NEW YORK COUNTY CLERK 05/05/2017 12:10

NYSCEF DOC. NO. 233

INDEX NO. 150973/2016

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SUPREME COURT OF THE STATE OF NEW YORK COUNTY OF NEW YORK In the matter of the application of Index No. 150973/2016 THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed Scarpulla, J. Securitization Trusts,

Petitioner,

for Judicial Instruction under CPLR Article 77 on the Distribution of a Settlement Payment

AFFIDAVIT OF DAVID M. SHEEREN

Before me, the undersigned authority, on this day personally appeared David M. Sheeren, who, being by me duly sworn, deposed as follows:

- I am a member of the Bar of the State of Texas and an associate in the law firm of 1. Gibbs & Bruns, L.L.P., counsel for BlackRock Financial Management, Inc. and AEGON in the above captioned matter.
- I have personal knowledge of the facts stated in this affidavit, and they are all true 2. and correct. I make this affidavit in support of the Memorandum of Law in Support of Motion for Leave to Reargue filed on May 4, 2017 in the above captioned proceeding.
- 3. Exhibit 1 hereto is a true and accurate copy of the Court's Decision and Order ("Decision") entered April 5, 2017 (Doc. No. 193).
- Exhibit 2 hereto is a true and accurate copy of the transcript of the August 31, 2016 4. hearing in this proceeding.
- Exhibit 3 hereto is a true and accurate copy of the transcript of the March 15, 2016 hearing in this proceeding.
 - Exhibit 4 hereto is a true and accurate copy of the Verified Petition (Docket No. 1). 6.

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Exhibit 5 hereto is a true and accurate copy of the Memorandum of Law in Support 7. of the Verified Petition (Docket No. 10).

- Exhibit 6 hereto is a true and accurate copy of the Brief of Certain Institutional 8. Investors concerning the Remaining Disputed Trusts (Docket No. 96).
- Exhibit 7 hereto is a true and accurate copy of American International Group, Inc.'s 9. Memorandum of Law on Allocation of The Settlement Payment (Docket No. 103).
- Exhibit 8 hereto is a true and accurate copy of Supplemental Brief of Tilden Park Capital Management LP and Prosiris Capital Management LP (Docket No. 122).
- Exhibit 9 hereto is a true and accurate copy of Blue Mountain Parties' 11. Memorandum of Law on Allocation of the Settlement Payment (Docket No. 149).
- Exhibit 10 hereto is a true and accurate copy of Center Court, LLC's Response to Prosirus and Tilden Park's Opening Submission (Docket No. 65).¹

FURTHER AFFIANT SAYETH NOT.

SWORN TO AND SUBSCRIBED before me on the 4th day of May, 2017.

Hose M. D. Brennaw Notary Public in and for The State of Texas



¹ The Exhibits hereto include the main substantive merits briefs submitted by the parties. The Court is also referred to Docket Entries 96-180, which are prohibitively voluminous.

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

PRESENT:	SCARPULLA, SALIANN		PART	39
•	Justic	e		
In the Matter of the A	pplication of			
THE BANK OF NEW YORK MELLON, in its Capacity as Tru or Indenture Trustee of 530 Countrywide Residential Mortgag Backed Securitization Trusts,		INDEX NO.	1509	73/2016
	Petitioner,	MOTION DATE	09/2	1/2016
	ns under CPLR Article 77 a Settlement Payment.	MOTION SEQ. NO.	(001
The following papers,	numbered 1 to, were i	ead on this application to/for	special	proceeding
Notice of Motion/ Petition	n/ OSC - Affidavits - Exhibits	. No	o(s)	
Answering Affidavits - E	xhibits	No	o(s)	
Replying		No	(s)	
ORDERED decision.	that the petition is decided in accord	lance with the accompang	ying memo	randum
:				
DATE: 33	17	Jahan le		PULLA, JSC
1. CHECK ONE 2. APPLICATION 3. CHECK IF APPROP	: CASE DISPOSED : GRANTED DENIEL RIATE : SETTLE ORDER	X NON-FINAL DISPOSITE GRANTED IN PART SUBMIT ORDER		OTHER
	DO NOT POST	FIDUCIARY APPOINT	MENTF	REFERENCE

INDEX NO. 150973/2016

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

In the Matter of the Application of

NYSCEF DOC. NO.

THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed Securitization Trusts, **DECISION/ORDER**

Index No. 150973/2016 Motion Seq. No. 001

Petitioner,

For Judicial Instructions Under CPLR Article 77
On the Distribution of a Settlement Payment,

HON. SALIANN SCARPULLA, J.:

Petitioner the Bank of New York Mellon seeks judicial instructions on how to distribute a portion of the \$8.5 billion settlement payment entrusted to it as trustee of 530 residential mortgage-backed securities trusts ("the Covered Trusts"). Certain certificateholders from the various trusts dispute how the settlement payment should be distributed.

In June 2011, the Bank of New York Mellon ("the Trustee") entered into a Settlement Agreement on behalf of the Covered Trusts to resolve allegations that Bank of America Corporation, BAC Home Loan Servicing LP, Countrywide Financial Corporation, and Countrywide Home Loans, Inc. breached certain representations and warranties contained in the pooling and servicing agreements ("PSAs") or sale and servicing agreements and indentures (collectively, "the Governing Agreements") for the Covered Trusts. Under the Settlement Agreement, each of the

¹ Countrywide Home Loans, Inc. is the originator and seller of the residential mortgage-backed securities, and Countrywide Financial Corporation is its parent company. BAC Home Loans Servicing, LP (formerly known as Countrywide Home Loan Servicing, LP) is the master servicer of the loans, and Bank of America Corporation is its parent company. In July 2008, Bank of America acquired Countrywide.

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Covered Trusts is designated to receive a specified portion (an "Allocable Share") of the \$8.5 billion settlement payment.

Shortly after the settlement was executed, the Trustee commenced an Article 77 proceeding to obtain court approval of the Settlement Agreement. On January 31, 2014, Justice Barbara Kapnick approved the majority of the Settlement Agreement, with the exception of the release for loan modification repurchase claims. Subsequently, the First Department affirmed and modified Justice Kapnick's decision to "approve the settlement in all respects, including the aspect releasing the loan modification claims." *In re Bank of New York Mellon*, 127 A.D.3d 120, 128 (1st Dep't 2015).

On February 5, 2016, the Trustee commenced this proceeding seeking interpretation of the Settlement Agreement, *i.e.*, specific instructions on how the settlement payment should be distributed. On that date, I directed any interested persons to submit an answer to the petition by March 4, 2016. I further directed the Trustee to place the settlement payment in escrow during the pendency of this proceeding.

On May 12, 2016, I issued a partial severance order and partial final judgment for five hundred and twelve of the Covered Trusts, for which there was no dispute as to payment of the Allocable Share attributable to those Covered Trusts. On November 18, 2016, I issued a second partial severance order and partial final judgment for three uncontested trusts, CWALT 2007-OA2, CWALT 2007-OA10, and CWHL 2006-OA4. As per the agreement of the Trustee and those Covered Trusts, the partial judgments directed distribution according to the Standard Intex method. Fifteen disputed trusts remain.

Section 3(d) of the Settlement Agreement states that the Allocable Share for each Covered

Trust shall be distributed "in accordance with the distribution provisions of the Governing

Agreements . . . as though it was a Subsequent Recovery available for distribution on that

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distribution date."² The Settlement Agreement further provides that – "after the distribution of the Allocable Share" – the Trustee shall "allocate the amount of the Allocable Share for that Covered Trust in the reverse order of previously allocated Realized Losses, to increase the Class Certificate Balance, Component Balance, Component Principal Balance, or Note Principal Balance, as applicable . . . to which Realized Losses have been previously allocated . . . pursuant to the Governing Agreements."

The above distribution method set forth in the Settlement Agreement – known as the "pay first, write up second" method – has been the Trustee's typical order of operations for distributing payments among certificateholders. Notwithstanding that the Trustee has historically utilized this method, the Trustee claims that a controversy has arisen in connection with some of the Covered Trusts because the pay first, write up second method results in a distribution under which a large amount of the Allocable Share will bypass senior certificates, and will be paid out instead to junior certificates with realized losses.

This distribution result will occur for certain Covered Trusts that have an "overcollateralization" structure. The purpose of overcollateralization is to create a cushion of excess mortgage loans that will insulate the trust's certificateholders from losses. At the outset, an overcollateralized trust starts out with an initial principal balance of underlying mortgage loans that exceeds the initial principal balance of certificates. The advantage of this structure is that, in the event that a mortgage loan defaults and is written off, the remaining mortgage loans are intended to be sufficient to cover the principal balance of certificates. In general, overcollateralized trusts have a target amount of overcollateralization, referred to as an overcollateralization target amount.

² The Settlement Agreement also provides that in the event that the Governing Agreement does not define "Subsequent Recovery," the Allocable Share must be distributed "as though it was unscheduled principal available for distribution on that distribution date."

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The Trustee asserts that the trusts at issue are no longer overcollateralized due to the default of an unexpectedly high number of mortgage loans, which have eliminated any previously existing cushion of excess loans. In instances where the principal balance of the mortgage loans has fallen below the principal balance of the certificates, the trusts experienced write downs to maintain parity between the loan balances and certificate balances.

The Trustee explains, however, that under the pay first, write up second method, the overcollateralization targets for the trusts will "not be satisfied before the distribution or after the distribution, but *during* the distribution process – in between step one (payment) and step two (write up) – [when] the OC Target is temporarily, and artificially, met." The Trustee claims that, as a result of this temporary and artificial overcollateralization, a large proportion of the Allocable Share will not pay off the principal balance of senior certificates first, but will instead pay junior certificates with realized losses.

In light of this anticipated outcome, the Trustee seeks instructions on whether the Trustee should: (1) follow the Settlement Agreement and continue its practice of "pay first and write up second" but make an adjustment to the overcollateralization in order to prevent "leakage" to the junior certificates; (2) follow the Settlement Agreement and continue its practice of "pay first and write up second" but make no adjustment to the overcollateralization calculation, thus permitting leakage; or (3) change its general order of operations in the Covered Trusts to "write up first and pay second" notwithstanding the language of the Settlement Agreement.³

Certificateholders American International Group, Inc. and its affiliates (collectively "AIG") and Aegon and Blackrock Financial Management, Inc. ("Institutional Investors") argue that the first

³ The petition further seeks: (a) an order that the Court shall retain exclusive jurisdiction over this matter for the purposes of rendering additional instructions as are necessary or appropriate in the administration of the Covered Trusts; and (b) an order barring litigation of the questions raised herein outside the context of this proceeding.

method described above (referred to as the "Standard Intex Method") should apply. Tilden Park Capital Management LP ("Tilden Park"), Prosiris Capital Management LP ("Prosiris"), and BlueMountain Credit Alternatives Master Fund L.P. and its affiliates ("Blue Mountain") argue that the second method described above should apply. Lastly, Center Court, LLC ("Center Court") seeks the third method – write up first and pay second – to be applied.

The parties raise two issues. The first issue concerns the CWABS 2006-12 trust, where one certificateholder has challenged the Settlement Agreement's choice of distributing the Allocable Share as a Subsequent Recovery. The second issue concerns whether the Standard Intex method; the pay first, write up second method; or the write up first, pay second method should apply to the fourteen remaining trusts ("the Fourteen Trusts").⁴

Discussion

I. CWABS 2006-12 Trust

Under the Settlement Agreement, the trust CWABS 2006-12 ("the 2006-12 Trust") is designated to receive approximately \$62 million dollars as its Allocable Share. Section 3(d) of the Settlement Agreement states that the Trustee shall distribute the Allocable Share according to the distribution provisions of the Governing Agreements "as though it was a Subsequent Recovery available for distribution on that distribution date."

TIG Securitized Asset Master Fund LP ("TIG") objects to the distribution of the Allocable Share as a Subsequent Recovery. Specifically, TIG contends that treating the Allocable Share as a Subsequent Recovery is a violation of the 2006-12 Trust's Governing Agreement, and the Allocable Share must instead be treated as Excess Cash Flow.

⁴ The Fourteen Trusts are: CWALT 2005-61, CWALT 2005-69, CWALT 2005-72, CWALT 2005-76, CWALT 2005-IM1, CWALT 2006-OA10, CWALT 2006-OA14, CWALT 2006-OA3, CWALT 2006-OA7, CWALT 2006-OA8, CWALT 2007-OA3, CWALT 2007-0A8, CWMBS 2006-3, and CWMBS 2006-OA5.

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In opposition, Pacific Investment Management Company LLC ("PIMCO") and Center Court argue that TIG's objection should be precluded because it is untimely, barred by *res judicata*, and not within the scope of this proceeding. They also argue that treating the Allocable Share as a Subsequent Recovery does not violate the 2006-12 Trust's Governing Agreement.

Center Court and PIMCO contend that TIG failed to raise its objection in this proceeding until June 27, 2016. Although Center Court and PIMCO argue that TIG's opposition should be stricken as untimely, I accept TIG's opposition papers. At the June 22, 2016 court conference, TIG and PIMCO informed me that they intended to submit papers by June 27, and I agreed to accept their papers by that deadline.

Next, PIMCO argues that the doctrine of *res judicata* bars TIG's objection because it could have been raised in the prior Article 77 proceeding before Justice Kapnick. *Res judicata* bars a party from litigating "a claim where a judgment on the merits exists from a prior action between the same parties involving the same subject matter." *In re Hunter*, 4 N.Y.3d 260, 269 (2005). *Res judicata* generally precludes "claims actually litigated," but also applies to "claims that could have been raised in the prior litigation." *Id.*

To determine whether a claim is barred by *res judicata*, our courts apply a transactional analysis approach which holds that "once a claim is brought to a final conclusion, all other claims arising out of the same transaction or series of transactions are barred, even if based upon different theories or if seeking a different remedy." *O'Brien v. City of Syracuse*, 54 N.Y.2d 353, 357 (1981). The purpose of the *res judicata* doctrine is "to provide finality in the resolution of disputes" and is based on "[c]onsiderations of judicial economy as well as fairness to the parties." *Reilly v. Reid*, 45 N.Y.2d 24, 28 (1978).

