REDACTED

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

– x

In the Matter of the Application of	:	Index No. 150973/2016 IAS Part 39
THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed Securitization Trusts,	:	Justice Scarpulla
	:	Mot. Seq. 001
Petitioner,	x	**AMERICAN INTERNATIONAL GROUP, INC.'S MEMORANDUM OF LAW ON ALLOCATION OF THE SETTLEMENT PAYMENT**
For Judicial Instructions under CPLR Article 77 on the Distribution of a Settlement Payment.		

– –

TABLE OF CONTENTS

Page

I. PRELIMINARY STATEMENT 1

II. STATEMENT OF FACTS 5

- A. Procedural History 5
- B. Structure Of Disputed Trusts 6
- C. Methodologies For Distributing The Settlement Payment 8

III. ARGUMENT 12

- A. The Text And Structure Of The AIG Trusts, The Intent Of The Settlement Agreement, And Applicable Course Of Dealings All Support Distribution Of The Settlement Payment Pursuant To The Standard Intex Method. 12
  - 1. The Standard Intex Method Is The Only Method Consistent With The Text And Structure Of The AIG Trusts. 12
  - 2. The Undisputed Intent Of The Settlement Agreement Was To Distribute The Settlement Payment To The Most Senior Tranches. 15
  - 3. Market Participants Share The Trustee's Understanding That Super-Senior Bonds Should Receive All Or Most Of The Settlement Payment. 16
    - (a) Course Of Dealings Is Relevant To Interpreting The Settlement Agreement And PSAs. 16
    - (b) The Standard Intex Method Reflects How Market Participants Understood The Disputed Trusts To Function. 18
  - 4. The Objectors' Preferred Distribution Method Would Result In An Unjust Windfall For Junior Certificateholders. 19
- B. None Of The Objectors Has Standing To Dispute Application Of The Standard Intex Method To CWALT 2007-OA10. 23
- C. The Allocable Shares Should Be Allocated Among Certificates In The AIG Trusts As Of The Date They Are Distributed. 23

IV. CONCLUSION 25

TABLE OF AUTHORITIES

Page

Cases

Castellano v. New York, 43 N.Y.2d 909 (1978) 22

Cole v. Macklowe, 99 A.D.3d 595 (1st Dep't 2012)....................17, 22

Ferran v. City of Albany, 116 A.D.3d 1194 (3d Dep't 2014)....................23

Gary Friedrich Enterprises, LLC v. Marvel Characters, Inc.,
716 F.3d 302 (2d Cir. 2013)....................12

In re Lehman Brothers Holdings Inc.,
530 B.R. 601 (S.D.N.Y. 2015)....................17

In re Lipper Holdings, 1 A.D. 3d 170 (1st Dep't 2003) 22

New York State Assn. of Nurse Anesthetists v. Novello, 2 N.Y.3d 207 (2004)....................23

Uhlfelder v. Weinshall, 47 A.D.3d 169 (1st Dep't 2007) 23

Ward v. Nat'l Geographic Society,
284 Fed. App'x 822, 2008 WL 2595181 (2d Cir. June 27, 2008)....................17

Waverly Corp. v. City of New York,
48 A.D.3d 261 (1st Dep't 2008) 12

Miscellaneous

Restatement (Second) of Contracts, § 223 (1981) 17

J.P. MORGAN, SECURITIZED PRODUCTS WEEKLY, "NON-AGENCY RMBS AND HOME PRICE COMMENTARY" (FEB. 5, 2016) 4, 15

I. PRELIMINARY STATEMENT

Senior bondholder American International Group, Inc. and its undersigned affiliates (collectively, "AIG") submit this brief in response to arguments made by junior bondholders Blue Mountain, Prosiris, and Tilden (collectively, the "Objectors") concerning distribution of the portion of the $8.5 billion Bank of America settlement payment (the "Settlement Payment") allocable to three residential mortgage-backed securities ("RMBS") held by AIG (the "AIG Trusts").[1] Both the June 28, 2011 Settlement Agreement,[2] and the Pooling and Servicing Agreements (the "PSAs") that govern the operations of each AIG Trust, require the Settlement Payment to be distributed primarily or entirely to the "super-senior" bonds held by AIG.

Sections 3(d)(i) and (ii) of the Settlement Agreement require the portion of the Settlement Payment allocated to each trust (each, an "Allocable Share") to be distributed pursuant to a "pay first, write-up second" methodology. Specifically, the Allocable Share is to be distributed among various tranches based upon the certificate principal balances outstanding at the time of the distribution. Following distribution of the Settlement Payment, the certificate principal balances are then "written up" to the extent of any unpaid realized losses.

The purpose of this "pay first, write-up second" methodology is to ensure that only bonds that have outstanding principal balances prior to distribution of the Settlement Payment receive any portion of it. Thus, written-down junior bonds, such as those held by the Objectors, would

---

[1] The three AIG Trusts are CWALT 2006-OA10, CWALT 2007-OA3, and CWALT 2007-OA10. AIG holds certificates in the 4A1, 2A1, and 1A1 tranches of those trusts, respectively, which are the most senior tranches. With respect to CWALT 2007-OA10, none of the Objectors claims any interest in this trust.

[2] Dkt. No. 3 (attached as Exhibit A to the Affirmation of Jordan A. Goldstein in Support of AIG's Memorandum of Law on Allocation of the Settlement Payment to the Disputed Trusts ("Goldstein Affirmation" or "Goldstein Aff."). Except where otherwise specified, "Exhibits" or "Ex." shall refer to exhibits to the Goldstein Affirmation.

typically receive little or nothing in the settlement. The undisputed testimony of the drafters of the Settlement Agreement supports this conclusion—the purpose of the Settlement Agreement was to benefit the most senior bonds, rather than junior bonds that had already been written down. Under the Objectors' preferred methodology, however, *over half* of the Allocable Shares for the AIG Trusts would flow to partially or fully written-down junior bonds, rather than the most senior bonds. That would be an unanticipated and unfair outcome, because the Objectors' preferred methodology directly contradicts the text and intent of the Settlement Agreement.

The PSAs support this conclusion. Specifically, if the Objectors' preferred distribution methodology were applied to the AIG Trusts, the trusts would become structurally unbalanced and undercollateralized and, in the words of one market participant, "[REDACTED]." [REDACTED] (Ex. B). By contrast, if AIG's preferred distribution methodology is employed, the trusts will remain adequately collateralized, consistent with the structure of the PSAs.

