man would exercise under the circumstances in the conduct of his own affairs. The court noted that:

The trustee must in the post default context act prudently, but only in the exercise of those rights and powers granted in the indenture. The scope of the trustee's obligation then is still circumscribed by the indenture . . . . The trustee is not required to act beyond his contractually conferred rights and powers, but must, as prudence dictates, exercise those singularly conferred prerogatives in order to secure the basic purpose of any trust indenture, the repayment of the underlying obligation (*id.* at 13).

The Trust Indenture Act, "Duties and responsibilities of the trustee," 15 USC §7700o (c), states that upon the event of default, "[t]he indenture trustee shall exercise . . . such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the

circumstances in the conduct of his own affairs.” Moreover, as noted above, the Indenture itself charges BNY, as Collateral Trustee, with the duty to exercise its powers in accordance with the Indenture and to “use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.”

In determining that \$28.6 million was a reasonable sum to reserve for litigation expenses, BNY contacted each of the Series Trustees and solicited their estimates of the legal fees that they had incurred and expected to incur in the future in defending themselves in the Bluebird actions (Lundberg Aff., Ex. 19). BNY engaged outside counsel to review the information it received (Reply Memo, n 7). Following the review, BNY’s Default Advisory Committee met and determined that the amount in the reserve should equal the total of the estimates plus 10% to cover litigation contingencies (Lundberg Aff., Exs. 36, 37). BNY then periodically reassessed whether the reserve amount was adequate to meet the projected litigation needs. BNY contends that the actions it took in setting up the reserve were, as a matter of law, reasonable and prudent.

Bluebird’s argument, that there are questions of fact about whether BNY acted reasonably and prudently, is without merit. As to Bluebird’s assertion that questions of reasonableness and prudence are fact intensive and cannot be decided on summary judgment, in *Matter of Bank of NY*, (35 NY2d 512, 519 [1974]), the Court of Appeals granted summary judgment on the question of the reasonableness of a trustee’s actions. In that case, the court found that there was not a sufficient basis to surcharge a trustee regarding decisions he made

in the management of a trust. Therein, the record disclosed that the trustee acted in good faith and that there was no evidence that he failed to exercise diligence and prudence in the care and management of the funds, "as, in general, prudent men of discretion and intelligence in such matters, employ in their own like affairs" (*id.* at 518-519) (citations omitted). Indeed, the court in that case went on to state:

It was not shown in any instance that the losses to the trust fund resulted from imprudence or negligence. There was evidence of attention and consideration with reference to each decision made. Obviously, it is not sufficient that hindsight might suggest that another course would have been more beneficial; nor does a mere error of investment judgment mandate a surcharge.

(*id.* at 519; *see also Matter of Morgan Guar. Trust Co. of N.Y.*, 89 Misc 2d 1088, 1090 [Sur Ct, NY County 1977] [where no triable issue of fact existed about whether the trustee acted reasonably, no hearing on the motion for summary judgment was required]).

In this case, Bluebird's list of BNY's alleged derelictions, including BNY's alleged failure to assess the reasonableness of the estimates it received from the trustees or its failure to get outside opinions about how to establish a reserve, do not raise questions of fact regarding the reasonableness of BNY's methodology in establishing and maintaining the litigation reserve. It cannot be said, as a matter of law, that BNY failed to act as a "prudent man" in a similar circumstance. Under the controlling documents, the trustees were to be indemnified out of the Liquidating Trust's proceeds for all the expenses, including attorneys' fees, they incurred in performing their duties. At the time that BNY established the reserve it did not know that some of the trustees would settle with Bluebird and/or waive their fees.

Moreover, BNY did not know whether the trustees' fee requests would be rejected based on a trustee's wrongful conduct. BNY was not required to be prescient in making its decisions regarding the amount of money in the litigation reserve (see *Matter of Bank of New York*, 35 NY2d at 519); it was simply required to act as a prudent man in similar circumstances. BNY did so by soliciting fee estimates from the defendant trustees, totaling those estimates and adding 10% to cover unforeseen contingencies. Bluebird's post hoc complaints fail to raise a material question of fact regarding BNY's reasonable and prudent actions in establishing and maintaining the litigation reserve.

Accordingly, it is

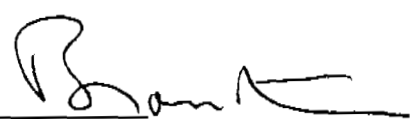
ORDERED and ADJUDGED that the fifth cause of action seeking a declaratory judgment is denied; and it is further

ORDERED that defendant Bank of New York's motion for summary judgment dismissing the complaint as against it is granted and the complaint is dismissed with costs and disbursements to defendant as taxed by Clerk of the Court upon submission of an appropriate bill of costs; and it is further

ORDERED that the clerk is directed to enter judgment accordingly.

Dated: New York, New York  
 June 7, 2010

**UNFILED JUDGMENT**  
 This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representatives must appear in person at the Judgment Clerk's Desk (Room 141B).

  
 Hon. Eileen Bransten, J.S.C.