TIG raises an objection to the Settlement Agreement here that it did not raise in the prior Article 77 proceeding. In the prior proceeding, the Court determined that "a full and fair

opportunity" had been offered "to all Potentially Interested Persons, including the Trust
Beneficiaries, to make their views known to the Court, to object to the Settlement and to the
approval of the actions of the Trustee in entering into the Settlement Agreement, and to participate
in the hearing thereon." *In re Bank of N.Y. Mellon.*, 42 Misc. 3d 1237(A) at 14 (Sup. Ct. New York
County 2014). Because TIG had a full and fair opportunity to raise its objection to the Settlement
Agreement's terms in the prior proceeding, TIG's objection in this proceeding is now barred by *res judicata*. 5

As no other certificateholder raises an objection to the distribution of the Allocable Share as a Subsequent Recovery, I direct the Trustee to distribute the Allocable Share for the 2006-12 Trust as though it was a Subsequent Recovery, pursuant to the terms of the Settlement Agreement and the PSA for the 2006-12 Trust.

II. The Fourteen Remaining Trusts

In regards to the Fourteen Trusts, the parties dispute whether the Allocable Share should be distributed according to: (1) the Standard Intex method; (2) the pay first, write up second method; or (3) the write up first, pay second method.

The Settlement Agreement sets forth two operations that the Trustee must follow in distributing the Allocable Share for each of the Fourteen Trusts. First, the Settlement Agreement states that the Trustee shall distribute the Allocable Share to certificateholders "in accordance with

⁵ TIG argues that treating the Allocable Share as a Subsequent Recovery is a violation of the 2006-12 Trust's Governing Agreement. Even if I were to entertain the merits of this argument, I find it to be unpersuasive. Although TIG is correct in pointing out that the Allocable Share does not fit within the definition of "Subsequent Recovery" as it is not a recovery on a liquidated mortgage loan, the Allocable Share is nevertheless to be distributed "as though it was a Subsequent Recovery."

the distribution provisions of the Governing Agreements . . . as though it was a Subsequent Recovery available for distribution on that distribution date" (emphasis added).

Second, the Settlement Agreement directs the Trustee to "allocate the amount of the Allocable Share for that Covered Trust in the reverse order of previously allocated Realized Losses, to increase the Class Certificate Balance, Component Balance, Component Principal Balance, or Note Principal Balance, as applicable . . . to which Realized Losses have been previously allocated . . . pursuant to the Governing Agreements."

The parties do not dispute that the distribution provisions in the Settlement Agreement direct the Trustee to pay out the Allocable Share first, and then to write up the certificates in the amount of the Allocable Share as described above. To perform the first operation, the Trustee must pay the Allocable Share as though it was a "Subsequent Recovery," as that term is defined by the Governing Agreements. Each of the Fourteen Trusts have a Governing Agreement with slightly different terms. As the parties have not pointed out any significant differences between the Governing Agreements, I treat them similarly.

Each of the fourteen Governing Agreements contain a "Section 4.02 - Priorities of Distribution," which sets forth the order of distribution of the trust's funds among the certificates on a monthly basis. The amounts available to be distributed each month are called "Available Funds." Available Funds consists of certain amounts held in the trust's Certificate Account, including payments of principal and interest from the underlying mortgage loans. Available Funds also include Subsequent Recoveries, which are typically unexpected recoveries from mortgage loans that have been previously liquidated.

⁶ See e.g., CWALT 2005-61, Section 3.05.

Section 4.02 provides that Available Funds are to be distributed to certificates in the following general order: (1) interest; (2) principal in an amount called "the Principal Distribution Amount"; and (3) unpaid realized losses. Available Funds are distributed on a regular distribution date each month, which is usually the 25th of the month.

Because the Settlement Agreement requires the Allocable Share to be treated as a Subsequent Recovery, the Allocable Share must first flow into Available Funds, and then be distributed in the order established by Section 4.02. The parties do not dispute the portion of the Allocable Share that will be paid for the first category for distribution – interest.

The main dispute between the parties concerns how much of the Allocable Share will be apportioned to the second category for distribution – the Principal Distribution Amount. Funds that fall within the Principal Distribution Amount are generally paid out to certificates in order of seniority until their certificate balances equal zero.⁷

The express definition for "Principal Distribution Amount" is: "the excess, if any of (1) the aggregate Class Certificate Balance of the Certificates related to such Loan Group immediately prior to such Distribution Date, over (2) the excess, if any, of (a) the aggregate Stated Principal Balance of the Mortgage Loans in that Loan Group as of the Due Date in the month of that Distribution Date (after giving effect to Principal Prepayments received in the related Prepayment Period), over (b) the Group 1 Overcollateralization Target Amount or the Group 2

⁷ The PSAs contain specific directions regarding how the Principal Distribution Amount must be distributed. For example, the PSA for CWALT 2005-69 states, at Section 4.02, that the Principal Distribution Amount shall be paid sequentially: "(i) to the Class A-R Certificates, until its Class Certificate Balance is reduced to zero; (ii) concurrently, to the Class A-1, Class A-2 and Class A-3 Certificates, pro rata on the basis of their respective Class Certificate Balances immediately prior to such Distribution Date, until their respective Class Certificate Balances are reduced to zero; and (iii) sequentially, to the Class M-1, Class M-2, Class M-3, Class M-4, Class M-5 and Class M-6 Certificates, in that order, until their respective Class Certificate Balances are reduced to zero."

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Overcollateralization Target Amount, as the case may be, for such Distribution Date" (emphasis added). CWALT 2005-61 PSA.8

Under this definition, the Principal Distribution Amount has three components: (1) Class Certificate Balance ("Certificate Balance"); (2) Stated Principal Balance of the Mortgage Loans ("Loan Balance") and (3) the Overcollateralization Target Amount ("OT Target"). In other words, the Certificate Balance is the amount of principal owed on the certificates; the Loan Balance is the unpaid principal balance on the mortgage loans securing the certificates; and the OT Target is an established target for the Loan Balance to exceed the Certificate Balance.

Tilden Park, Prosiris, and Blue Mountain contend that the Principal Distribution Amount is calculated using the certificate balances "immediately prior" to the Distribution Date, as expressly stated in the Principal Distribution Amount definition. They further assert that the Principal Distribution Amount should be calculated using the simplified formula: Certificate Balance less (-) Loan Balance plus (+) OT Target.

In contrast, AIG and the Institutional Investors argue that the Principal Distribution Amount should be calculated using certificate balances that have first been adjusted upward in the amount of the Allocable Share on the Distribution Date, and the Principal Distribution Amount should then be paid out based on pre-distribution certificate balances. AIG and the Institutional Investors argue that this distribution method is consistent with the text of the Governing Agreements, as well as the overcollateralization and subordination features of the Fourteen Trusts.

Center Court agrees with AIG and the Institutional Investors that the Principal Distribution

Amount should account for the amount of the Allocable Share. However, Center Court argues that
the Governing Agreements require a write up first, pay second distribution. First, Center Court

⁸ The PSAs for the other thirteen trusts at issue contain substantially similar definitions for Principal Distribution Amount.

asserts that Available Funds must exclude a Subsequent Recovery in the month that it is received because it falls within the "Amount Held for Future Distribution." Second, Center Court claims that, even though a Subsequent Recovery is withheld for distribution in the month it is received, a Subsequent Recovery must be allocated to increase certificate balances in the month that it is received. As a result of this timing, Center Court concludes that certificate balances must be written up first in the amount of the Allocable Share, and then distributed to certificates.

The practical difference between the parties' positions is that: (1) under Tilden Park,
Prosiris, and Blue Mountain's interpretation, the Principal Distribution Amount essentially equals
the OT Target, and (2) under AIG, the Institutional Investors, and Center Court's interpretation, the
Principal Distribution Amount essentially equals the Allocable Share plus the OT Target.

An illustration of the difference between the two positions follows. Assuming that a trust's Allocable Share is \$56 million, and its OT Target is \$6.3 million, under the pay first, write up second method, the Principal Distribution Amount is equal to the Certificate Balance minus (-) the Loan Balance plus (+) the OT Target. Because the Certificate Balance and Loan Balance are equal (due to the lack of overcollateralization), the Principal Distribution Amount equals the OT Target, *i.e.*, \$6.3 million.

Under the Standard Intex method, the Principal Distribution Amount is equal to the

Certificate Balance plus (+) the Allocable Share minus (-) the Loan Balance plus (+) the OT

Target.¹⁰ Again, as the Certificate Balance and the Loan Balance are equal and cancel each other

⁹ The example of Allocable Share and OT Target amounts are taken from AIG's memorandum of law.

¹⁰ In its memorandum of law, AIG argues that the Standard Intex method should apply and cites to the affidavit of James K. Finkel, which contains a formula for calculating the Principal Distribution Amount, *i.e.*, (Certificate Balance + Allocable Share) – (Loan Balance – OT Target). This formula can be simplified to Principal Distribution Amount = Certificate Balance (+) Allocable Share (–) Loan Balance (+) OT Target, as shown above.

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effectively, the Principal Distribution Amount equals the Allocable Share plus (+) the OT Target – i.e., \$56 million + \$6.3 million, or \$62.3 million.¹¹

Thus, under the pay first, write up second distribution method, the Principal Distribution Amount is \$6.3 million, which goes to pay senior investors until their certificate balances equal zero, with the remainder of the Allocable Share to pay certificates with realized losses in order of seniority.

However, under the Standard Intex method, the Principal Distribution Amount is \$62.3 million, which means that the entire Allocable Share remaining after interest goes to pay investors in order of seniority until their certificate balances equal zero. As shown by this example, the parties' positions result in a significant disparity in how the Allocable Share is distributed.

Although the parties sharply dispute how the Principal Distribution Amount should be calculated, the Governing Agreement provides a straightforward directive regarding the amounts that need to be gathered, added together, and subtracted in order to calculate the Principal Distribution Amount. The definition of the Principal Distribution Amount states that it is the amount equal to the excess of the "Class Certificate Balance . . . immediately prior to such Distribution Date" over the excess of the "Stated Principal Balance of the Mortgage Loans" over the Overcollateralization Target Amount, *i.e.*, Certificate Balance less (-) Loan Balance plus (+) OT Target – the same formula put forth by Tilden Park, Prosiris, and Blue Mountain. ¹² As the Governing Agreements expressly indicate how to calculate the Principal Distribution Amount, the

¹¹ Center Court's method results in the same Principal Distribution Amount as the Standard Intex method. However, the Allocable Share is added first to increase the Certificate Balance amount, rather than separately adding in the Allocable Share as under the Standard Intex method.

¹² More specifically, this equation is derived from Certificate Balance – (Loan Balance – OT Target).

Trustee must follow this definition to calculate what portion of the Allocable Share must be distributed to certificateholders as the Principal Distribution Amount.

AIG and the Institutional Investors argue that the text, overcollateralization, and subordination features of the Fourteen Trusts' Governing Agreements require the Trustee to distribute the Allocable Share using the Standard Intex method. The Standard Intex method, however, adds an extra step – the addition of the Allocable Share – that is not reflected anywhere in the definition of the Principal Distribution Amount. While AIG and the Institutional Investors assert that the text of the Governing Agreements support distribution according to the Standard Intex method, there is no textual basis in the Governing Agreements for adding the Allocable Share to the calculation of the Principal Distribution Amount.

I fully agree with AIG and the Institutional Investors that the overcollateralization and subordination features of the Governing Agreements are designed to protect senior investors and ensure that they are paid their principal first. However, the parties plainly understood when they negotiated the Settlement Agreement that there could be instances where the Governing Agreements' general subordination scheme may not apply. Indeed, at oral argument on August 31, 2016, the Trustee's counsel expressly admitted that "Section 3(d)(1) of the settlement agreement provides that, 'once the allocable shares has hit those accounts, the trustee shall distribute it to investors in accordance with the distribution provisions of the governing agreements.' So that it was our understanding, then and now, that there could be different results obtaining a (sic) different trusts.

Further, Trustee's counsel stated "[t]hese are – with these common law PSAs are basically all equity rather than debt, but most of them look like debt. This is the one that looks like equity.

And so the settlement agreement does contemplate what classes other than the highest most might get some. And it draws the line below which they won't go . . . [depending on] [w]hatever the PSA

distributed as a Subsequent Recovery.

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or the indenture said." Accordingly, the general intent of the Governing Agreements to protect senior certificateholders over junior certificateholders does not operate to override the plain and unambiguous terms of the Settlement Agreement, which directs that the Allocable Share must be

In addition, I find Center Court's argument for a write up first, pay second distribution method to be unpersuasive. Though Center Court correctly points out that the definition of "Available Funds" excludes the "Amount Held for Distribution," the Settlement Agreement expressly requires the Allocable Share to be treated as though it were a Subsequent Recovery available for distribution on the Distribution Date. The Allocable Share flows into Available Funds, and is not an Amount Held for Distribution that will be distributed in the following month. Further, contrary to Center Court's interpretation, the Governing Agreements require the Principal Distribution Amount to be calculated using certificate balances immediately prior to the Distribution Date, and not as of any date.

As an alternative argument, AIG contends that the Settlement Agreement and Governing Agreements are ambiguous. AIG asserts that the Court should interpret the Settlement Agreement and the Governing Agreements in keeping with the "clear intent of the parties. . . that the most senior tranches are paid first and the more junior tranches would generally receive nothing from the settlement." However, because the Settlement Agreement and Governing Agreements are clear regarding how the Allocable Share must be distributed and how the corresponding Principal Distribution Amount must be calculated, I decline to find an ambiguity in the agreements. "Courts should not strain to find contractual ambiguities where they do not exist." *Diaz v. Lexington Exclusive Corp.*, 59 A.D.3d 341, 342 (1st Dep't 2009).