In addition to the contractual language, the investor community has understood the Settlement Agreement and PSAs to require distribution of the Settlement Payment in a manner that avoids a windfall to junior bondholders, while also maintaining the structural integrity of the trusts. The consistent view of market participants is that the AIG Trusts are intended to distribute the Settlement Payment primarily or entirely to the super-senior tranches.

One window into investor expectations is provided by Intex Solutions, Inc. ("Intex"), which is "the world's leading provider of structured fixed-income cashflow models and related analytical software." *Overview*, INTEX.COM, http://www.intex.com/main/company.php (last visited August 12, 2016). Intex has provided the investing community with financial models for predicting cashflows on RMBS for over a decade. *Id.*; *see also* Dkt. No. 1, Verified Petition ¶ 42

(describing Intex as "a leading provider of cash flow models that are used and relied upon by investors throughout the structured fixed income industry").

Intex's default methodology for modeling distribution of the Settlement Payment for the three AIG Trusts, as well as the 14 similar trusts that remain in dispute in this proceeding (together, the "Disputed Trusts"), is called the "Standard Intex Method."[3] The Standard Intex Method ensures that the Settlement Payment is distributed primarily or entirely to the most senior bonds.[4] Although Intex has recently added, at the request of undisclosed investors, two additional cashflow models to permit investors to model the Settlement Payment pursuant to "non-standard" methodologies (including the one advocated by the Objectors), Intex's president has testified that the Standard Intex Method is Intex's *default* methodology for investors to model distribution of the Settlement Payment to all 17 Disputed Trusts.[5] The Standard Intex Method is also the approach this Court has already ordered with the consent of all certificateholders represented in this proceeding, including the three Objectors, for distributing the Settlement Payment to the 512 trusts that were the subject of the Court's May 12, 2016, Partial Severance Order and Partial Final Judgment. Dkt. No. 77, at 7-8.

The clear consensus of the investor community is that the Standard Intex Method is the most commercially-reasonable methodology among the three models offered by Intex for

---

[3] *See* Affidavit of Intex Solutions, Inc., dated July 25, 2016 ("Intex Affidavit" or "Intex Aff.") (Ex. C), at ¶ 5.

[4] *See* Affidavit of James K. Finkel in Support of American International Group's Memorandum of Law on Allocation of the Settlement Payment, dated August 12, 2016 ("Finkel Affidavit" or "Finkel Aff.") (Ex. D) ¶¶ 30, 38.

[5] Intex Aff. ¶ 5. Moreover, with only limited exceptions, the Standard Intex Method has been the default method for nearly all the Disputed Trusts since 2011 (and at no point has the methodology advocated by the Objectors ever been Intex's default methodology). *Id.* App'x A.

distributing the Settlement Payment to the Disputed Trusts. The Standard Intex Method has also been described by third parties as the most commercially reasonable of the applicable methodologies. J.P. Morgan, for example, in an independent research report, concluded that the Standard Intex Method is "the most reasonable option of the three, as it follows the language in the [Settlement] [A]greement without leading to any structural issues."[6] Likewise, RMBS expert James K. Finkel has concluded, "[T]he Standard Intex Method is the most commercially-reasonable application of the Allocable Shares: it is supported by industry research and maximizes the recovery to the most senior certificates without compromising the integrity of the capital structure." Finkel Aff. ¶ 53. As discussed in greater detail below, AIG respectfully requests that the Court order the Trustee to distribute the Settlement Payment to the AIG Trusts pursuant to the Standard Intex Method.

Moreover, for one of the AIG Trusts (CWALT 2007-OA10), none of the Objectors claims any interest in the trust. AIG respectfully requests that the Court defer to AIG's request to apply the Standard Intex Method to the CWALT 2007-OA10 trust, as no certificateholder in this trust who has appeared in this proceeding (an "Interested Certificateholder") opposes such relief.

Finally, AIG responds to Prosiris and Tilden's argument that the Settlement Payment should be distributed as if it occurred as of February 25, 2016.[7] This argument has no logical or legal support. Nothing in the PSAs permits a distribution to relate back to a prior set of certificate balances, and even if there were such a provision, there is no reason why the relevant

---

[6] J.P. Morgan, *Securitized Products Weekly*, "Non-Agency RMBS and Home Price Commentary," at 4 (Feb. 5, 2016) (Ex. E); *see also* Finkel Aff. ¶ 31.

[7] *See* Memorandum of Law in Support of Respondents' Verified Answer to the Verified Petition ("Tilden Brief"), Dkt. No. 32, at 20-22.

date for relation back should be February 25, 2016, rather than, for example, the date Bank of America committed to pay $8.5 billion (*i.e.*, June 28, 2011)—or any other date in between then and now. In any event, there is no support in the PSAs for distributing the Settlement Payment as of a date other than the date on which the Settlement Payment is actually distributed.

Moreover, to the extent Prosiris and Tilden claim an entitlement to this extraordinary relief based upon any supposed delay in distributing the Settlement Payment to the Disputed Trusts, the reason distribution of the Settlement Payment has been delayed is because Prosiris and Tilden themselves singled out their 14 Disputed Trusts for special treatment and resolution by this Court. *Id.* at 13, 16 (Prosiris and Tilden arguing that their Disputed Trusts have "unique wording" and are "structured in a fundamentally different way than the other Covered Trusts."). Prosiris and Tilden have no basis to complain about delay they caused.

For the reasons discussed herein, AIG respectfully requests that the Court order the Trustee to distribute the Settlement Payment to the AIG Trusts using the Standard Intex Method and based upon the certificate principal balances in effect as of the distribution date.

II. STATEMENT OF FACTS

A. Procedural History

This proceeding was commenced under CPLR Article 77 by The Bank of New York Mellon, as Trustee for 530 Countrywide RMBS trusts, seeking a judicial instruction as to the proper method for allocating the $8.5 billion Bank of America settlement payment. Following briefing in response to the Trustee's Verified Petition, the Interested Certificateholders and the Trustee proposed a Partial Final Judgment with respect to 512 of the trusts, which this Court entered on May 12, 2016, adopting the Standard Intex Method for those trusts. Dkt. No. 77. The Court deferred resolution as to the remaining 18 trusts, including the 17 Disputed Trusts.

