

New York Commercial Division Round-Up

News & Updates on Cases Decided in the Commercial Division of the New York State Supreme Court

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[Trustee's Establishment of Litigation Reserve Deemed Reasonable Under The "Prudent Man" Standard](#)

By [Sarah Aberg](#)

In *Bluebird Partners, L.P. v. Bank of New York*, Index No. 1996-601016, 2010 NY Slip Op 31407(U) (Sup Ct, NY County, June 7, 2010), Justice Eileen Bransten of the New York Commercial Division, granted a summary judgment motion in favor of the Bank of New York, as a collateral trustee, because she found that the bank acted in a reasonable and prudent manner in establishing and administering a litigation reserve pursuant to an indenture and trust agreement.

The action arose from a 1987 Indenture and liquidating trust agreement (the "Trust") pursuant to which Continental Airlines ("Continental") issued \$350 million in bonds secured by over \$400 million in aircraft and airplane parts (the "Collateral"). Bank of New York ("BNY") was successor collateral trustee for the Trust and, under the Indenture and Trust, 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 Indenture also provided that, in the event of a default, the trustees were to be indemnified for all of the expenses, including attorney's fees, incurred in performing their duties. Finally, the Indenture set forth the standard of care governing BNY, as Collateral Trustee, in the event of default, as follows: 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."

In December 1990, Continental filed for bankruptcy and ceased making payments on the bonds, at which time approximately \$180 million of the bonds remained outstanding, secured by collateral worth approximately \$175 million. The Collateral declined in value by over \$100 million during the course of the bankruptcy proceeding. In February 1994, plaintiff Bluebird Partners, L.P. ("Bluebird"), an owner of more than \$71 million of the bonds, commenced a lawsuit against a number of the indenture trustees, alleging that they failed to protect the bond

holders' interest in the Collateral during Continental's bankruptcy. By December 1995, the Trust held approximately \$34 million, with \$25.6 million held in a litigation reserve, for the indemnification of banks and law firms that were sued by Bluebird.

Plaintiff then filed the instant action against BNY in February 1996, claiming that the controlling documents did not give BNY the right to establish a litigation reserve, and that BNY was wrongfully withholding Trust funds. The Court dismissed all but two of plaintiff's causes of action, holding 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." Plaintiff's two remaining claims sought (1) a declaratory judgment limiting defendants' lien on the trust funds to an amount determined to be reasonably necessary to satisfy defendants' indemnity rights (not in excess of \$5 million) and requiring BNY to make immediate distribution of all remaining funds, and (2) a judgment that BNY breached its fiduciary duty to Plaintiff. Plaintiff argued that the litigation reserve was excessive and that there were material facts in dispute regarding whether BNY acted prudently in establishing and maintaining the litigation reserve, including by failing to secure an outside opinion about the reasonableness of the reserve.

In response, BNY argued that, as a matter of law, it acted as a "prudent man" in establishing and maintaining the trust because BNY had, *inter alia*, learned from the trustee-defendants in the various Bluebird litigations the amount of fees they had incurred to date and expected to incur in the future, and followed the recommendation of its Default Advisory Committee in consultation with counsel to establish the reserve. BNY also argued that it relied on the "logical, common-sense reasoning" of its trust officers.

Justice Bransten found that the Indenture and Trust were prima facie evidence that BNY had an obligation to create and maintain a litigation reserve, and that BNY's first priority was payment of the Collateral Trustee's and the Series Trustees' reasonable expenses, including attorneys' fees. Relying on correspondence, deposition testimony and BNY's Default Advisory Committee notes, Justice Bransten found that, in determining the amount money to place in the litigation reserve, BNY acted in accordance with the "prudent man" standard articulated under New York law, the Trust Indenture Act, and the Indenture. Justice Bransten also noted that, while the trustee must act with undivided loyalty to the trust's beneficiaries, the "scope of the trustee's obligation [] is still circumscribed by the indenture."

Ultimately, Justice Bransten determined that BNY's determination that \$28.6 million was a reasonable sum to reserve for litigation expenses was consistent with the "prudent man" standard. Justice Bransten also noted that while questions of reasonableness and prudence are potentially fact intensive inquiries, that was not a reason to deny summary judgment, because the bank "was not required to be prescient in making its decisions regarding the amount of money in the litigation reserve, . . . it was simply required to act as a prudent man in similar circumstances."

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