AIG further contends that distributing a significant portion of the Allocable Share to junior certificates with realized losses must be avoided because it is a commercially absurd result. AIG

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appears to argue that, in light of this absurd result, the Court should supply terms to the Settlement Agreement and Governing Agreements to ensure that the Allocable Share is distributed pursuant to the Standard Intex method.

Under New York law, even in the absence of a claim for reformation, courts "may as a matter of interpretation carry out the intention of a contract by transposing, rejecting, or supplying words to make the meaning of the contract more clear." *Wallace v. 600 Partners Co.*, 86 N.Y.2d 543, 547 (1995). This "approach is appropriate only in those limited instances where some absurdity has been identified or the contract would otherwise be unenforceable either in whole or in part." *Id.*

Here, it is neither an absurd or unenforceable result that the Principal Distribution Amount calculated under the Governing Agreements may be small in proportion to the entire amount of the Allocable Share, resulting in the majority of the Allocable Share to be distributed to certificates with realized losses, particularly because the parties anticipated that this result might occur. Even if this distribution can be characterized as unusual, terms that are "novel or unconventional" do not render a result absurd. *Wallace*, 86 N.Y.2d at 548; *Jade Realty LLC v. Citigroup Commercial Mortg. Trust 2005-EMG*, 20 N.Y.3d 881, 884 (2012). Moreover, it is not absurd that, once the Principal Distribution Amount is distributed, it is in fact the *senior certificates* with realized losses that will be paid first before junior certificates with realized losses.¹³

Lastly, AIG and the Institutional Investors argue that the Settlement Agreement's purpose will not be achieved if the Allocable Share is primarily distributed to junior certificates with

¹³ See, e.g., CWALT 2005-61 PSA, Section 4.02(a)(4) states that the remaining Available Funds shall be distributed "sequentially, to the holders of the Class 1-A-1, Class 1-A-2, Class 1-A-3, Class 1-M-1, Class 1-M-2, Class 1-M-3, Class 1-M-4, Class 1-M-5 and Class 1-M-6 Certificates, in that order, in each case in an amount equal to the Unpaid Realized Loss Amount for each such Class."

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realized losses. They argue that the purpose of the Settlement Agreement is to compensate certificateholders for past and future losses caused by the alleged breaches of representations and warranties, but that the pay first, write up second method will result in a distribution based primarily on past losses only.¹⁴

While I understand that the plain language of the Settlement Agreement and Governing Agreements do not reflect the senior certificateholders' belief as to how Allocable Shares would be distributed with respect to these few trusts, I may not look beyond the four corners of the relevant agreement to determine the parties' intent, when the contract language itself is clear. Where the "parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing."

W.W.W. Assocs., Inc. v. Giancontieri, 77 N.Y.2d 157, 162 (1990); Vision Dev. Grp. of Broward Cty., LLC v. Chelsey Funding, LLC, 43 A.D.3d 373, 374 (1st Dep't 2007). In the interpretation of contracts, our courts are concerned "with what the parties intended, but only to the extent that they

¹⁴ The parties argue that statements made by Trustee's counsel Jason Kravitt in the prior Article 77 proceeding support their various arguments. In the prior proceeding, Kravitt stated: "[t]he 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 . . . [W]e also set in some rules to make sure that subordinate tranches didn't get money before senior tranches."

Allocable Share to junior certificates with realized losses is unfair because a settlement payment distributed over several months would not have resulted in the majority of the Allocable Shares to be distributed to junior certificateholders. As discussed above, it is in fact senior certificates with realized losses that will be paid before junior certificates with realized losses. In addition, the parties clearly knew that the Allocable Shares from the Settlement Agreement were enormous lump sums that would flow into the trusts, but they did not write the Settlement Agreement to account for this potential outcome.

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evidenced what they intended by what they wrote." *Rodolitz v. Neptune Paper Prods.*, 22 N.Y.2d 383, 387 (1968) (internal citation omitted).

The parties to the Settlement Agreement undoubtedly set out to create one global settlement to resolve the claims of 530 trusts, each with differing Governing Agreements. Through undoubtedly difficult and lengthy negotiations, the parties chose the defined term "Subsequent Recovery" as set forth in the differing PSAs – a choice that is responsible for the outcome in this decision.

In interpreting contracts, courts look "to the objective meaning of contractual language, not to the parties' individual subjective understanding of it." *Ashwood Capital, Inc.*, 99 A.D.3d at 6. Our courts "apply this rule with even greater force" – in cases like this one – involving "commercial contracts negotiated at arm's length by sophisticated, counseled businesspeople." *Id.* Upon careful examination of the plain language of the Settlement Agreement and Governing Agreements, I find that their objective meaning is to direct the Trustee to distribute the Allocable Shares for the Fourteen Trusts using the pay first, write up second method, which includes the calculation of the Principal Distribution Amount pursuant to the terms of the Governing Agreements.

Tilden Park and Prosiris also request that the Trustee distribute the Allocable Shares for the Fourteen Trusts as of February 25, 2016 – the next distribution date after this proceeding was commenced. They argue that I should direct distribution as of this date based on the Institutional Investors' attempt to delay this proceeding in order to divert payment to themselves.

I agree with AIG and the Institutional Investors that there is no support in the Governing Agreements for a distribution to relate back to a prior set of certificate balances. Further, I note that the two partial judgments previously entered in this proceeding directed distribution as of the next available distribution date, and did not relate back to February 2016. I do not find any reason to

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depart from that procedure in this case. I therefore direct the Trustee to distribute the Allocable Share for the Fourteen Trusts on the next available distribution date, in accordance with this decision.

Lastly, I deny the petitioner's request for: (a) an order that the Court shall retain exclusive jurisdiction over this matter for the purposes of rendering additional instructions as are necessary or appropriate in the administration of the Covered Trusts; and (b) an order barring litigation of the questions raised herein outside the context of this proceeding. If the parties need additional instructions or an order barring further litigation of the questions raised here, the parties may seek such relief as necessary.

In accordance with the foregoing, it is hereby:

ORDERED that the branch of the Bank of New York Mellon's petition seeking judicial instructions related to CWABS 2006-12 is severed and granted as described above; and it is further

ORDERED that the branch of the Bank of New York Mellon's petition seeking judicial instructions related to CWALT 2005-61, CWALT 2005-69, CWALT 2005-72, CWALT 2005-76, CWALT 2005-IM1, CWALT 2006-OA10, CWALT 2006-OA14, CWALT 2006-OA3, CWALT 2006-OA7, CWALT 2006-OA8, CWALT 2007-OA3, CWALT 2007-0A8, CWMBS 2006-3, and CWMBS 2006-OA5 is severed and granted as described above.

Settle judgments.

This constitutes the decision and order of the Court.

DATE: 3/31/17

SALIANNISCARPULLA, JSC

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2	SUPREME COURT OF THE STATE OF NEW YORK COUNTY OF NEW YORK: CIVIL TERM: PART 39	
3	X In the Matter of the Application of	
4	THE BANK OF NEW YORK, MELLON, in its Capacity Index No:	
5	As Trustee of Indenture Trustee of 530 150973/2016 Countrywide Residential Mortgage-Backed Securitization Trusts,	
7	Petitioner,	
8	For Judicial Instructions under CPLR Article 77 On the Distribution of a Settlement Payment	
9	X	
10	60 Centre Street New York, New York 10007	
11	August 31, 2016	
12	B E F O R E: THE HONORABLE SALIANN SCARPULLA	
13	JUSTICE APPEARANCES:	
14	MAYER BROWN, LLP	
15	Attorneys for Petitioner Bank of NY/Mellon 1221 Avenue of the Americas	
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17	MOLOLAMKEN	
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19	New York, NY 10022 BY: Steven F. Molo, Esq.	
20	Justin Ellis, Esq.	
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2 1 2 Appearances Continued: 3 MCKOOL SMITH 4 Attorneys for Center Court One Bryant Park - 47th Floor 5 New York, NY 10036 BY: Gayle Rosenstein Klein, Esq. 6 7 SCHLAM, STONE & DOLAN, LLP Attorneys for Blue Mountain 8 26 Broadway New York, NY 10004 9 John M. Lundin, Esq. WOLLMUTH, MAHER & DEUTSCH, LLP 10 Attorneys for TIG 500 Fifth Avenue 11 New York, NY 10110 12 BY: Michael C. Ledley, Esq. 13 14 15 16 17 18 19 20 21 22 23 24 25 VANESSA MILLER Senior Court Reporter 26

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3 Proceedings 1 2 THE COURT: Okay. So I have the second group of objectors today; correct? You've sent me some 3 information and some documents by e-mail a couple of days 4 5 ago; correct? All right. How do you want to present this? 6 Someone has a screen up, so I assume that someone wants 7 to use that screen, unless you're giving it to me as a 8 9 gift, then I say thank you very much. 10 MR. MOLO: I want to use the screen, your 11 Honor. Okay. So why don't we start with 12 THE COURT: 13 AIG? All right. Go ahead. 14 15 MR. GOLDSTEIN: Can I speak from, your Honor, here? 16 17 Where's our podium? I mean, it THE COURT: 18 might be better, if you'd like to, you can use the 19 podium. 20 MR. GOLDSTEIN: Sure. Thank you. 21 And, your Honor, I have some demonstratives 22 which I may refer to, if that's all right. 23 THE COURT: Okay. Good. Let's mark this as a Court exhibit as Defendant 24 AIG's 1. 25 (Whereupon Defendant AIG's Exhibit 1, was marked 26

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and received into evidence by the court reporter.)

MR. GOLDSTEIN: Thank you, your Honor. Jordan Goldstein for AIG and its affiliates.

As we argued in our August 12th submission, your Honor, and in prior submissions, the Standard Intex Method is the most appropriate way to distribute the remaining settlement payment as to the 17 trusts that are still at issue, and that's for four reasons: The first is that it's the most consistent with the structure and intent of the settlement agreement; second, it's the most consistent with the structure and intent of the pooling and servicing agreements; the third, it avoids a absurd and commercially unreasonable result, which is what would occur were Tilden's preferred methods to be followed; and the fourth is it's the most consistent with the expectations of the market participants.

Just to address each of them in turn -- THE COURT: Okay.

MR. GOLDSTEIN: -- the trustee testified in the first Article 77 proceeding before Justice Kapnick that the purpose of the settlement agreement was to ensure that the most senior holders were paid in advance of the more junior holders and the Standard Intex Method assures that.

The second is that the settlement agreement

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reflects a paid-first-write-up-second methodology, which obviously, we spent a lot of time on in the earlier parts of this proceeding. The purpose of that paid-first-write-up-second methodology is that money is distributed based upon the pre-distribution balance of the certificates. In other words, if the certificate is entirely written down, it's generally going to get nothing. And to the extent it has a small principal balance, it would only get a very small pro-rata portion. Again, the Standard Intex Method reflects that.

In terms of the pooling and servicing agreements, we've cited a lot of law in our briefs which are -- the main point being that you read agreements as a whole, and you read it contextually and you don't read clauses in isolation. The key purpose of the PSAs, pooling and service agreements, is that the most senior bonds are insulated from losses, and that's through two methods: One is over collateralization. In other words, the underlying collateral exceeds the balance of the certificate; and the second is, to the extent that collateral arose, the most junior certificates take losses first in order to insulate the more senior ones in the capital structure --

THE COURT: So if I went back to those 65 days of hearing that we had on the first settlement on the

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settlement agreement, would that be reflected in the transcript of those hearings that the philosophy of the settlement agreement was that senior secured were going to be over collateralized, junior secured were going to take the losses first, which is the way it generally occurs, right? Junior certificate holders take the losses first. And so they may be written up to a hundred percent; correct? And then if there are additional losses, the senior certificate holders take them and payment is the other way; correct?

MR. GOLDSTEIN: Yes.

THE COURT: And is that reflected in the transcript from the settlement agreement, that that was how the parties intended that this settlement be distributed?

MR. GOLDSTEIN: Yes.

Your Honor, on Page 15 of the brief we put in on August 12th, there is a quote from Jason Kravitt, attorney at Mayer Brown, counsel for the trustee, where he says precisely that. And we have a fairly lengthy block quote. I'm not going to read it, but it reflects that principle.

THE COURT: And so does someone who buys, for example, a junior subordinated debt in the market, would that be -- or subordinated bond, I guess it would be,

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2	would that be the same price as a senior bond? In other
3	words, the value of the junior bond is much less;
4	correct?
5	MR. GOLDSTEIN: Right, right.
6	THE COURT: And that reflects the understanding
7	that it may or may not be that the junior bonds get paid,
8	so, therefore, you can buy them in much more, I guess,
9	cheaply than senior bonds; is that correct?
10	MR. GOLDSTEIN: That's correct.
11	So we don't have visibility on what Tilden and
12	Prosiris paid for their bonds. But our understanding
13	THE COURT: Were Tilden and Prosiris holders of
14	junior bonds at the time of the settlement agreement?
15	MR. GOLDSTEIN: I
16	THE COURT: Or I will ask them.
17	MR. GOLDSTEIN: Perhaps
18	THE COURT: Where are they?
19	MR. MOLO: What was the question?
20	THE COURT: Were you holders of bonds at the
21	time of the settlement agreement?
22	MR. MOLO: Excuse me. I'll find out for sure.
23	(Pause in proceedings.)
24	MR. MOLO: To be clear, at the time that the
25	settlement was presented, we were not, but
26	THE COURT: You were not.