B. Structure Of Disputed Trusts

As noted above, the Settlement Agreement provides that the Settlement Payment should be paid pursuant to a "pay first, write-up second" methodology—in other words, based on the principal balances of the certificates prior to distribution of the Allocable Shares.[8] Under this methodology, to the extent a certificate is heavily written down, it would typically receive little or none of the settlement.[9] The Trustee has noted that prioritizing senior bonds over more junior ones is fundamental to the capital structure of the trusts and to the Settlement Agreement. *See* Dkt. No. 1, Verified Petition ¶ 28 (the "protecting of more senior Certificateholders from risk of loss" is "an essential purpose of the overcollateralization structure").

The capital structure of these trusts is also determined by the level of collateralization. The AIG Trusts are "overcollateralization trusts," meaning that, at issuance, the principal balance of the underlying mortgage loans exceeded the principal balance of the RMBS certificates issued to investors.[10] This overcollateralization created a "cushion" of excess mortgage loans that was intended to insulate the RMBS, and particularly the most senior bonds, from losses.

---

[8] The certificates in an RMBS offering are divided into tiers, or "tranches," with varying degrees of seniority. Generally speaking, principal payments are used to pay down the tranches in sequential order (*i.e.*, the senior-most tranche is repaid first, and so on), while "realized losses" from the underlying loan pool are allocated in reverse-sequential order (*i.e.*, the junior-most tranche becomes impaired first, until it is written off, and so on).

[9] "Writedowns" or "realized losses" are caused when the aggregate principal balance of the underlying loans falls below the aggregate principal balance of the certificates that are collateralized by those loans. *See, e.g.*, CWALT 2006-OA10 PSA, at 2 (definition of "Applied Realized Loss Amount") (Ex. F).

[10] *See, e.g.*, CWALT 2006-OA10 Prospectus Supplement, at S-19 (Ex. G) ("'Overcollateralization' refers to the amount by which the aggregate stated principal balance of the mortgage loans exceeds the aggregate class certificate balance of the offered certificates. On the closing date, (a) the aggregate stated principal balance of the mortgage loans is expected to exceed the initial aggregate class certificate balance of the certificates (other than the Class X Certificates) by approximately $13,913,572.").

As the underlying mortgage loans have defaulted over the years following issuance, however, that cushion has been reduced. Eventually, defaults in the mortgage loans reduced the aggregate principal balance of the loans to the aggregate principal balance of the RMBS certificates, thus erasing the overcollateralization protection. Once the aggregate principal balance of the underlying mortgage loans fell *below* the aggregate certificate balance, the certificates began taking writedowns, beginning with the most junior tranches. Finkel Aff. ¶¶ 14-15. These writedowns ensure that the RMBS trust is never undercollateralized, and thus are central to the entire structure of the AIG Trusts, as the principal balance of the certificates cannot exceed the principal balance of the underlying loans.

Overcollateralization protects the senior bonds from losses. As explained by the Trustee, overcollateralization "is designed to create credit enhancement, or protection, for more senior Certificateholders …. If the overcollateralization falls short of the required 'Overcollateralization Target Amount' … then principal distributions cannot flow to 'junior' or 'subordinated' Certificateholders." Dkt. No. 1, Verified Petition ¶ 23. The junior tranches are designed to absorb losses for the senior tranches and typically receive principal payments only after the senior tranches are fully paid off. As the Trustee notes, "This senior-subordinate structure means that, as a general matter, subordinated Certificates are riskier than senior Certificates and, therefore, carry higher yields and are typically assigned lower ratings at closing." *Id.* Thus, the junior certificates exist to protect the more senior ones.

C. Methodologies For Distributing The Settlement Payment

As discussed above, the Settlement Agreement specifies that each Allocable Share should be treated "as though it was a Subsequent Recovery." § 3(d)(i).[11] The PSAs for the AIG Trusts require Subsequent Recoveries to be distributed as "Available Funds," pursuant to Section 4.02 of the PSAs. This section (also referred to as the payment "waterfall") provides that Available Funds are distributed first as interest on the certificates, and then as principal up to the "Principal Distribution Amount." To the extent Available Funds remain after the Principal Distribution Amount is paid, the balance is used to repay any unpaid realized losses, beginning with the most senior certificates (which take losses only after the more junior certificates are fully written-down). Under the Settlement Agreement, once that distribution is complete, the amount of any Subsequent Recoveries is used to "write up," in order of seniority, any certificates that still have outstanding unpaid realized losses.

For purposes of calculating the Principal Distribution Amount, the Disputed Trusts employ an "overcollateralization target" (or "OC Target") that is set at a fixed and relatively low value at this stage in the trusts' life (approximately 0.5 percent of the stated principal balance of the mortgage loans at the time the certificates were issued). Finkel Aff. ¶ 16. The OC Target is a component of the Principal Distribution Amount. Under the Objectors' preferred distribution

---

[11] "Subsequent Recoveries" have traditionally been limited to unexpected amounts received by the loan servicer after a realized loss was taken in a prior month. *See In re Application of The Bank of New York Mellon*, Index No. 150973/2016, 7/13/2016 Tr. at 6:24-7:2 (Mr. Ware [counsel for Trustee]: "[A] true subsequent recovery is a trailing recovery on a specific mortgage loan that had a loss in the past. The loss is reversed and new money comes unexpectedly into the deal reversing a prior loss ….") (Ex. H); *see also* CWALT 2006-OA10 PSA, at 39 (defining "Subsequent Recoveries") (Ex. F). By contrast, the "Subsequent Recoveries" addressed under the Settlement Agreement are not specific to any particular loan, and constitute not only recoveries for past losses, but for *future* losses as well. *See* Settlement Agreement ¶ 3(c)(i) (Ex. A).

method, the Principal Distribution Amount is calculated as the difference between the outstanding balance of the certificates and the outstanding balance of the underlying mortgage loans, plus the OC Target. Because the Disputed Trusts are no longer overcollateralized (*i.e.*, the outstanding balance of the certificates now equals the outstanding balance of the underlying mortgage loans), the Principal Distribution Amount for the AIG Trusts, under the Objectors' formulation, would equal the very low OC Target. In other words, only a small portion of the Settlement Payment would be distributed as the Principal Distribution Amount, leaving the majority of the Settlement Payment to be diverted to repay realized losses. Because losses have primarily affected the more junior tranches, the approach favored by Objectors would result in the bulk of the Settlement Payment flowing to the junior tranches of the AIG Trusts, ***even to tranches that are fully written-off***.

