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Bank of America Avoids Multiple Liability By Filing Interpleader Complaint

By Amanda Zablocki

On October 12, 2010, Judge Melvin L. Schweitzer held that Bank of America's filing of an interpleader complaint to resolve ambiguities in an indenture contract was in good faith, reasonable, and prudent, and therefore denied the defendant's motion to dismiss. *Bank of America, N.A. v. Prima Capital Advisors LLC, Index No. 600740/10 (Sup. Ct., NY County Oct. 12, 2010)*. The Court further held that a material question of fact existed, weighing against summary judgment. *Id.*

Prima Capital Investors LLC ("Prima") is an advisory firm that, among other things, establishes investment vehicles through which its clients and other investors may purchase various types of assets. In May 2005, Prima created an investment vehicle that issued notes (the "2005 Notes") to various investors (the "2005 Note holders"). The 2005 investment vehicle is comprised of two companies: Prima Capital CDO 2005-1 Ltd. and Prima Capital CDO 2005-1 Corp (serving together as the "2005 Issuer"). The 2005 Issuer used funds paid by the 2005 Note holders as the purchase price for the 2005 Notes to purchase commercial mortgage assets. In November 2006, Prima created a second investment vehicle issuing notes (the "2006 Notes") to investors (the "2006 Note holders"). The 2006 investment vehicle is likewise comprised of two companies: Prima Capital CRE Securitization 2006-1 Ltd. and Prima Capital CRE Securitization Corp (the "2006 Issuers," and together with the 2005 Issuers, the "Issuers"). The 2006 Issuer used funds paid by the 2006 Note holders as the purchase price for the 2006 Notes to purchase commercial mortgage assets.

Pursuant to two indentures, issued in 2005 and 2006, Prima engaged LaSalle Bank N.A. to serve as Trustee with respect to the 2005 and 2006 Notes. In October 2007, Bank of America, N.A. purchased LaSalle and assumed all of the agreements entered into by LaSalle with respect to the Notes and Indentures. The 2005 Issuer issued nine classes of Notes under the 2005 indenture, designating classes A-1 through F as Senior Notes, and classes G and H as Junior Notes. Similarly, the 2006 Issuer issued eleven classes of Notes under the 2006 Indenture, designating classes A through G as Senior Notes, and classes H through K as Junior Notes. Each class of Notes is subordinated to the class(es) above it, and the income flows down sequentially to each class.

Pursuant to the 2005 Collateral Management Agreement ("CMA") and the 2006 CMA, Prima served as Collateral Manager for the 2005 Notes and the 2006 Notes, respectively. As Collateral Manager, Prima was tasked with "determining whether Collateral Interests have become Impaired Interests or Credit Risk Interests." *Bank of America, N.A., p. 5.* The Indentures define Impaired Interests as follows:

> A Collateral Interest with respect to which foreclosure or default (whether or not declared) with respect to the underlying Commercial Mortgage Loan has occurred or, with respect to any Collateral Interest that is a CMBS, CRE CDO Security or a REIT Bond (i) the rating of such Collateral Interest has been reduced by at least three rating subcategories or withdrawn by any Rating Agency from the ratings that were in place as of the Closing Date (or, in the case of Substitute Collateral Interest, the date of substitution) or has been put on "credit watch" or similar status for possible downgrading, qualification or withdrawal or

(ii) since the date such Collateral Interest is delivered to the Trustee, the principal amount thereof has been reduced without receipt of a corresponding principal distribution as a result of allocation to such Collateral Interest of a "realized loss," "collateral support deficit," "additional trust fund expense" or similar item.