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8 Proceedings 1 But by the time --2 MR. MOLO: 3 THE COURT: So you had no -- by the time the settlement agreement had already been put into place, you 4 5 bought. By the time it was final, we 6 MR. MOLO: No. had --7 THE COURT: So the testimony --8 9 MR. MOLO: So it was during the period of time. 10 THE COURT: So the testimony had already occurred when you bought. 11 Correct. As is the case --12 MR. MOLO: 13 THE COURT: So there was no surprise to you that the testimony had occurred when you bought -- the 14 testimony that we're talking about right now and in front 15 of Judge Kapnick where the scheme was --16 Right. We very much bought with 17 MR. MOLO: 18 purpose. 19 THE COURT: Okay. Good. 20 MR. MOLO: And AIG, by the way, I believe is similar --21 I'm just asking you. 22 THE COURT: I don't want there to be any dispute that you bought in knowing what 23 the deal was. 24 25 MR. MOLO: Correct, correct. It wasn't what you bought in after 26 THE COURT:

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all the testimony explaining how this was supposed to happen.

Okay. Good. Thanks. Okay. Go ahead.

MR. GOLDSTEIN: Sure.

So, as I said, there are four reasons, starting with the settlement agreement, and that's what we just discussed. In terms of the pooling and servicing agreements, the structure of those deals is to protect the most senior holders from losses and Tilden's approach usually flipped that on its head. It has the senior holders receiving less than half of the settlement and has junior holders, including ones that are completely written down, receiving the lion's share of the settlement.

Tilden put in two experts affidavits. What's interesting is that neither of them has any coherent explanation for why the result that Tilden's advocating makes any sense. For example, if the settlement payment, we gave this example in our brief, instead of being paid all next month, for example, were just spaced out over ten months, one ten next month, one ten the month after, one ten the month after that, virtually all of this flows to the super senior holder. It really is this fortuity that all of this would actually come in in a single month, that, under their interpretation, leads to this

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2 leakage to the more junior holders.

And the second point is their experts have not put forward any explanation that this structure was intentional; that the parties to the PSAs ever intended that this would result. In addition, their experts don't contest that the Standard Intex Method most accurately reflects how market participants understood these deals to function.

And, finally, we put in an affidavit from Intex. And, obviously, as your Honor knows, we took discovery from them in order to get to that point. In Intex, that affidavit make very clear that the Standard Intex Method is; A, a default method for all 17 trusts; and, B, for, really, the last all or nearly all of the last five years has been the default method for all of those trusts.

So, again, to your Honor's point, certainly
Prosiris and Tilden would've been aware, at the time they
purchased, it appears, that this is how the market
understood these to function. And I'm happy to answer
any questions about that, your Honor. I'm also happy to
address some of the points in their brief that they put
in on August 26th.

So on --

THE COURT: I guess I have two questions.

MR. GOLDSTEIN: Yes.

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THE COURT: One is that I know I spoke with

Justice Friedman weeks ago about her decision that she

recently made. And I wanted to ask you whether you

thought there was anything in Justice Friedman's decision

that is relevant here. I've read it a couple of times,

but, I mean, it's not quite the same issue. It's more an

issue of whether or not the settlement was, I guess,

similar to an arbitrary and capricious type of --

MR. GOLDSTEIN: Right.

THE COURT: But is there anything in that decision that you want to point out here?

MR. GOLDSTEIN: Yes, your Honor.

So the Gibbs & Brun law firm, on behalf of their holders, put in a submission, but I think the key point that they highlighted was on this record date argument. So Tilden and Prosiris were basically arguing that if there is a payment that occurs subsequent to the Court entering judgment, that the trustee should, essentially, relate -- should pay it based upon the principal balances as they existed in February 2016.

So the key point, key response to this -- and this is consistent with a portion of the opinion that you just mentioned that Gibbs & Bruns flagged their supplemental submission, which I believe they put in on August 12. It was a little later in the day after we put

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in our primary submissions, is, there's nothing in the pooling and servicing agreements that permits payment based upon principal balances or based upon the principal balances other than on the date of which the payment is made. So there's simply nothing in the PSAs that support -- there's no logic that really supports that.

I mean, the settlement agreement was agreed to in June of 2011. There's no reason why February 2016 is some magic date that everything should relate back to. And Tilden and Prosiris have not put in any principal reason for why February 2016 is the relevant date other than, I presume, that they would make more on that date rather than June of 2011.

They do cite the delay that's occurred since
February. I mean, that, quote, unquote, "delay" is
because the trustee filed a verified petition seeking an
instruction from the Court. And Tilden singled out its
14 trust as unique, and that's their word, unique and
deserving of some special treatment. And so we've
litigated that. And so that's the nature of these
things. Tilden also argues that part of the reason
there's been delay is because we sought discovery on
Intex. Now, Tilden actually cites that Intex discovery
in support of its position. And it seems difficult to
come to understand why the Intex discovery is relevant

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2	when Tilden cites it, but somehow, irrelevant or dilatory
3	when we cite it. And then, finally, the trustee itself,
4	in prior hearings before your Honor, has said that
5	Tilden's approach would be impractical, and that's the
6	trustee's word.
7	So the J.P. Morgan decision has some references
8	to record date issues and so on, and it's consistent with
9	the position that AIG has articulated.
LO	THE COURT: And the last thing: You brought up
11	that one trust Prosiris and Tilden didn't have any
L2	interest in one of the trusts?
L3	MR. GOLDSTEIN: Right.
L4	THE COURT: And I didn't see anything that was
L5	inconsistent with that; is that correct? I wrote it
L6	down.
L7	MR. GOLDSTEIN: There's the CWALT 2007 OA10.
L8	THE COURT: Right.
L9	MR. GOLDSTEIN: I mean, in one of their initial
20	pleadings, they gave a list
21	THE COURT: Right. But, okay. And so in your
22	pleading, I tagged it. Let me
23	MR. GOLDSTEIN: I don't believe they disputed
24	that point.
25	THE COURT: Is that correct? That you
26	don't one of the AIG trusts, CWALT 207 OA10, Prosiris

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2	and Tilden doesn't have an interest in; is that correct,
3	Counsel?
4	MR. MOLO: Yes.
5	THE COURT: So that's going to go. I mean, you
6	can prepare a judgment for that one.
7	MR. GOLDSTEIN: Okay. Thank you, your Honor.
8	THE COURT: Because you don't have standing to
9	object to that one; correct?
10	MR. MOLO: Right.
11	THE COURT: Okay.
12	MR. GOLDSTEIN: I'm sorry. I just want to
13	respond quickly to just a couple of points that they
14	mentioned in their August 26 brief.
15	One of the points they make is that AIG is
16	somehow collaterally estopped from maintaining its
17	present position. And there are three responses to that,
18	your Honor: The first is that our arguments in the
19	initial pleadings that they're citing are the March 4th
20	ones were made in response to the verified petition. The
21	verified petition raised an issue of transitory over
22	collateralization, this idea of whether or not there
23	would be a mid-month calculation of over
24	collateralization that would result in leakage. So our
25	arguments were directly responsive to that. It was not
26	responsive to distribution amount or the 17 trusts. So

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we simply did not join issue in those initial pleadings.

Secondly, to the extent there is an overlap, our position has been consistent. It's been that the super senior holders, based upon the structure of the bond, should receive priority and there should not be leakage with the juniors. So there's simply not a conflict.

And the third, in our later submissions, we specifically carved out, at the point that we knew that the 17 bonds were at issue, we responded only to the -- at one point, 515 then it was 512, but we responded to the bulk of the bonds. And we expressly carved out, and then the parties disagreed about these remaining bonds. We're going to deal with them separately. So there really is no collateral estoppel issue, but I just wanted to respond to that.

And, also, they raised a res adjudicata issue. I don't quite see what that would be. We've always agreed that the settlement agreement should be enforced, the question is how to interpret things. But AIG's position, just to be clear, is that the settlement agreement is binding and should be enforced.

THE COURT: No. I don't think that -- I mean, you can argue that, but I didn't argue that with you. I don't think there's any res adjudicata or collateral estoppel here. But I'm happy to hear argument on it, if

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2	you want to. I wouldn't focus on it if I were you, okay.
3	Anything else?
4	MR. GOLDSTEIN: Just quickly to conclude, your
5	Honor
6	THE COURT: Go ahead.
7	MR. GOLDSTEIN: just to go back to your
8	Honor's question at the beginning: Tilden purchased
9	these bonds for, it appears, a very small percentage on
10	the dollar. Presumably this was
11	THE COURT: After the settlement.
12	MR. GOLDSTEIN: After settlement.
13	THE COURT: And this is going to be my first
14	question to you, Counsel: You were not involved in
15	negotiating, drafting, hearing anything with your clients
16	about the settlement agreement. That's the first
17	question I asked you. You took afterwards, and you took
18	a look at these two documents, and my sense is that you
19	found a little hook, and so now you're arguing something
20	that I don't really think anyone who entered into that
21	settlement agreement ever thought was going to happen.
22	So that is my first discussion with you.
23	And, frankly, since you weren't around and you
24	didn't have anything at the time of the settlement
25	agreement was put in place, from an overall perspective,
26	that's what it looks like. And so the question then

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17 Proceedings 1 becomes is your interpretation what the parties, who 2 3 entered into the settlement agreement, thought was going to happen? Number one; number two, is it commercially 4 5 reasonable to pay junior written-off debt more than senior debt? I mean, these are issues that you really 6 need to focus on. 7 MR. MOLO: I look forward --8 9 THE COURT: I don't see them. 10 MR. MOLO: -- to doing it. And I'm sure you can hear the 11 THE COURT: 12 reason why I'm asking you these questions, because what 13 you are arguing is, in some ways, viscerally counterintuitive. So --14 MR. MOLO: I look forward to it. 15 THE COURT: Good. Let's go. 16 17 MR. GOLDSTEIN: Thank you, your Honor. 18 MR. SHEEREN: And, your Honor, it might make 19 sense for the remainder of the super seniors to present 20 before --Does anyone else have any 21 THE COURT: Oh. 22 other arguments that they want to add in? 23 MR. SHEEREN: Yes, your Honor. Just briefly. 24 THE COURT: Sure. Absolutely. 25 I'm sorry. I didn't mean to --

No.

MR. GOLDSTEIN:

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THE COURT: I didn't mean for you to only take

AIG's position.

MR. SHEEREN: Not at all. Not at all. Thank you, your Honor.

David Sheeren on behalf of AEGON and BlackRock, who, like AIG, are super senior holders. Our clients hold in 16 of the 17 trusts, so they hold them broadly.

We join in the arguments you just heard from AIG, but I wanted to make a couple of additional points: The fundamental goal of any contract interpretation has to be the effectuated intent of the parties; that's the And, your Honor, Tilden Park and Prosiris's interpretation isn't just inconsistent with the intent of the parties, the settlement agreement, to the governing document, the PSAs and with respect to prospectus It's the total opposite. It would flip supplements. seniority structure in these trusts. As your Honor pointed out, that is viscerally counterintuitive. only is it counterintuitive, it's just a flawed interpretation of a contract read as a whole. It doesn't make any sense. And the case law in New York says, Look at the commercial reasonableness of the outcome that the parties are advocating. And, here, the outcome is fundamentally unreasonable. And I'm going to walk through a couple of points about that.

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And, by the way, the trustee's petition pointed out what should be the obvious point, which is the essential purpose of over collateralization is to insulate the senior from losses. They recognize that. That's obviously front and center of our arguments. to follow the Tilden Park interpretation would be the exact opposite of insulating the seniors from losses. Wе pointed out in our briefs that the prospectus supplements, which are, by law, incorporated into the parties' contract, and, therefore, form part of the agreement among the parties, those prospectus supplements describe in detail the purpose of subordination and the purpose of over collateralization. And you see exactly the trustee's point that they had central purpose is to insulate the seniors from losses. So that's the purposes of these deals.

We showed in our brief that if you followed Tilden's Park approach, shortly after the settlement payment was made, the seniors are going to suffer tens of millions in losses; that can't be the purpose of these contracts, your Honor. Under the standard commercially reasonable Intex approach, the seniors wouldn't suffer losses for six to eight years in the example we gave in our brief. And on that basis alone, frankly, you can see whose interpretation reasonably effectuates the intent of

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the drafters here.

Second main point, your Honor, is when you read the Tilden Park response, they talk about a cap on principal distribution. There's this cap. They call it It's a cap. That's the sole basis on which they a cap. say tens of millions of dollars should flow to their junior bonds because of this cap. But there's no explanation of the cap in the brief. But as your Honor knows, the cap is this defined termed called the over collateralization target amounts. Tilden Park says, Once you reach the over collateralization target amounts, any marginal dollar on top of that goes to their bonds. Honor, if that was a reasonable basis to allow leakage, you would think their brief would reference the term "over collateralization target amount." When you look at the brief, they don't even talk about it. It's in one of the 120 footnotes. They are running from that term because it doesn't make any sense to cap the principal distributions by that thing called the over collateralization target amount.

And, by the way, over collateralization target amount, it sure sounds like it has something to do with over collateralization, but even Tilden Park, in their prior briefs to the Court, admitted that the settlement payment itself doesn't create over collateralization.

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There's no temporary illusory over collateralization;
Tilden Park argued that. And so they're running from
that term because it doesn't make sense to cap
distributions based on the appearance of the over
collateralization target being met. So that's an
important point. And you also see that the expert
reports that they've submitted totally ignore that term.
It doesn't appear in the expert reports because,
candidly, it doesn't make any sense. So what can they
say about it?

So just to close, your Honor, we agree with AIG that the commercially and reasonable outcome here is the payments of the settlement funds in full to the senior-most bonds. And, your Honor, you see the market expectations not only in the Jason Kravitt testimony, who obviously was a key witness at the trial --

THE COURT: I did see it. I read the testimony. Yes.