For example, the OC Target for Loan Group 4 of the CWALT 2006-OA10 trust (the loan group in which AIG holds certificates for this trust) is $6.3 million as of July 31, 2016, which is roughly 11 percent of the $56.0 million allocated in the Bank of America settlement to bonds in this loan group. Finkel Aff. ¶ 39. As a result, under the Objectors' construction of the PSA (which Intex terms the "After Distributions Method"), ***nearly 90 percent*** (*i.e.*, $50 million) of the Settlement Payment allocated to this loan group would flow to repay realized losses. The 4A1 tranche held by AIG would be paid first to the extent of its losses, but because that tranche has sustained only $15.6 million in realized losses, the remaining $34.0 million of the Settlement Payment would flow to the fully written-off 4A2 tranche held by Tilden (which presently has $178.5 million in realized losses). Thus, Tilden's ***entirely written-off*** junior tranche in this trust would receive ***over 60 percent*** of the Settlement Payment allocated to this loan group. *Id*.

By contrast, under Intex's default "Standard" method for the 17 Disputed Trusts, the Settlement Payment would flow primarily or entirely to the super-senior tranches (as intended). Again using the example of Loan Group 4 of the CWALT 2006-OA10 trust, under the Standard Intex Method the Principal Distribution Amount would be calculated, not as $6.3 million, but as $62.3 million (*i.e.*, the $56.0 million Allocable Share for this loan group *plus* the $6.3 million OC Target for this loan group). Because the Principal Distribution Amount would exceed the Allocable Share, the full amount of the Allocable Share would be distributed at the initial stage of the waterfall to whichever certificates have pre-distribution principal balances outstanding. None of the payment would flow to repay unpaid realized losses. Finkel Aff. ¶ 38.

Besides ensuring that the senior-subordinate structure of the trusts is respected, such that the Settlement Payment flows entirely or nearly so to the most senior tranches and does not "leak" to fully written-down tranches, the Standard Intex Method also avoids the anomaly of leaving the trusts undercollateralized. Again using the example of the CWALT 2006-OA10 trust, under the Standard Intex Method, the certificate principal balance of the Loan Group 4 certificates would be $244.1 million both before and after distribution, which would equal the outstanding principal balance of the underlying mortgage loans for this loan group, thus avoiding any undercollateralization (which makes sense, as the principal balance of the underlying loans has not changed as a result of distributing the Settlement Payment). By contrast, under the Objectors' After Distributions Method, Loan Group 4 in this trust would be undercollateralized by $49.6 million after distribution of the Settlement Payment, because the aggregate certificate principal balance of 244.1 million would be written up by $49.6 million (*i.e.*, the $56.0 million Allocable Share *less* the $6.3 million Principal Distribution Amount (as calculated under the After Distributions Methodology)), even while the $244.1 million principal balance of the

underlying loans remains unchanged. Finkel Aff. ¶¶ 37-39. As discussed further below, Intex has described the After Distributions Method as " ." (Ex. B) (emphasis added).[12]

The Standard Intex Method is Intex's "default" method for modeling these trusts. *See* Intex Aff. ¶ 5; *see also* (Ex. I) . In fact, from August 2011 until early 2016, the *only* method Intex used to model 13 of the 17 Disputed Trusts was the Standard Intex Method. Intex Aff. ¶¶ 5-6 & App'x A.[13] Later, in response to specific requests from undisclosed certificateholders, Intex added the After Distributions Method and the Before Distributions Method on a trust-by-trust basis, though the After Distributions Method (advocated by the Objectors) has *never* been Intex's default model. *Id.*

---

[12] The third scenario modeled by Intex is the Before Distributions Method, which follows a "write-up first, pay second" methodology and is a hybrid of the other two approaches. Under this approach, the principal balances of the certificates are written up before distributions are made, based on the Allocable Shares. Because certificate balances are written up based upon the expected Settlement Payment, the majority of the funds would flow to the super-senior bonds held by AIG (as under the Standard Intex Method), though a small amount of the funds could flow to the more junior written-down bonds held by the Objectors (since those could now have certificate balances). Finkel Aff. ¶ 29. However, Intex has described the Before Distributions Method as (Ex. J).

[13] The only exceptions were the CWALT 2005-72, CWALT 2006-OA10, CWALT 2007-OA3, and CWHL 2006-3 trusts. Even with respect to these four trusts, the Before and After Distributions Methods were not added to the Standard Intex model until late 2014/early 2015, and by March 2015, the Standard Intex Method had again been designated the default for modeling distributions of the Settlement Payment for all 17 Disputed Trusts. *Id.* App'x A.

III. ARGUMENT

A. The Text And Structure Of The AIG Trusts, The Intent Of The Settlement Agreement, And Applicable Course Of Dealings All Support Distribution Of The Settlement Payment Pursuant To The Standard Intex Method.

1. The Standard Intex Method Is The Only Method Consistent With The Text And Structure Of The AIG Trusts.

Prosiris and Tilden have argued, based upon isolated portions of the PSAs, that the Principal Distribution Amount should not account for the expected write-up of the certificates pursuant to Section 3(d)(ii) of the Settlement Agreement. *See* Tilden Brief, Dkt. No. 32, at 13. However, "[w]hen interpreting a contract under New York law … we do not consider particular phrases in isolation, but rather interpret them in light of the parties' intent as manifested by the contract as a whole." *Gary Friedrich Enterprises, LLC v. Marvel Characters, Inc.*, 716 F.3d 302, 313 (2d Cir. 2013) (citations, alterations, and internal quotation marks omitted); *see also Waverly Corp. v. City of New York*, 48 A.D.3d 261, 264 (1st Dep't 2008) ("in considering the intention of the parties, a court should read a contract as a whole and consider its various clauses contextually"). Read "as a whole," *Waverly*, 48 A.D.3d at 264, the PSAs, including their calculation of the Principal Distribution Amount, should be interpreted in light of what the Trustee has called the "essential purpose of the overcollateralization structure—protecting the more senior Certificates from risk of loss." Dkt. No. 1, Verified Petition ¶ 28. The Objectors' After Distributions Method, however, turns that "essential purpose" on its head, by ensuring that the vast bulk of the Settlement Payment would flow to junior bonds, rather than the super-senior bonds the Trustee has said should be "protect[ed]." *Id*.