Id. When Prima instructed Bank of America to declare certain Impaired Interests no longer impaired and to disburse the income from those interests accordingly Bank of America declined to do so, believing there was an ambiguity in the Indentures as to whether the Collateral Manager had the authority to declare Impaired Interests to be no longer impaired. Concerned about exposure to multiple liability, Bank of America issued a notice to the holders of the 2005 and 2006 Notes regarding the recharacterization of the Impaired Interests and inviting the Note holders' input and interpretation of the relevant provisions of the Indenture. Bank of America informed the Note holders that the interest payments on the relevant notes would be held in an escrow account pending resolution of the issue. Prima notified Bank of America of its position that Prima's order fell within its discretion and Bank of America's failure to honor the order was a breach of the Indenture. One group of Note holders, Oz Master Fund Ltd, et al. ("Oz"), notified Bank of America of its position that once the Collateral Interest was declared "Impaired," the recharacterization was permanent, claiming that neither the Indenture, CMA or related Offering Memorandum contemplated recharacterization, and market practice is consistent with its position.

On March 23, 2010, Bank of America initiated an Interpleader action pursuant to CPLR 1006. Both Oz and Prima answered and asserted counterclaims against Bank of America. Bank of America's moved to dismiss Prima's second affirmative defense and counterclaims. Prima opposed Bank of America's motion to dismiss and cross-moved for dismissal of the Interpleader and for summary judgment. Soon thereafter Oz also moved for summary judgment.

The Court found that the provision of the CMAs that afforded Prima the task of "determining whether Collateral Interests have become Impaired Interests or Credit Risk Interests" was "tellingly . . . silent" on the issue of whether Prima had the authority to declare the reverse. *Id.* at p. 12. The Court found in contrast that the CMAs provided Prima with "full power and authority 'to do any and all things in connection with its servicing and management duties which it may deem necessary or desirable and are permitted or not expressly prohibited by this Agreement or the Indenture." *Id.* at pp. 12-13. Finding neither Prima's nor Bank of America's contentions regarding the contradictory nature of these sections to be convincing, open questions remained as to a material fact, which rendered the Court unable to grant summary judgment.

Prima also argued that Bank of America could not bring an interpleader action where it could not establish that it was subject to multiple liability. Bank of America argued in response that New York courts have sanctioned the use of interpleader as an anticipatory action and that a stake holder is not required to objectively assess the validity of claims against it. *Id.* at pp. 13-14 (citing *Fischbein, Badillo, Wagner v. Tora Realty Co., 193 A.D.2d 442 (1st Dept 1993)*; *Bank of New York v. First Millennium, Inc., 607 F.3d 905, 922 (2d Cir. 2010)*; *United States Trust v. Alpert, 10 F. Supp. 2d 290, 301 (S.D.N.Y. 1998)*; *Viewhaven, Inc. v. Danan*, No. 85 Civ. 9603 (LLS), 1986 WL 6779, at *2, 1986 U.S. Dist. LEXIS 24279 (S.D.N.Y. June 12, 1986)).

The Court held that the interpleader action was justified because: (1) Bank of America had been notified by Note holders holding opposing opinions with respect to Prima's authority to recharacterize the Interests; (2) the determination of this issue will result in an allocation of economic benefits favoring only one group of competing Note holders; (3) the opposing positions of the Note holders; and (4) Bank of America acted in good faith, reasonably and prudently when it filed the Interpleader.

Two distinct issues are therefore raised by this decision. First, *Bank of America, N.A.* appears to adopt a somewhat liberal view of the requirements that should be present in order to file a proper interpleader action. Justice Schweitzer seems to adopt the standard set forth in *Viewhaven, Inc*. — that the validity of an interpleader action rests on "whether 'the party requesting it has real and reasonable fear of double liability and

vexatious, conflicting claims.'" *Bank of America, N.A.*, at p. 14 (citing *Viewhaven, Inc*., 1986 WL 6779, at *2).

Second, Justice Schweitzer's decision left open the issue, at this time, whether Impaired Interests can be recharacterized to be no longer impaired. Since the Court found that the CMAs contained contradicting provisions regarding Impaired Interests, indenture trustees and collateral managers should carefully review similar agreements when requested to take action or requesting a party to take action.

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