MR. SHEEREN: But, your Honor, Intex hadn't even created this toggle that would align with Tilden Park's interpretation until 2014. The settlement agreement was posted in June of 2011 and the trial concluded in November of 2013 and we got a trial order shortly thereafter. So they're late to the game. And they clearly have, you know, an opportunistic textural

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1	Proceedings
2	argument, but it doesn't make any sense. For that
3	reason, we would ask the Court to overrule their
4	objection.
5	Thank you.
6	THE COURT: Okay. Thank you, Counsel.
7	Did you want to add to that?
8	MS. KLEIN: Your Honor, we are a senior
9	support certificate holder. And we suggest that it's
10	probably best for us to bring up arrears since we are
11	advocating for the write up first pay second.
12	MR. MOLO: Yes. It is my screen.
13	THE COURT: And a very nice one it is.
14	MR. MOLO: Thank you very much. Thank you very
15	much. I hope you'll agree with the contents that you're
16	about to see on it.
17	We are here, Judge, seeking to enforce the
18	settlement agreements as written and the PSA as
19	written
20	THE COURT: Well, let me just say this, let's
21	lay this out: You weren't a party to the original
22	proceeding, although AIG, BlackRock and AEGON were.
23	MR. MOLO: Correct.
24	THE COURT: So at the time that this settlement
25	agreement was reached, you had no interest in this; you
26	had no idea what the intent of the parties from the

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1	Proceedings
2	settlement agreement is; you weren't here for the
3	testimony; you didn't hear any of that; correct?
4	MR. MOLO: Right.
5	THE COURT: So I hear from the parties who
6	actually were
7	MR. MOLO: Right.
8	THE COURT: negotiating the settlement
9	agreement, who were part of the settlement agreement, and
10	they tell me this is what everyone intends, that's what I
11	see. And I certainly was not a party to that. But it is
12	clear to me that everyone who was here at the time is
13	taking a different view from you about how this
14	settlement agreement should be read.
15	MR. MOLO: Okay. Well
16	THE COURT: So we start with that.
17	MR. MOLO: Two points of clarification.
18	THE COURT: Yes.
19	MR. MOLO: I don't believe that AIG owned these
20	bonds.
21	THE COURT: Okay. They may not have owned
22	these particular bonds.
23	MR. MOLO: Right. But they were clearly
24	involved. They were at the table.
25	THE COURT: They knew what was going on.
26	Everyone knew what you intended to do and everyone that

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24 Proceedings 1 was there, at the time when the settlement agreement was 2 entered into, is telling me exactly the opposite from 3 you, the buyer later, thinks that the settlement 4 5 agreement --I, with all due respect, disagree 6 MR. MOLO: with you --7 THE COURT: Tell me who agrees with you who was 8 9 there at the time. MR. MOLO: Jason Kravitt. 10 Okay. He was not -- and he didn't 11 THE COURT: hold any --12 13 MR. MOLO: No. He was the lead negotiator, as 14 Mr. --THE COURT: He was not a holder. 15 MR. MOLO: He was the -- they quote Jason 16 Kravitt in their brief, and I agree with Jason Kravitt. 17 18 THE COURT: All right. I embrace the quotation that he 19 MR. MOLO: 20 gave. 21 THE COURT: Yes. All right. Let me just tell you what he said. 22 MR. MOLO: This was his testimony: "The tranches who are the most 23 senior who suffered losses get the cash first." That's 24 from their brief. "The tranches who are the most senior 25 who suffered losses get the cash first." And in these 26

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2	particular trusts, with the language of these PSAs, those
3	tranches are the tranches that are held, the bonds that
4	are held by Tilden Park and Prosiris.
5	Let me just show you, Judge
6	THE COURT: Okay.
7	MR. MOLO: You know, we're painted as these
8	evil junior bondholders
9	THE COURT: Not evil. Let me say, I don't
10	think you look in fact, I see a halo over your head.
11	MR. MOLO: Thank you very much.
12	THE COURT: But what I am saying is you
13	certainly paid a lot less, a lot less for your interest
14	in this trust than the senior bondholders; correct?
15	MR. MOLO: Well, I
16	THE COURT: And why do you think you paid less?
17	Because you're supposed to get half of the recovery? Do
18	you think that that makes sense?
19	MR. MOLO: Well
20	THE COURT: I mean
21	MR. MOLO: I'd like to explain to you how it
22	does.
23	THE COURT: Okay. Let me see how this does.
24	Yes.
25	MR. MOLO: Okay. So, first, we start with this
26	proposition that we're not the super seniors.

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26 Proceedings 1 THE COURT: Correct. 2 That's the people here who are on 3 MR. MOLO: the other side of this table --4 5 THE COURT: Is that like a super delegate? You can never -- you have to vote and that's it? You can't 6 change your mind? 7 All right. 8 Yes. 9 MR. MOLO: But what we are are the senior support certificate. We're the second tranche in the 10 debt class. And this is a debt class that as whatever it 11 is, 14, 15 classes up there in this particular 12 securitization. And that's the position that we 13 routinely maintained in these trusts. 14 15 Now, we're not risky junk bonds --THE COURT: Wait a second. Now, let me ask 16 You see this list? 17 you: 18 MR. MOLO: Is any of the other certificate 19 THE COURT: 20 holders but you making this claim about how the money should be distributed? 21 22 MR. MOLO: Well, those --23 THE COURT: Yes or no? All those other classes, have any of them put in briefs about how they 24 should -- the money should be distributed? You're 25 agreeing that this is --26

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1	Proceedings
2	MR. LUNDIN: Yes. Our submission, which is very
3	short, makes a couple of points, but, basically,
4	Tilden
5	THE COURT: Which class are you?
6	MR. LUNDIN: I must confess, your Honor, I
7	don't know the particular tranche. And to anticipate
8	your question, sitting here today, I do not know when my
9	clients purchased their bonds.
10	THE COURT: Well, then, you weren't here at the
11	time? You, Counsel, were not?
12	MR. LUNDIN: No. I was not in the proceeding.
13	THE COURT: Okay. So then you are after
14	settlement, probably prior to when this is
15	MR. LUNDIN: I don't know, your Honor. But I
16	can assure you that I certainly had no involvement in the
17	settlement.
18	THE COURT: Okay. Thank you.
19	MR. MOLO: Okay. So the point of this chart is
20	to show that we're not at the bottom. In fact, we were
21	very, very senior. And, in fact, these bonds are
22	triple-A rated. And what these bonds had, again, putting
23	these transactions in context, 14 deals, the average
24	value of the deals was a billion dollars. It ranged from
25	375 million to two-and-a-half billion. You had the five
26	primary securitization underwriters involved in this;

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UBS, Deutsche Bank, Barclays, Countrywide, Bank of America. And the three key law firms, Sidley, McKee Nelson, Thacher Proffitt. So these are highly negotiated, sophisticated transactions. And I think your Honor knows, these are not deals where somebody says, Let's go to a securitization deal and then let's go sell bonds. They put these deals together with key bondholders, or the key tranches having negotiated the terms. So no two deals are necessarily alike. Some of them are alike.

And the reason I showed you this is we're not talking about this being like a Sidley Austin form or a Thacher, Proffitt form or a UBS form. These are all different deals with these key players all involved and they have this language --

THE COURT: So what I suspect is that all these bonds are out there and you're buying bonds only because now your PSAs have an interesting twist to them, or something going on with them, that 90 percent of the other bonds don't have.

MR. MOLO: Yes.

THE COURT: And so you say, Hey, maybe I might get Scarpulla, in terms of my bonds, to interpret the settlement agreement in a way that is different because all of the other 500 trusts have taken their money in a

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29 Proceedings 1 certain way. 2 You don't have to do that. 3 MR. MOLO: THE COURT: Right? 4 You don't have to do that. 5 MR. MOLO: THE COURT: No? 6 You don't have to do that at No. 7 MR. MOLO: all. In fact, you should interpret the settlement 8 9 agreement just as its written, just as Jason Kravitt said it, on the senior-most tranche, or, "the tranches who 10 were more senior who suffered the losses get the cash 11 first." So that's what the settlement agreement says and 12 that's what was intended. 13 These particular PSAs, you're absolutely right. 14 15 The language in these PSAs is a little bit different, 16 although significantly so when we are talking about the 17 amount of money at stake in this particular situation, but it's a little bit different --18 And that's why you bought those 19 THE COURT: bonds. 20 21 MR. MOLO: Correct. 22 THE COURT: Correct? 23 Absolutely. MR. MOLO: THE COURT: That's my whole point. You bought 24 the bonds thinking, Maybe I'm going to get come into 25 court and convince this Court that my interpretation 26

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between the PSA and the settlement agreement gets me
something that the other 500 trusts, which have a little
bit different language, don't get.

MR. MOLO: Well, a little bit different language is, we know in the world we live in, can make a great deal of difference.

THE COURT: I don't know that that makes a difference in a commercially reasonable -- whether a interpretation of the settlement agreement is commercially reasonable as a whole.

MR. MOLO: Okay. Well, may I?

THE COURT: Yes.

MR. MOLO: Okay. All right.

THE COURT: Yes.

MR. MOLO: So I want to address two points.

I'm going to talk about the language in one second. But before that, what the super seniors have here in over collateralization, put very plainly, is credit enhancement; right? These are bonds that were safer than people further down the chain because of that feature of over collateralization; right? That was negotiated among these parties in the various deals that were done. What the senior support certificate holders had, again, because, you know, they're at the top, you know. I can't tell you right now what the interest rates

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were for each of these bonds, but, obviously, you know, they're getting some kind of protection here. The protection they got was the specific language in the waterfall here that wasn't present in these other deals, just as you said. I agree, Judge. This is language that is different.

Now, you asked me is it commercially reasonable. Absolutely it's commercially reasonable, because if you're going to buy that bond, and you're subordinated, there's no question you're subordinated to the super senior. If you're subordinated, you want to still get whatever protection you can get. And, you know, between Sidley Austin, McKee Nelson, Thacher Proffitt and all those underwriters in these 14 deals, with whoever the original bondholders were, that negotiation occurred and. This was the credit enhancement that number two in the debt stack get.

THE COURT: But that is after the settlement agreement. So you can --

MR. MOLO: No. This was here before the settlement agreement. This is here when these parties decided, no, the settlement agreement says what it says, what these parties decided is reflected in the PSA. I'm not --

THE COURT: I have to say, when I looked back

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and looked at the transcript and I asked Judge Kapnick this question, did anyone suggest, while these days and days and days of hearings, that this is the way any part of the settlement was going to be paid out, she said no. And if you can point to me testimony during the hearing of the settlement agreement where this -- the way that specifically now you're asking me to interpret the settlement agreement would be, I'd love to read that. That would be very helpful.

I mean, but I'm telling you MR. MOLO: Sure. right now what was designed here -- and I'm going to get the language, okay. We'll go to the language of the PSA. What was designed in these bonds. You're absolutely We bought these afterwards. This wasn't something that we came up with. This was something that at the time these deals closed between 2005 and 2007, these sophisticated parties, advised by top Wall Street lawyers, came to the conclusion that the super seniors would get credit enhancement through over collateralization and the senior support certificates would get credit support, being number two in the chain, they would get credit support by the language in the waterfall --

THE COURT: Again, I would like you to point me out anywhere, in the entirety of the settlement agreement

Vanessa Miller Senior Court Reporter

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1	Proceedings
2	testimony, where anyone said, By the way, Judge Kapnick,
3	with respect to some of these trusts, the senior over
4	collateralized will not get paid before the junior
5	bondholders. I didn't see that anywhere.
6	MR. MOLO: Well
7	THE COURT: And that leads me to believe that
8	no one anticipated that. If you have testimony, and I
9	won't hold you to it today, but if you have testimony to
10	that effect, I would love to see it.
11	MR. MOLO: Okay. But the question is
12	THE COURT: Because my job here is not about
13	what happened between you in 2005
14	MR. MOLO: I understand.
15	THE COURT: and 2007. Mine is a settlement
16	agreement was reached; the parties negotiated that
17	settlement agreement; they intended to have a certain
18	effect. And so what I need to do is to put that intent
19	in place.
20	MR. MOLO: Agreed.
21	And the number one intent I mean, in addition
22	to what Mr. Kravitt said, is apply the PSAs as written
23	THE COURT: No.
24	MR. MOLO: It says that.
25	THE COURT: That is not correct.
26	MR. MOLO: It says

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34 Proceedings 1 2 THE COURT: It does not say -- the settlement agreement does not say apply it as -- it says that to the 3 extent there is inconsistency, but that was a different 4 5 thing. This was not inconsistent. And it MR. MOLO: 6 was fully intended. Again --7 THE COURT: Yes. 8 MR. MOLO: -- allow me for one second. 9 THE COURT: Yes. All right. Whether or not, 10 I'm going to let you go for a while. 11 Okay. You can do whatever you want. 12 MR. MOLO: I want to make sure any question that you have is 13 answered. 14 15 Settlement Agreement 3(d), it says "Nothing --Believe me. I've read this 16 THE COURT: 17 settlement agreement more times than I wish I had. 18 Believe me when I tell you. "Nothing is intended or shall be 19 MR. MOLO: 20 construed" --THE COURT: 21 No, no. I tell you lawyers, 22 lawyers, lawyers. Only lawyers can come up with an 23 agreement like that. So, yes. Go ahead. 24 25 But the agreement does say that MR. MOLO: "nothing is intended or shall be construed to amend the 26

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governing agreements"; right?

THE COURT: Right. Yes.

MR. MOLO: Now, Judge, again, this is highly negotiated. And, I mean, it may have been required, this waterfall provision, in order to get the triple-A rating on these specific deals, that's a possibility here too. But when you say, Well, how could anyone have anticipated it, right? And res adjudicata obviously raises -- it bars any issue that was raised or could have been raised; right?