The AIG Trusts were not designed to function in the manner advocated by the Objectors. Because of the poor performance of the underlying mortgage loans, the AIG trusts are no longer overcollateralized, and are instead at parity (meaning the aggregate principal balance of the

certificates equals the aggregate principal balance of the mortgage loans). Finkel Aff. ¶ 16. Under the terms of the PSAs, the trusts *cannot* be undercollateralized: to the extent the mortgage loan balances decrease to less than the certificate balances, the certificates must be written down. *See, e.g.*, CWALT 2006-OA10 PSA § 4.02(i) (Ex. F).

Were the Trustee to follow the After Distribution Method favored by the Objectors, however, the AIG Trusts would be undercollateralized at the conclusion of the distribution. Finkel Aff. ¶ 53. As the below numerical example shows, distribution of the Settlement Payment pursuant to the Objectors' methodology would result in the CWALT 2006-OA10 trust, for example, being undercollateralized by nearly $100 million, and the loan group for which AIG holds a certificate being undercollateralized by $49.6 million. *Id.* ¶ 27 (table).

As explained in more detail in Mr. Finkel's accompanying affidavit, in the CWALT 2006-OA10 trust, the 4A1 bond has an outstanding principal balance of $244.1 million, while the bond below it (the 4A2) has a principal balance of zero. *Id*. Under the Objectors' methodology, only $6.3 million of the $56.0 million Allocable Share would flow through the Group 4 certificates as the Principal Distribution Amount. Once the bonds are written up at the second step, the outstanding certificate principal balance for this loan group would be $293.7 million (*i.e.*, $244.1 million *less* $6.3 million *plus* $56.0 million). But the principal balance of the underlying mortgage loans for this loan group (*i.e.*, $244.1 million) *would not change* as a result of distributing the Settlement Payment. Accordingly, Loan Group 4 would then be undercollateralized by $49.6 million if the Trustee followed the After Distributions Method. *Id.*

By contrast, under the Standard Intex Method, the entire $56.0 million Allocable Share would be paid as the Principal Distribution Amount to the 4A1 tranche. Thus, the certificate principal balance for this tranche would decrease from $244.1 million to $188.1 million

following payment of the Principal Distribution Amount. This balance would then be written up to the extent of any writedowns, which are presently $15.6 million for the 4A1 tranche. The ending certificate balance for the 4A1 tranche would therefore be $203.7 million (*i.e.*, $244.1 million *less* $56.0 million, *plus* $15.6 million). *Id.* ¶ 25 (table). For the 4A2 tranche, which began with a zero certificate balance, the remainder of the $56.0 million allocable share (*i.e.*, $56.0 million *less* $15.6 million) would be used to write up the 4A2 tranche from its present zero balance, to a new certificate balance of $40.4 million. Thus, the final certificate balances for this loan group would be $244.1 million ($203.7 million for the 4A1 tranche *plus* $40.4 million for the 4A2 tranche), which is what it was initially, and would therefore remain equal to the principal balance of the underlying mortgage loans. *Id.* The Standard Intex Method, in contrast to the After Distributions Method, would therefore avoid leaving the trusts undercollateralized.

Recognizing that a distributions method that leaves the trusts undercollateralized would be commercially unreasonable, [REDACTED] (Ex. K). By contrast, [REDACTED] (Ex. J).

Likewise, RMBS expert James K. Finkel has concluded that "the Intex Standard Method is the most commercially-reasonable application of the Allocable Shares: it is supported by industry research and maximizes the recovery to the most senior certificates without compromising the integrity of the capital structure." Finkel Aff. ¶ 53. So, too, independent

research analysts at J.P. Morgan have concluded, after reviewing each of the three Intex models, that "***The Standard Intex Method is the most reasonable option of the three***, as it follows the language in the [Settlement] [A]greement without leading to any structural issues." *Supra* n.6 (emphasis added).

2. The Undisputed Intent Of The Settlement Agreement Was To Distribute The Settlement Payment To The Most Senior Tranches.

Per Sections 3(d)(i) and (ii) of the Settlement Agreement, the Settlement Payment is to be distributed based upon the principal balances of the certificates prior to distribution. Under these provisions, the Settlement Payment should be allocated solely to those certificates with outstanding principal balances. In fact, Section 3(d)(ii) includes express language to foreclose an interpretation that certificates written up under the Settlement Agreement should receive any part of the Settlement Payment. *See* Settlement Agreement ¶ 3(d)(ii) (Ex. A) ("For the avoidance of doubt, this Subparagraph 3(d)(ii) is intended only to increase Class Certificate Balances …as provide for herein, ***and shall not affect the distribution of the Settlement Payment provided for in Subparagraph 3(d)(i)***.") (emphasis added). Together, these provisions ensure that heavily written-down tranches would typically receive little or none of the Settlement Payment.

This common-sense understanding—that the most senior bonds should receive all or nearly all of the Settlement Payment when more junior bonds have been written down—is confirmed by sworn testimony from the Trustee in the first Article 77 proceeding before Justice Kapnick, where the Court approved the Settlement Agreement at the request of the Trustee. Jason Kravitt, a senior attorney at Mayer Brown representing the Trustee, testified as follows:

> The way we wrote the Settlement Agreement is that ***it's the tranches who are most senior who suffered losses who get the cash first, therefore, the people who are holding subordinated and most subordinated tranches, likely, will not get any cash out of the settlement if the losses in the settlement went to any of the senior level tranches***. So, if you made a bet on a subordinated tranche, this wouldn't necessarily get you any cash distributed out of the settlement…. [T]he

> recovery goes first in line to the senior holders and then the next level and so on down to the bottom…. ***[W]e also set in some rules to make sure that subordinate tranches didn't get money before senior tranches.***

In re Application of The Bank of New York Mellon, Index No. 651786/2011, 7/12/2013 Tr. 1878:2-1879:12 (Ex. L) (emphasis added). The clear intent of the parties to the settlement was precisely what Mr. Kravitt testified to, that the most senior tranches are paid first and the more junior tranches would generally receive nothing from the settlement.

Consistent with the understanding and intent of the parties to the Settlement Agreement, AIG respectfully requests that the Court require the Trustee to use the Standard Intex Method to distribute the Settlement Payment to the AIG Trusts, as that is the only Intex methodology that preserves the purpose and intent of the Settlement Agreement.

3. Market Participants Share The Trustee's Understanding That Super-Senior Bonds Should Receive All Or Most Of The Settlement Payment.

(a) *Course Of Dealings Is Relevant To Interpreting The Settlement Agreement And PSAs.*

In addition to considering the PSAs in light of the trusts' structure and the Trustee's own statements about the purpose of the Settlement Agreement, the Settlement Agreement and PSAs should be interpreted in light of market participants' understanding of how these deals were expected to function with respect to the Settlement Payment. As this Court has noted, "Course of dealing can be in the community, in the industry." *In re Application of The Bank of New York Mellon*, Index No. 150973/2016, 6/22/2016 Tr. at 13:7-9 (Ex. M). Course of dealing is "not just between two parties. It might be a market's course of dealing, it might be an industry's course of dealing." *Id.* at 13:23-25. Here, the course of dealing of RMBS market participants clearly supports application of the Standard Intex Method to the AIG Trusts.

New York courts regularly consider course of dealings when interpreting contracts. Course of dealings and industry practice are particularly relevant when one interpretation would

create a commercially-unreasonable result, as would occur if the Objectors' preferred distribution method were applied to the Settlement Payment. *See, e.g.*, *Cole v. Macklowe*, 99 A.D.3d 595, 596 (1st Dep't 2012) (describing "the well settled principle that a contract should not be interpreted to produce an absurd result, one that is commercially unreasonable, or one that is contrary to the intent of the parties"); *see also In re Lehman Brothers Holdings Inc.*, 530 B.R. 601, 609 & n.4 (S.D.N.Y. 2015) (analyzing contract under New York law in light of "market expectations and practices, as evidenced by market behavior").

Courts are particularly inclined to consider course of dealings when the relevant contracts are ambiguous, as here. Indeed, this entire Article 77 proceeding is premised on the existence of "competing interpretations of the relevant agreements." Dkt. No. 1, Verified Petition ¶ 2.[14] But even if there were no ambiguity in the contracts, course of dealings remains relevant to interpreting them. As the Second Circuit has explained, "There is no requirement that an agreement be ambiguous before evidence of a course of dealing can be shown, nor is it required that the course of dealing be consistent." *Ward v. Nat'l Geographic Society*, 284 Fed. App'x 822, 2008 WL 2595181, at *2 (2d Cir. June 27, 2008) (quoting Restatement (Second) of Contracts, § 223 (1981) cmt. b) (internal quotation marks omitted). Rather, "It is hornbook contract law that: 'Course of dealing may become part of an agreement either by explicit provision or by tacit recognition, or it may guide the court in supplying an omitted term….'" *Id.*

In any event, Prosiris and Tilden themselves cite course of dealings in arguing for their preferred distribution of the Settlement Payment, and therefore have waived any objections to

[14] As stated in the Verified Petition, "The questions presented in this proceeding concern the interpretation of the distribution provisions of the Governing Agreements. These contractual issues are subject to competing interpretations and their resolution will dictate how—and to whom—the Allocable Shares of the Covered Trusts are distributed." *Id.*

AIG's invocation of this doctrine. In their March 4, 2016 brief, Prosiris and Tilden argued that the Trustee's past practice of distributing much smaller Subsequent Recoveries should govern how the $8.5 billion Settlement Payment should be distributed. Tilden Brief, Dkt. No. 32, at 19. During a June 22, 2016 Court hearing in this matter, they again acknowledged that "all course of dealing is relevant" and asked the Court to consider course of dealings in ruling on the appropriate allocation methodology for the Disputed Trusts. *In re Application of The Bank of New York Mellon*, Index No. 150973/2016, 6/22/2016 Tr. at 12:4-6, 12:22-23 (Ex. M). Although AIG disagrees that the Trustee's past practices for distributing one-off unexpected loan recoveries should be followed in allocating the $8.5 billion Settlement Payment,[15] AIG agrees with Prosiris and Tilden that course of dealings (properly understood) *is* relevant to interpreting the PSAs.

(b) *The Standard Intex Method Reflects How Market Participants Understood The Disputed Trusts To Function.*

Under the Standard Intex Method, the Allocable Share is distributed to the outstanding certificates based upon their pre-written up balances (consistent with the "pay first, write-up second" order of operations of the Settlement Agreement), and the Principal Distribution

[15] The relevant course of dealings in this proceeding is how the *Settlement Payment* has been understood to be distributed, not how prior Subsequent Recoveries have been understood to be distributed. As noted above, the Settlement Payment is intended to compensate for both past and future losses, in contrast to Subsequent Recoveries. *See supra* note 11. In addition, as discussed above, the AIG Trusts were simply not designed to accommodate *in a single month* the influx of cash at issue in the settlement. Accordingly, prior course of dealings as to how Subsequent Recoveries have been treated for the AIG Trusts is not relevant in determining how the *Settlement Payment* should be distributed. [REDACTED] (Ex. N) [REDACTED]

Amount is calculated to reflect the anticipated distribution of the Settlement Payment to prevent leakage of settlement proceeds to written-down junior tranches. Finkel Aff. ¶¶ 24-25.

Intex has described this outcome as [redacted] (Ex. N). Moreover, as noted above, Intex has designated the Standard Intex Method as its default model, and has explained to its clients that this approach is [redacted] (Ex. K). By contrast, Intex has characterized the After Distributions Method, advocated by the Objectors, as [redacted] (Ex. B). The fact that Intex, the market leader in creating cashflow models for the RMBS investor community, has designated the Standard Intex Method as its "default" approach for investors underscores that market participants have generally understood the Settlement Payment to flow primarily or entirely to the super-senior bonds. *See* Intex Aff. ¶ 5.