In 2010, eight months before the settlement agreement was signed, Credit-Suisse issued an analyst report telling the world that this trustee, BONY, actually paid, as we're saying it should be paid, through the waterfall in this way, all right, on one of the very 14 bonds at issue. So there was no mystery about this. This wasn't some little secret gotcha. It was a provision that was negotiated and it was a provision that was tested.

In fact, frankly, I don't even think the trustee had to even come here with this proceeding. I think the trustee was pushed because these other big investors were barking at the trustee saying, You can't let this happen, I've got to come to court and have this straightened out. The trustee has done exactly what we're asking be done in

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the past. So now, if, in fact, a different distribution through the waterfall occurred, it's going to be contrary to the only course of dealing that's occurred on these bonds through this PSA.

THE COURT: I think that the settlement agreement makes clear that there are things that are in the bonds that are no longer applicable. That's the whole point of the settlement agreement.

MR. MOLO: It doesn't --

THE COURT: It does. For example, how we treat certain money is set forth in the settlement agreement and it's set forth differently than some of the PSAs.

That's what the settlement agreement was there for.

MR. MOLO: But the waterfall provision is followup --

THE COURT: Okay.

MR. MOLO: -- and the way this PSA works is that the settlement proceeds, these are called subsequent recoveries under the settlement agreement, are considered available funds. The available funds under this waterfall first go to pay interest; second, they pay principal up to a principal distribution amount, that's an amount that's calculated. When we were talking about over collateralization, that's not -- I mean, that wasn't something that moved from month to month. The principal

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distribution amount is the key amount. And then, to the most senior tranches of bonds with losses, most senior tranches of bonds.

And so the difference here between these other over collateralization trusts that's already been resolved, that those are settled. And these are that the balance, the distribution, the cap, on what the super seniors get is calculated before the balances get written up. You see it uses the term -- this PSA uses the term "immediately prior and not the balance on the distribution date."

And if you'll forgive the basicness of these graphics, this is just being done for illustrative purposes. I just want to show you. This is the way the waterfall would normally work when the bonds -- people were paying their mortgages and the bonds would work. The senior holders would get what they get, and this would be the principal distribution, this red line here. So the seniors would get what they get. Then, we, the senior support certificates, would get what we get. And all way on down the line, all the way down the chart that I showed.

Now, what happened was in the crux, when people stopped paying their mortgages, okay, or people stopped paying the mortgages that caused the crisis, but the

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mortgages stopped getting paid. So what was traditionally the revenue into the trust dries up.

Who gets paid first? Of course, the super seniors. They're getting their principal distribution; they're getting in interest. And, we, the senior support holders are taking a loss. And these other losses, the other tranches all the way down the road, they're completely out. We were at least getting something, okay.

So what the settlement agreement does is it treats the payment as a subsequent recovery, okay, and that subsequent recovery comes in. And just like Jason Kravitt said, I just asked you to do what Jason Kravitt said should be done. The senior-most bonds with losses get paid first. And that would be the super seniors. To the extent that they have losses, their losses -- and we're talking across 14 trusts that would make it a very broad generalization. But, I mean, it might be three percent, four percent, or something like that. Our bonds are devalued probably by 35 percent or so. Okay. they get whatever they get coming to them. We get then, being the senior-most bond that suffered losses, right? The senior-most tranches that suffered losses. tranche one, tranche two. If there's no more to make up their losses and there isn't enough for us to hit our

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1	Proceedings
2	principal distribution amount, you know. We're still
3	going to go from maybe 35 percent losses, if this pays
4	as we're saying it should pay and as the trustee paid in
5	2010, we're still going to be 25 percent. I mean, there
6	are still going to be significant losses that these bonds
7	will have experienced. And then it ends.
8	So this is the system. And it makes sense;
9	right? I mean, it makes perfect
10	THE COURT: No. It doesn't really make sense
11	to me that you paid very little and you get a lot. That
12	doesn't make sense.
13	MR. MOLO: That's a completely different issue.
14	That issue
15	THE COURT: That doesn't make sense to me.
16	Then why would anyone agree to settle that way?
17	MR. MOLO: Because what we paid
18	THE COURT: Why would AIG and BlackRock and
19	AEGON, who are there at the time of the settlement, agree
20	to that scheme?
21	MR. MOLO: Because what we paid for the bonds
22	is wholly irrelevant.
23	THE COURT: Okay. Only if I interpret it this
24	way; right?
25	MR. MOLO: No, no. Not at all. Because all
26	I'm asking you to do is interpret the settlement

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1	Proceedings
2	agreement as written and then enforce the PSA as it is
3	THE COURT: So the one thing I asked you, why
4	were the people that negotiated this settlement
5	agreement, who have the most to lose, agree to that
6	scheme at the time?
7	MR. MOLO: Because I don't know why. AIG
8	THE COURT: Well, okay. I have to figure out
9	why, because I have to interpret the settlement
10	MR. MOLO: No, no. You don't have to figure out
11	why
12	THE COURT: I do have to figure out what the
13	parties intended when they entered into the settlement
14	agreement. I didn't draft the settlement agreement, nor
15	did your clients. Your clients weren't even around when
16	it came to being negotiated and drafted.
17	MR. MOLO: Because
18	THE COURT: Sir, can you sit down please?
19	Hold on. Let's go off the record.
20	(Discussion held off the record.)
21	THE COURT: All right. So I'm just going to
22	ask you, my court officer is instructed not to let anyone
23	in the well. I mean, it's just a safety issue.
24	Okay. So what I was saying is that the question
25	of what is irrelevant because what the Court is doing
26	and what the Court should be doing is looking first to

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the face of the agreement; right? And the agreement -- when I say "the agreement", it's really two agreements here; it's the settlement agreement and then it's the PSA. And the fact that this bond, again, and these 14 bonds had this waterfall provision, was not a secret. These are smart and sophisticated parties --

THE COURT: I know. That's what I'm saying. So the people who negotiated the settlement agreement, which is not verified --

MR. MOLO: Right.

THE COURT: -- must have known that -- and I cannot imagine that they would have intended this result in negotiating the settlement agreement. Why would they?

MR. MOLO: Well, the reason that they would do that is because when you go back to the issue of where these folks were, that high, senior-most bonds, senior-most tranches who've suffered losses. Jason Kravitt didn't say, Our intention is that the super senior be made 100 percent whole and that any over collateralization that they may have enjoined would persist --

THE COURT: And he certainly didn't say that in a big payout like this, the junior would get way more than the more senior bondholders.

MR. MOLO: No. He said that the senior-most

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bonds with losses. And in this situation, we are, to a small extent, the super seniors, but we are the senior-most bond. And that was something that was negotiated by those five underwriters, those three law

firms in 14 different deals.

Now, I don't know that my friend, Mr. Goldstein, actually read the affidavit that we supplied because the affidavits -- and you're asking about commercial reasonableness, right? So one of them was from somebody that was a senior trader, a person who had done a number of other things related to RMBS. The other gentleman, Aronoff is a lawyer, Cornell-trained lawyer, who started out at Thacher Proffitt, who then went to Paine Webber, who worked for a bond insurer, had extraordinary experience, extraordinary experience in this area. to the extent the Court -- this is what Aronoff said in his affidavit: "I have over 30 years experience analyzing and designing payment priority, waterfalls, in RMBS transactions." He said, "in payment priority that limits certain cash flow distributions to senior bonds is not at all unusual or unique." He goes onto say that, "the reason that you would do that is to make the less-senior bond more marketable to investors. credit enhancement."

THE COURT: This is assuming that there's no

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2 settlement agreement. That's what I'm saying to you.

That the settlement agreement -- it's almost like you're

4 pretending that that didn't occur.

MR. MOLO: Not at all, because --

THE COURT: But you are, because when the settlement agreement comes in, it is not what the parties intended under the original trust agreement. It's how the parties that settled the loss under these trust agreements agreed and intended for the money to be paid out. That's what I'm here to determine.

MR. MOLO: Right.

THE COURT: Not what the people in 2005 or 2007 agreed upon.

MR. MOLO: Right.

And what they said, the parties in the settlement agreement, was that, "nothing in the settlement agreement is intended or shall be construed to amend the governing agreement."

THE COURT: Right. But amending it doesn't -interpreting how to pay out money, I said this at the
last hearing, is not amending the settlement agreement. I
can tell you that that is where I'm heading.

MR. MOLO: It says you treat it as a subsequent recovery, right? That's a designed term in these agreements --

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1	Proceedings
2	THE COURT: In the settlement agreement, it is
3	said that they're going to be treated as a subsequent
4	MR. MOLO: Correct. And this is how subsequent
5	recoveries work under this waterfall in these bonds. And
6	for good reason, because this is a form of credit
7	enhancement to the second-most senior bond tranche of
8	bonds. So it makes perfect sense. It's commercially
9	reasonable. And they've failed to say to provide one
10	piece of evidence that says it's commercially
11	unreasonable other than, you know, we want more money and
12	we want to be over collateralized to
13	THE COURT: I think they put in a lot of
14	information.
15	MR. MOLO: Not on the point of commercial
16	reasonableness.
17	And let's talk about Intex. Okay.
18	Intex when I got involved in this case, as your Honor
19	may recall, Intex was we were hotly contesting whether
20	Intex should be deposed
21	THE COURT: We were.
22	MR. MOLO: whether we should go to
23	Massachusetts.
24	THE COURT: I wasn't, but you were.
25	MR. MOLO: No. You were there saying, Why are
26	these people in my courtroom bothering me over Intex.

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And I had to ask myself the same thing. Just getting involved in the case, I thought, Wow, this must be really an important thing. And we almost went to Massachusetts for a motion to compel and we got delayed several times and we had a phone conference. And at the end of the day, finally, finally, the skies parted and we were marching forward to have the Intex deposition taken.

And what happened? That backfired on Mr. Goldstein, completely backfired. Instead of having this robust deposition where we were going to go forward and depose the President of Intex and find out what Intex means, he comes forward sheepishly with this affidavit. And the affidavit -- you might remember another phone call we had about whether the deposition was going forward. I said, you know, Judge, I haven't seen the affidavit, and, you said, Well, take a look at it and let me know whether there's something there that's going to cause you to take the deposition a little more. And I did. And I said, why would I ever want to depose this And here's why: man.

First of all, you have to understand what Intex is: Intex is a modeling tool. All right. When a bank is buying bonds like these and it wants to price them and have its own forecast and modeling, it often has to have that modeling system served by or blessed by regulators.

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That's how -- this is not what we're talking about here.

This is a software provider -- I don't know this, but my guess is given the holdings that BlackRock and AIG have in this sort of security that they're probably two of the biggest customers of Intex.

And what could they get Mr. Intex to say? is what they got him to say, Intex: They got him to say that -- can we put up the Intex? Yeah, okay. what he says, George Jigarjian, the President of Intex, on behalf of Intex says, "Intex provides no assurances as to how a trustee...will or should pay on any given deal."; that, "these models did not reflect Intex's opinion or belief that either the Standard Intex Model or one of the other models is the correct or best way to pay." In other words, he said, it's a modeling tool. And we have -- what they call toggles, you know, these different ways that you can configure it. And then there's the quote, "Standard Intex Model", which happened to be the first one which happened to coincide -- I believe it first shows up in 2015 after AIG buys these bonds.

So they don't say -- because I would've asked this at the deposition, you know, Did AIG call you up and ask you about, you know, this modeling. And we never got that. Instead, we got the affidavit. I didn't need to

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47 Proceedings 1 take the deposition because I got the man who is Mr. 2 Intex saying, We provide no assurances as to how a 3 trustee will or should pay. And, by the way, Intex has 4 5 never actually -- there's never been a payment consistent with the Intex model. 6 Well, the Standard Intex Method 7 THE COURT: doesn't reflect the way that you're asking me to; 8 9 correct? Correct. Absolutely. Because it's 10 MR. MOLO: 11 wronq. THE COURT: Does not --12 13 MR. MOLO: Because it's wrong. Well, that's your opinion. But 14 THE COURT: they're not saying -- he's not saying, And by the way, 15 16 the Standard Intex Method is wrong. He's not saying that at all. 17 18 MR. MOLO: No. He's saying it is what it is. THE COURT: It is what it is. 19 It is a model. 20 MR. MOLO: 21 And that is absolutely a way to pay THE COURT: 22 under your trust. Which, it would be a way --23 MR. MOLO: THE COURT: Is that correct? 24 That's correct. I could take the Standard Intex Method, apply them to 25 your trust and it would result in payment the way that 26

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1	Proceedings
2	AIG and BlackRock and AEGON are asking you to pay;
3	correct?
4	MR. MOLO: Or they can ask us to load up a car
5	with cash
6	THE COURT: I'm just asking if that is a true
7	statement? Yes? It is a true statement.
8	MR. MOLO: If they want to pay according to
9	the, quote, "Standard Intex Model"
10	THE COURT: Yes.
11	MR. MOLO: which is wrong, by the way. But,
12	more importantly, I'll come to that in a second. More
13	importantly, to pay it that way, it's like if the trustee
14	had a car loaded up with this cash and rolled down the
15	windows and drove on the FDR and have the cash goes
16	elsewhere. It doesn't matter. What they would like to
17	do is rewrite the PSAs to follow the Standard Intex
18	Model.
19	If I could have Chart 11 up, please. The
20	Standard Intex Model violates the settlement agreement
21	and the PSA. Settlement Agreement 3(d) requires that you
22	follow the PSAs and the trustee shall distribute in
23	accordance with the distribution provisions of the PSAs.

The PSAs say you compute the principal distribution

amount before you write up the certificate balances and

the Standard Intex Model says you compute the principal

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distribution amount after writing up the certificate
balances. So Intex gets it wrong to the extent that you
can even rely on it.

What seems to be overlooked here, and what AIG and BlackRock and no one else has addressed, the trustee has actually applied the waterfall payment method that we are urging the Court to apply --

THE COURT: Prior to the settlement agreement.