4. The Objectors' Preferred Distribution Method Would Result In An Unjust Windfall For Junior Certificateholders.

The Objectors' proposed After Distributions Method would permit speculators who may have recently acquired written-off senior support bonds for pennies on the dollar to receive an unjust share of the Settlement Payment. Under the Objectors' preferred methodology, the Principal Distribution Amount would equal on average 15 percent of the Allocable Shares for the relevant loan groups in the AIG Trusts. Finkel Aff. ¶¶ 39, 44, 49.[16] The remaining 80 to 90

[16] Specifically, the Principal Distribution Amount under the After Distributions Method would be $6.3 million for Loan Group 4 of the CWALT 2006-OA10 trust, and the Allocable

percent of the Allocable Shares in each trust would be distributed to repay past unpaid realized losses (which were primarily or entirely incurred by non-super-senior certificates). *Id.* However, the Settlement Payment purports to be calculated based on both past *and future* expected losses (including anticipated losses to the super-senior tranches). *See* Settlement Agreement ¶ 3(c)(i) (Ex. A). The Objectors' preferred methodology, however, would distribute the Settlement Payment almost entirely based only on *past* losses (which have generally impaired only the more junior tranches), thus contravening the clear purpose and intent of the Settlement Agreement by distributing the bulk of the Settlement Payment to written-down junior bonds, even when the super-senior tranches are expected to take future losses. That result is directly contrary to the structure of the AIG Trusts, which are intended to protect the senior bonds by first allocating losses to junior securities.

The following table illustrates the expected distribution of the Allocable Shares to the three tranches held by AIG under Intex's three methodologies:[17]

Share for this loan group would be $56.0 million. Finkel Aff. ¶ 39. For Loan Group 2 of the CWALT 2007-OA3 trust, the Principal Distribution Amount would be $2.2 million under the After Distributions Method, and the Allocable Share would be $16.4 million. *Id.* ¶ 44. For Loan Group 1 of the CWALT 2007-OA10 trust, the Principal Distribution Amount would be $1.2 million under the After Distributions Method, and the Allocable Share would be $7.3 million. Finkel Aff. ¶ 49.

[17] *See* Finkel Aff. ¶ 10.

Security	CWALT 2006-OA10 4A1	CWALT 2007-OA3 2A1	CWALT 2007-OA10 1A1	Total Settlement Payment Distribution[18]
Allocable Share Of Settlement For Loan Group Held By AIG	$55,959,920	$16,504,111	$7,286,719	**$79,750,750**
Standard Intex Method (AIG's approach)	$55,959,920	$14,343,872	$6,267,673	**$76,571,464**
After Distributions Method (Objectors' approach)	$21,917,610	$1,944,742	$991,204	**$24,853,556**
Before Distributions Approach (write-up first, pay second)	$49,068,751	$12,321,407	$6,267,673	**$67,657,830**
Difference Between AIG's Approach And Objectors' Approach	**$34,042,310**	**$12,399,130**	**$5,276,469**	**$51,717,909**

As the above chart shows, applying the Objectors' After Distributions Method would generally allocate the bulk of the Settlement Payment to partly or entirely written-down senior-support bonds, such as the Objectors', even when those bonds are fully written off. By contrast, the Standard Intex Method would allocate the bulk of the Settlement Payment to the most senior bonds in the capital structure, which was the clear intent of the Settlement Agreement and is the interpretation most consistent with the structure of the PSAs. As noted above, counsel for the Trustee testified to Justice Kapnick in support of the Settlement Agreement that, "The way we wrote the Settlement Agreement is that it's the tranches who are most senior who suffered losses who get the cash first, therefore, the people who are holding subordinated and most subordinated tranches, likely, will not get any cash out of the settlement if the losses in the settlement went to any of the senior level tranches." *In re Application of The Bank of New York Mellon*, Index No. 651786/2011, 7/12/2013 Tr. 1878:2-8 (Ex. L).

[18] The "Total Settlement Payment Distribution" column reflects how much of the Settlement Payment each tranche would expect to receive in the month the Settlement Payment is distributed, depending on which Intex method is employed. Over the life of the trusts, the Standard Intex Method would result in an additional $31.9 million being received by super-senior certificateholders in the above tranches, as compared to using the After Distributions Method. Finkel Aff. ¶¶ 32-36.

The unfair outcome sought by the Objectors is solely a function of the timing of the Settlement Payment. If the same Settlement Payment were simply distributed over ten consecutive months, the Principal Distribution Amount (even under the Objectors' methodology) would not be exceeded by the Allocable Share, and all or nearly all of the Settlement Payment would flow to the super-senior bonds. This is a case that requires judicial resolution precisely because the PSAs at issue were not designed to accommodate the concentrated influx of settlement proceeds at issue here.

As the Appellate Division has recognized, "A contract should not be interpreted to produce a result that is absurd, commercially unreasonable or contrary to the reasonable expectations of the parties." *In re Lipper Holdings*, 1 A.D. 3d 170, 171 (1st Dep't 2003) (rejecting an interpretation of a contract that "would bestow a windfall on certain limited partners"); *accord Cole*, 99 A.D.3d at 596. Likewise, the Court of Appeals has held that "[t]o carry out the intention of a contract, words may be transposed, rejected, or supplied, to make its meaning more clear." *Castellano v. New York*, 43 N.Y.2d 909, 911 (1978) (holding that this constitutes "an interpretation rather than what might be characterized as a reformation" and therefore was "properly within the jurisdiction of the Court of Claims"). The only resolution that conforms to the structure, intent, and purpose of the Settlement Agreement and PSAs is to distribute the Settlement Payment to the AIG Trusts pursuant to the Standard Intex Method, which this Court has already applied to the other 512 trusts in this proceeding. The Standard Intex Approach is also the only approach that conforms to the expectations of market participants and avoids the "commercially unreasonable" result sought by the Objectors, whereby the Settlement Payment—which was undeniably intended to benefit the most senior investors—would instead be diverted to more junior tranches.

B. None Of The Objectors Has Standing To Dispute Application Of The Standard Intex Method To CWALT 2007-OA10.

None of the Objectors has claimed an interest in CWALT 2007-OA10, one of the three AIG trusts. Accordingly, AIG respectfully requests that the Court defer to AIG's unopposed request to apply the Standard Intex Method to this trust. *See, e.g.*, *Ferran v. City of Albany*, 116 A.D.3d 1194, 1195 (3d Dep't 2014) ("Inasmuch as [a party] does not own or have any possessory interest in the subject property, he does not have any injury in fact or any actual stake in the outcome of this matter.") (citations omitted); *Uhlfelder v. Weinshall*, 47 A.D.3d 169, 181 (1st Dep't 2007) ("[A] plaintiff must show 'injury in fact,' meaning that plaintiff will actually be harmed by the challenged … action.") (quoting *New York State Assn. of Nurse Anesthetists v. Novello*, 2 N.Y.3d 207, 211 (2004)) (internal quotation marks omitted).

C. The Allocable Shares Should Be Allocated Among Certificates In The AIG Trusts As Of The Date They Are Distributed.

Prosiris and Tilden have asked the Court to distribute the Allocable Shares as of February 25, 2016, rather than when this proceeding is resolved. Tilden Brief, Dkt. No. 32, at 22. As previously noted by AIG, *see* Dkt. No. 60, at 4-7, Prosiris and Tilden have never cited any logical or legal basis for this argument. Their only argument is that the Trustee's filing of the Verified Petition and the Court's subsequent Order to Show Cause affected the anticipated distribution date, but they do not explain why these events, among the countless notable events since the Settlement Agreement was finalized on June 28, 2011, should freeze the certificate principal balances for purposes of distributing the Settlement Payment. In any event, the PSAs make no provision for freezing certificate balances as of an arbitrary date in the midst of litigation. Such an approach would be a near impossibility, as recognized by Trustee's counsel:

> There's no going back and saying, well, what would it have looked like had these funds been distributed in February. That's impractical. It would affect subsequent distributions if we go back in time and try to figure out what the

> distribution would have looked like then, and no other investor is suggesting that we do that.

In re Application of The Bank of New York Mellon, Index No. 150973/2016, 3/15/2016 Tr. at 13:5-11 (Mr. Ingber) (Ex. O). Moreover, the Objectors' extraordinary request would contradict the payment method set forth in the Settlement Agreement, which provides that the Allocable Share is to be treated "as though it was a Subsequent Recovery available for distribution ***on that distribution Date***." Settlement Agreement ¶ 3(d)(i) (emphasis added) (Ex. A). Again, as stated by Trustee's counsel:

> The funds are distributed based on a distribution date based on funds that are in the certificate account as of a particular date. These funds never made their way to the trustee's, really, the trustee's distribution account for distribution, because we were here before Your Honor saying there's an issue …. So, once there's resolution of the issue, and funds are taken out of escrow, and they are placed in a distribution account by a particular determination date, we're going to distribute in that month.

In re Application of The Bank of New York Mellon, Index No. 150973/2016, 3/15/2016 Tr. at 12:2-13 (Mr. Ingber) (Ex. O). Distributing the Settlement Payment as of a prior date, even assuming that were permissible under the PSAs or Settlement Agreement, would also contravene investors' settled expectations for how these deals should pay.

Although Prosiris and Tilden appear to claim an entitlement to this unsupported remedy based upon delay in the proceedings, they never specify *whose* delay. The Settlement Agreement was executed on June 28, 2011. Arguably, there has been over five years of "delay" in seeing the $8.5 billion paid to investors, yet the Objectors do not seek to turn the clock back to 2011.[19] Instead, they argue that the Settlement Payment should made as if it occurred in

[19] One potential explanation for the Objectors' apparent reluctance to fully embrace their own request and thus seek to turn back the clock to the execution date of the Settlement Agreement may be because if the Settlement Payment were actually distributed as of June 28, 2011, under the Objectors' After Distributions Method the Settlement Payment would primarily

February 2016. But there is no principle behind this argument. The date as of which the Objectors seek to fix a record date is arbitrary in the lifecycle of the Bank of America settlement and is a thinly-veiled attempt to maximize the Objectors' profits. In any event, all or much of the delay in this Article 77 proceeding with respect to the AIG Trusts is of the Objectors' own making, caused by their decision to single out their Disputed Trusts as "unique" and therefore deserving of special treatment by this Court. *See, e.g.*, Tilden Brief, Dkt. No. 32, at 13.

As there is no basis for distributing the Settlement Payment as of any date other than the date it is actually distributed, AIG respectfully requests that the Court deny the Objectors' request to distribute the Settlement Payment as of February 25, 2016.

IV. CONCLUSION

For the reasons set forth above, AIG respectfully requests that the Court order the Trustee to distribute the Allocable Shares to the AIG Trusts pursuant to the Standard Intex Method.[20]

AIG also respectfully requests that the Court deny Prosiris and Tilden's request to distribute the Allocable Shares as of February 25, 2016, and instead direct the Allocable Shares to be distributed by the Trustee in the ordinary course once this dispute is resolved.

---

flow to junior mezzanine bonds (since those were the only bonds that had writedowns at that time), rather than the senior-support bonds the Objectors now hold (which had not experienced writedowns as of June 2011). Finkel Aff. ¶ 26 n.10.

[20] Pursuant to this methodology, the Trustee should be ordered to calculate the Principal Distribution Amount based upon the "written-up" certificate principal balances (that is, by calculating the Principal Distribution Amount as the sum of the Class Certificate Balances immediately prior to the next Distribution Date following the Transfer Target Date, plus the Allocable Share for that trust, less the Stated Principal Balance of the Mortgage Loans as of the Due Date in the month of the next Distribution Date following the Transfer Target Date (after giving effect to Principal Prepayments received in the related Prepayment Period), plus the Overcollateralization Target for the next Distribution Date following the Transfer Target Date). The Allocable Share would then be distributed among particular tranches based upon the pre-distribution Class Certificate Balances (with the Principal Distribution Amount calculated per the prior sentence).

Dated: New York, New York
August 12, 2016

QUINN EMANUEL URQUHART
& SULLIVAN, LLP

By: /s/ Jordan A. Goldstein

Michael B. Carlinsky
Jordan A. Goldstein
David D. Burnett
51 Madison Avenue, 22nd Floor
New York, New York 10010
(212) 849-7000

Attorneys for Respondents American International Group, Inc., AIG Financial Products Corp.; AIG Property Casualty Company; American General Life Insurance Company; American Home Assurance Company; American International Reinsurance Company, Ltd.; Commerce and Industry Insurance Company; Lexington Insurance Company; National Union Fire Insurance Company of Pittsburgh, PA; The United States Life Insurance Company in the City of New York; and The Variable Annuity Life Insurance Company