MR. MOLO: Correct.

THE COURT: Correct. So, again, that is prior to the settlement agreement.

MR. MOLO: Which would have the settlement agreement modifying the terms of the PSA.

THE COURT: All the settlement agreement says is that it would not amend the PSAs.

MR. MOLO: Right. And this would be a substantial amendment.

THE COURT: And I am unwilling, at this

point -- and I may not agree with you that this is an

amendment of distributing money. I'm not making a

decision today. But I am having a difficult time with

the prospect that determining how to pay the money is an

amendment to the PSA under the settlement agreement; that

is my issue. And it has always been my issue. It's my

issue with the other --

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50 Proceedings 1 MR. MOLO: 2 Sure. -- group of trusts who want me to 3 THE COURT: pay them above senior certificate holders too. 4 5 MR. MOLO: Right. I don't think anyone --6 THE COURT: 7 MR. MOLO: Okay. -- frankly, I don't think anyone, 8 THE COURT: 9 at the time the settlement agreement was negotiated and 10 days and days of testimony about it, anticipated that anyone would come in and say what you are saying now. 11 12 And so you cannot ignore that. The settlement agreement intervened between this, the PSA and payment today. 13 I feel like you're not -- except for saying to me that 14 15 the settlement agreement can't change this, and, I agree, you can't amend your PSA. 16 17 MR. MOLO: Right. 18 THE COURT: But my problem with that is that I 19 don't believe that determining how to pay what is termed 20 money under the settle agreement necessarily is an 21 amendment to the PSAs. 22 MR. MOLO: Okay. Going back a bit. conversation this afternoon --23 I mean, you know, let me say again, 24 these are difficult issues. And I'm raising them with 25 you now for a conversation. I have not made up my mind. 26

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51 Proceedings 1 MR. MOLO: I agree. I'm confident you're going 2 3 to --I'm listening to what you're THE COURT: 4 I promise you that I'm listening with both ears. 5 saying. And I don't doubt it for a minute. MR. MOLO: 6 THE COURT: All right. 7 Going back three steps, right, is, 8 MR. MOLO: 9 as I said, this structure -- and it's not me saying it, 10 it's Aronoff, it's our other experts saying, This is not just one-off unicorn structure. This is a structure that 11 12 is there for a purpose, okay. And so it was on the radar And, in fact --13 screen. 14 THE COURT: So then show me some testimony. 15 I'm showing that in 2010, there is MR. MOLO: 16 a --17 I'm asking you, again, if you think THE COURT: 18 that the parties who negotiated this settlement agreement anticipated and believed that this is how the money was 19 20 going to be distributed with respect to these trusts, 21 show me some testimony. There were 65 days of testimony, I don't recall. 22 maybe 64. It was around --23 It was a lot. MR. MOLO: It was a lot. Show me some 24 THE COURT: 25 testimony where the parties who actually negotiated this settlement said, Yeah, and under at least 17 trusts of 26

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1	Proceedings
2	several hundred million dollars, this is how it's going
3	to work. I didn't see it. And I, again, invite you
4	to
5	MR. MOLO: Okay. And you know what? I'm going
6	to go back through the transcript after I leave here.
7	THE COURT: Good.
8	MR. MOLO: But I don't know that we need to go
9	back further than
10	THE COURT: I think you do because it is the
11	intent. You cannot ignore the settlement agreement to
12	the extent that you are.
13	MR. MOLO: I don't disagree with you.
14	But what does Kravitt's testimony mean? What
15	does his statement mean? If we can go back to
16	the here. This one. What does it mean?
17	THE COURT: Did he put that up when he was
18	testifying?
19	MR. MOLO: No. He didn't put it up.
20	THE COURT: That's my whole point. That's you
21	putting that demonstrative up saying, Here's how I'd like
22	the settlement agreement to be interpreted. But I would
23	like to know what the parties, at the time, anticipated.
24	MR. MOLO: Well, when he said the senior-most
25	tranches, right, that experienced losses, that's what
26	happens here with what we're talking about. The

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53 Proceedings 1 senior-most tranches. 2 3 THE COURT: Okay. I don't know how much clearer it can MR. MOLO: 4 We, the senior support holders, suffered significant 5 And we're not talking about compensating all these 6 people down here. We're saying, Take these proceeds and 7 apply them first to the seniors --8 9 THE COURT: So if I apply these proceeds, how much would the senior holders get and how much will the 10 senior support holders get? 11 MR. MOLO: The difference -- I can't tell you 12 the exact dollars. 13 Just give me a ballpark. 14 THE COURT: 15 MR. MOLO: May I talk to my client for one second? 16 THE COURT: Of course. 17 18 (Pause in proceedings.) I don't think it should be that THE COURT: 19 20 difficult. I'm sure you've been thinking about this and you have these numbers. 21 22 MR. MOLO: I was expressing percentages, by the 23 way. I'm talking about a dollar 24 THE COURT: No. How much of the payment would go to the senior 25 number. holders and how much would go to the senior support 26

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54 Proceedings 1 holders? I won't hold you to a penny. 2 We're talking about across all --3 MR. MOLO: Approximately. THE COURT: 4 MR. MOLO: -- all of this in these trusts, not 5 what our --6 THE COURT: 7 Yes. MR. MOLO: -- holders would get? I mean, the 8 difference is several hundred million dollars. 9 THE COURT: Well, let me hear. 10 So if the difference is, the second layer will 11 get several hundred million dollars more than the 12 more-senior level; is that what you're telling me? 13 MR. MOLO: I'm saying the senior-most tranche 14 with losses. 15 THE COURT: Okay. So here, let me make it 16 easier. 17 18 MR. MOLO: Okay. THE COURT: The senior support holders --19 20 MR. MOLO: Right. 21 -- a junior class --THE COURT: 22 MR. MOLO: Right. 23 THE COURT: -- of bondholders --MR. MOLO: 24 Correct. THE COURT: -- will get several hundred million 25 dollars more than the senior holders? 26

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55 Proceedings 1 MR. MOLO: Correct. 2 3 THE COURT: The holders of more senior bonds, if I interpret --4 5 MR. MOLO: Correct. -- the settlement agreement your 6 THE COURT: 7 way. MR. MOLO: But they're not experiencing the 8 9 losses. THE COURT: 10 I just --MR. MOLO: That's the difference. 11 I'm asking you if that's the bottom 12 THE COURT: line. 13 MR. MOLO: 14 Yes. 15 THE COURT: Okay. 16 MR. MOLO: But because it was intended by the 17 settlement agreement, because it was intended by the PSA, all right. 18 THE COURT: I haven't seen it intended by the 19 20 settlement agreement. You make have it intended by the 21 I'm not taking any position on that right now. 22 MR. MOLO: Okay. 23 But can I say I haven't seen THE COURT: anything, which is why I keep asking you show me some 24 testimony, show me something from the people at the time 25 the settlement agreement was negotiated, because I 26

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1	Proceedings
2	haven't seen anything at the time the settlement
3	agreement was negotiated, or the testimony afterwards,
4	that would indicate that the parties intended that the
5	senior support holders, a junior class of bondholders,
6	would receive from the settlement proceeds several
7	hundred million dollars more than the more-senior
8	bondholder.
9	MR. MOLO: Okay.
10	THE COURT: That is what I'm saying.
11	MR. MOLO: Can I offer you a construct to think
12	about it
13	THE COURT: Sure.
14	MR. MOLO: that would make it more
15	acceptable, perhaps? No. The reason I'm saying that is
16	because what I'm hearing from you, Judge, is that you're
17	saying, How could it possibly be that these junior people
18	are getting money and the senior people
19	THE COURT: I'm not saying that so much is how
20	could it possibly be that the people who negotiated the
21	settlement agreement
22	MR. MOLO: Okay.
23	THE COURT: wanted that to occur. That is
24	what I'm saying. I can't imagine that anyone would
25	actually negotiate a settlement agreement, someone who
26	was in the best and the toughest position I mean, the

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senior holders were driving this truck. And I can't imagine, at the time they were negotiating the settlement, they said, And by the way, I'll take several hundred million dollars less than the less senior support holders, of which your clients didn't even hold at the time.

MR. MOLO: Okay. But they did get what they were entitled to. They got what they were entitled to. They get the subsequent recovery to the extent that they experienced the losses, then it flows down to the senior-most tranches.

Now, they could've written it, right, they could've written it to say, Only the senior-most tranche shall recover ever. And there is some language in there about very junior classes that are completely wiped out not getting anything. There's language to that effect in various parties, so they could've done that. They thought about that sort of concept. But, instead, what Kravitt said is, the senior-most tranches --

THE COURT: I don't think that's true because your client wasn't even there when the settlement agreement was negotiated. How could you make that representation? You don't know what the seniors bondholders negotiated.

MR. MOLO: No. The trustee's counsel.

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58 Proceedings 1 I'm sorry. Okay. 2 THE COURT: Oh. 3 MR. MOLO: He's the lead negotiator for the trustee. 4 5 THE COURT: All right. All right. If anyone is going to speak with sort 6 MR. MOLO: of the most pure voice as to what was intended, you would 7 think it would be the lead negotiator for the trustee. 8 And he's the one saying, Here's what -- through the back 9 and forth of that -- and, by the way, you know, if they 10 brought the wrong bonds, they bought these bonds at the 11 time, they'd be saying, of course that was the case. 12 These bonds were bought after as well. 13 No, no. But they were holders at 14 THE COURT: 15 the time. MR. MOLO: They were holders, certainly. 16 17 And they were at the table THE COURT: 18 negotiating hard during this settlement agreement. Which is why it's res adjudicata 19 MR. MOLO: 20 because it wasn't raised in negotiation and it wasn't 21 raised at any point --And so then if that's -- then I 22 THE COURT: 23 should accept the interpretation of the people who are there at the time that the settlement was negotiated. 24 25 MR. MOLO: No. You should accept the language in the documents. 26

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THE COURT: Well, here's the problem: If the two sides had a disagreement about what the documents say, and there is a side that is there at the time the document are negotiated, and there's a side that wasn't --

MR. MOLO: We only get to that if they show there was a absurdity. And there is no absurdity when a triple-A rated bondholder --

THE COURT: Okay.

MR. MOLO: -- is compensated for losses. And the second-highest bondholder, in the whole series of debt holders, is compensated. It's a lost compensation provision that is in this PSA.

And as I said, don't take my word for it.

Aronoff says in his affidavit and our other experts say in their affidavit say that this is something that is contemplated sometimes. And when these parties are going back and forth, like we talked about before, you know, they have this level of intensity and you've got a group of investors saying, You know what, I'll get in on that deal, but if I want to get in that deal, the super seniors have credit support, they're getting over collateralization, I want my credit support. Now credit support can take a lot of different forms, but in these deals --

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60 Proceedings 1 THE COURT: But we're not talking about 2 Yes. 3 just that deal. I keep saying this to you is that deal plus the settlement agreement. 4 5 MR. MOLO: I agree. I feel that you want me to just 6 THE COURT: No. take the deal as the deal, but it's not the deal as the 7 It's the deal as the settlement agreement. 8 9 MR. MOLO: I agree. And the settlement 10 agreement, the settlement proceeds are treated as subsequent recoveries and then considered under the PSAs 11 available funds, and this is how you pay available funds 12 13 under this agreement. It's not a hundred percent the same in every PSA, just as many things are not because 14 15 they're negotiated. 16 THE COURT: Okay. 17 MR. MOLO: So, I mean -- and, again, the 18 difference in the language that we talked about, and this is the result -- which is not, you know, it's not like 19 20 some great unfairness here and it's not as if --21 THE COURT: But wait a second. Let's talk 22 about that. MR. MOLO: 23 Sure. At the end of the day, are you 24 THE COURT: 25 going to get more money than the senior holders? I'm not -- we are going to get more 26 MR. MOLO:

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1	Proceedings
2	cash.
3	THE COURT: Yeah. Okay. Well, cash is money;
4	right? It's not like you can hold a worthless security.
5	But you are actually going to get more
6	MR. MOLO: But our losses are going to go,
7	again, it's a very broad generalization, from around 35
8	percent to 25 percent. Their losses are going to be
9	probably around two percent. All right.
10	THE COURT: Okay. But let me say that, at the
11	end of the day, you will get paid more on your bonds than
12	the senior
13	MR. MOLO: As the contract calls for.
14	THE COURT: is that correct?
15	MR. MOLO: Correct.
16	THE COURT: No. As the way that you want me to
17	interpret the settlement agreement.
18	MR. MOLO: Well, I mean
19	THE COURT: Yes. Okay.
20	MR. MOLO: Yes. And the only way, by the way,
21	that we rewrite it, the only way we get to where you're
22	saying, well, we should go back and look and see what
23	they said and what they thought, is if this would somehow
24	be rendered an absurdity, that the contract would somehow
25	be absurd. And it is not absurd; it's something that
26	made these bonds more marketable; it's something that got

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them that a triple-A credit rating; it's something that, in these highly-negotiated transactions, all right, was put in there for a reason. And that negotiation that occurred from the settlement agreement said treated as a recovery. And so, whatever that means in each PSA, not a subsequent recovery, only if it means that the super seniors get even further over collateralized and the negotiated for or the classic negotiated for, this other form of credit support, doesn't get that.

THE COURT: It definitely doesn't say that. I agree.

MR. MOLO: And, no. And they could've done that, though, and said -- they could've done that because they do it in certain respects with other things.

THE COURT: Okay. Anything else you want to talk about?

MR. MOLO: If you're not convinced yet --

THE COURT: I mean --

MR. MOLO: How much time do you have?

THE COURT: This is a very difficult --

MR. MOLO: I don't disagree with you. I don't

disagree with you.

Let me just address one other thing: The date of the payment, you know. The trustee received the funds on February 10th. The settlement agreement requires

	63
1	Proceedings
2	distribution on the next available distribution date,
3	which is February 25th. These proceeds were filed, even
4	though there was this prior course of dealing in 2010.
5	And because of these other holders pushing, this
6	proceeding is what it is. We had to go through the whole
7	Intex brouhaha and we wound up that went over like a
8	lead balloon. And so we've been delayed here.
9	And as we explained before, \$400,000 a month on
10	one bond alone, AIG benefits by this delay. So we would
11	ask that the fair thing, this is an equitable proceeding,
12	is to go back and treat it nunc pro tunc.
13	THE COURT: I have to say, Judge Friedman did
14	say something
15	MR. MOLO: You know what was different there?
16	The settlement proceeds had not yet been received by the
17	trustee.
18	THE COURT: Yeah, but
19	MR. MOLO: There's a difference.
20	THE COURT: But she made sort of a legal point
21	that I don't disagree with. So I'll go back and look.
22	MR. MOLO: Fine. But there is a difference.
23	THE COURT: But I'm not going to on the
24	legal point, I'm not going to
25	MR. MOLO: I appreciate you indulging me.
26	MR. GOLDSTEIN: Your Honor, may I respond to

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1	Proceedings
2	one
3	THE COURT: Well, I want to hear from someone
4	who I haven't heard from.
5	MR. WARE: Your Honor, Michael Ware, Mayer
6	Brown, for the trustee.
7	As the Court knows, we are completely,
8	completely neutral on the merits of this interesting
9	dispute, although we are glad we filed the case rather
10	than let this all happen when one of these guys was
11	suing
12	THE COURT: That is so true.
13	So, I mean, but you're there. You're the
14	negotiator. Do you recall any testimony at the hearing
15	about how do you recall anyone testifying that this is
16	how any of the money was going to be paid out?
17	MR. WARE: I didn't attend the whole trial
18	THE COURT: Right. But do you recall anyone
19	putting in testimony to that effect?
20	MR. WARE: Well, I will say that Section
21	3(d)(1) of the settlement agreement is really pretty
22	clear on a couple of things. And this is actually why I
23	wanted to speak now because and I'll hit that point in
24	a second on this record date issue. There is a very
25	comprehensive I thought this issue had dropped out of
26	the case, which is why we didn't put papers in.

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1	Proceedings
2	My friend, Mr. Molo, said that the trustee
3	received the money in February. That's not the relevant
4	test. The relevant test
5	THE COURT: What does the settlement agreement
6	say?
7	MR. WARE: Well, the relevant test is in the
8	settlement agreement, and this is Section 3(d)(1) that,
9	"after the allocable share for each covered trust has
L O	been deposited into the certificate account or collection
11	account for each covered trust, then the mechanism for
L2	payment starts."
L3	When we came to you in February
L4	THE COURT: And I put the money in
L5	treasuries
L6	MR. WARE: You put the money in treasuries and
L7	it never hit those accounts.
L8	THE COURT: It hasn't hit the accounts. I
L 9	agree.
20	MR. WARE: That is the first part, the first
21	decretal paragraph of the order to show cause: "As an
22	interim measure necessary to permit the Court to direct a
23	trustee on the distribution of the allocable shares, the
24	trustee is directed to enter into the escrow
25	agreement" skipping words here, "and to deposit the
26	settlement payment into escrow before the settlement

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payment is deposited into the certificate accounts or collection accounts."

So what we did in February, as lawyers for the bank, and then the Court approved, was we stopped that process from happening so that to predetermine this exact argument. And I thought it had dropped out of the case until I saw counsel's papers over the weekend.

Let me answer the question put to me: I wasn't there at every day of the trial and partners of mine tried the case, but I know the answer. Section 3(d)(1) of the settlement agreement provides that, "once the allocable shares has hit those accounts, the trustee shall distribute it to investors in accordance with the distribution provisions of the governing agreements." So that it was our understanding, then and now, that there could be different results obtaining a different trusts.

THE COURT: So there could be -- and that was the understanding at the time, that some senior bondholders were not going to get paid under the junior bond, whatever the trusts were?

MR. WARE: The only break that was put on that in the settlement agreement is at the very bottom of Section 3(d)(1), which does specify a class of securities so low, that no matter what, they get nothing.

THE COURT: So at the time, you're saying that

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67 Proceedings 1 people anticipated that the senior-most bondholders do 2 3 not get paid first. MR. WARE: I won't put it that way. But the 4 last sentence of Section 3(d)(1) provides that, blahdee 5 blah, blah, skipping words, "distribution of allocable 6 7 shares in a particular covered trust governed would result" -- skip, skip, "in money being payable to class 8 9 of REMIC residual interest", then there's a fix to stop that. So those are the lowest. 10 These are -- with these common law PSAS are 11 12 basically all equity rather than debt, but most of them look like debt. This is the one that looks like equity. 13 And so the settlement agreement does contemplate what 14 15 classes other than the highest most might get some. And it draws the line below which they won't go --16 Will get some or will get more? 17 THE COURT: 18 MR. WARE: I --19 THE COURT: Depending on whatever the PSA --Whatever the PSA or the indenture 20 MR. WARE: said. 21 22 THE COURT: Okay. So that is very helpful. 23 Thank you. I second what Mr. Ware said. 24 MR. MOLO: 25 MS. KLEIN: Some demonstratives, your Honor. THE COURT: Thank you. 26

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1	Proceedings
2	(Handing.)
3	MS. KLEIN: I did not hire Mr. Molo.
4	Your Honor, Gail Klein from Goldsmith for Center
5	Court. Center Court is a senior support certificate
6	holder and Center Court was there at the time and owned
7	its bonds, even though we did not appear in the Article
8	77 proceeding. And I am here today to close whatever
9	loop Tilden and Prosiris claim that there is.
10	I first want to address the absurdity argument
11	because I do think that Tilden Park and Prosiris's
12	argument on how the PSAs work does produce an absurd
13	result that is highly time dependent and that's why
14	they're arguing so staunchly for the February date.
15	If you go to the 11-by-17 sheet of paper that I
16	just gave you
17	THE COURT: Yes.
18	MS. KLEIN: there are four different buckets
19	here. And the top row that you'll see is Center Court's
20	interpretation on the C
21	THE COURT: Oh, my goodness. Wait a second,
22	Counsel. I need to put my glasses on.
23	MS. KLEIN: I apologize for the size, your
24	Honor. I did the best I could.
25	THE COURT: No. Listen
26	MS. KLEIN: So the top row of this is Center

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Court's interpretation of Group 1 of the CWALT 2005-61

Trust, which is the trust that we have alleged we own in.

And the OC target for Group 1 of this trust is 1,542,918.

The left side of this row is just assuming that the distribution of the allocable share of \$7.3 million comes in May of 2016, and the right side assumes that it came in May of 2012. You can see there is no difference in the principal distribution amount highlighted under the Center Court interpretation.

The next row is the Tilden and Prosiris Again, the same distribution of the \$7.3 interpretation. million. On the left side of this second row is assuming on May 2016 and the right side is assuming May 2012 and you can see the difference in the distribution that Meaning, the senior bondholders may get happens. \$925,751. But, oh my goodness, wouldn't it be great, in May of 2012 to be a 1M3 bondholder and it would be great to be a 1M1 bondholder in 2016. This is exactly the absurd result that happens and why Tilden Park and Prosiris keep saying, your Honor, set the record date earlier, because the senior tranches are incurring losses and, in fact, they're going to hit the senior certificates and the most senior certificates soon, which is why they're desperate to move this back, because that's their magic date. So here is the evidence of your

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absurd result.

And the next two rows are the same thing with just the second group of the CWALT '05-61, again, demonstrating that it is magic to be a holder in a certain date. But if you interpret the PSA on a write up first pay second, which is if you have to default to the PSA we are going to demonstrate to you is the right way, the distribution to the certificate holders for the allocable shares never, ever changes depending on the date. And, therefore, that is the most fair interpretation; it is the right interpretation under the PSA; and it is uncontrovertible that what Prosiris and Tilden are seeking is an unfair windfall based upon identifying, as your Honor said, some random loophole that no one else saw, that no one intended.

If you turn with me to the deck that I put together --

THE COURT: Yes.

MS. KLEIN: -- I will demonstrate to you now how the write up first pay second is the appropriate methodology.

THE COURT: Okay.

MS. KLEIN: First of all, the settlement agreement, Section 3(d)(i) says that, "the settlement payment shall be treated as though it were a subsequent

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recovery available for distribution on that distribution date." So the money comes in to the distribution account and the trustee says, Aha, it is available on the next distribution date.

If you turn the page with me to Page 2, the settlement amount or the settlement agreement says, "nothing in the subparagraphs is intended to or shall be construed to amend any governing agreements." This is why Tilden and Prosiris say the settlement agreement is wrong. You have to go to the settlement agreement. And the next sentence says, Well, if your Honor modifies Subparagraph 3(d)(i), "it shall not constitute a material change to the settlement agreement."

So if your Honor does not believe that it should follow the pay first write up second, it can, in fact, follow the PSA's plain terms and do write up first pay second, which is the most fair and reasonable. And which, by the way, we are a senior support certificate. More money goes to our friends, the super senior certificates. So we are here coming in good faith with, really, not supporting our own interests, but the interest of the right thing under --

THE COURT: And you were there at the time the settlement was negotiated.

MS. KLEIN: Our clients -- my client did own, at

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the time of the settlement agreement was approved, and during the Article --

THE COURT: During the hearing.

MS. KLEIN: -- Article 77 proceeding.

THE COURT: And did anyone of those proceedings, when they were looking at that settlement agreement in intense detail, did anyone talk about the possibility of what Prosiris is talking about today?

MS. KLEIN: Your Honor --

THE COURT: And Tilden?

I'm not aware if Center Court MS. KLEIN: participated in the proceeding. I certainly did not. But I will tell you that it's fundamental to bondholders, who are the ones who are pressing the interest, that they get recovered for their losses. And Mr. Molo made a big deal about Mr. Kravitt saying the bonds that suffered Well, quess what? The loss is the fact that the trusts were stuffed with mortgages that were not as they were represented. The loss is not a Realized Loss, big "R", big "L", under the PSA. The loss is the loss of the value of your bond because, ultimately, one day, you are going to suffer a loss and not going to be made whole as the trust was intended. And so that's when, when you talk about losses, it's the loss of the value to the trust which hits the most senior bonds first and

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2 ultimately trickles down.

So if you turn to Page 3 of the deck that I put in front of you, each month, only available funds are distributed. Each of these 17 agreements say, under Section 4.02, "on each distribution date, the available funds for distribution shall be distributed in this order of priority."

If you turn with me to Page 4, available fund includes those that are in the certificate account net of what's called the amount held for future distribution.

And I apologize for walking you through these very long contract terms --

THE COURT: No. I'm very happy, because I didn't draft this.

MS. KLEIN: So, again, you have available funds.

If you turn to Page 5 of the deck, these available funds are net of the amount held for distribution. And if you look at the definition of amount held for distribution, which is on Page 5, guess what? It includes subsequent recoveries received in the month of such distribution date. So these funds are treated as though they are subsequent recoveries available for distribution, which means they have to have previously been held for distribution while the certificates are written up. It's the only way it works.

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And it's very important because you write up --

THE COURT: You're saying that that whole thing about "before" as opposed to "on" or "after" doesn't comport with what's in the settlement agreement.

MS. KLEIN: It doesn't. The funds -- now, remember, this is a one-time payment --

THE COURT: Right. I agree. It's a one-time payment --

MS. KLEIN: It's unanticipated by anyone. It's a huge amount of money. So if you treat it as it were a subsequent recovery, you assume it's going to be held for a month before it's distributed.

And during that time, if you flip the page to Page 6, that during that time, the funds and the certificate account, as of the 22nd of the month, are held for distribution while it is written up for the certificates.

And if you turn to Page 7, the advances, the reason Page 7 is of interest is that the purpose of an amount held for future distribution is to allow compensation to the master servicer because the master servicer has advances. So you get the subsequent recoveries, which are usually only about 10 or \$20,000, they go help pay the master servicers whose advanced fees, who owes them back and then they get put in while

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the certificates have already been written up.

THE COURT: So why wasn't this one giant payment as opposed to -- was that the way the settlement agreement was structured at the time?

MS. KLEIN: Again, I was not a party to the negotiation, but I assume that Countrywide wanted to ameliorate its liability and make one payment.

THE COURT: And that was it.

MS. KLEIN: And be done.

THE COURT: Okay.

MS. CLIENT: Certainly, this probably could've been structured another way.

But, again, demonstrating that these subsequent recoveries are properly an amount held for distribution, if you look at the settlement agreement, which I've excerpted again on Page 8, under 3(d)(i), it says "provided, however, the master servicer shall not be entitled to receive any portion of the allocable shared distributed to any covered trust." So while a subsequent recovery generally helps first pay the master servicers, the parties agree, no, no, no that doesn't happen this time.

Moving onto Page 9, it then says, "on each distribution date, the trustee shall allocate the amount of subsequent recoveries for the loan group to increase

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the class certificate balance of the certificates." Here we go to the guts of the agreement. The subsequent recoveries are in; they're being held for the next distribution date because they're not available funds. And, yet, under 4.02(j), they are written up the class certificate balances. So this is the crux of you write up first under these PSAs and then distributed second. And if you do that, in fact, what happens is the most senior bonds are compensated.

Page 10 is just similarly the application under a separate agreement, which is CWALT '06-A3.

And, again, the principal distribution amount definition, which is on Page 11, says that the principal distribution amount is the excess of the aggregate certificate balance immediately prior to the distribution date over the excess of the stated principal balance over the Group 1 target.

And then finally, your Honor, on Page 12 of the deck, again, showing --

THE COURT: This is the shrunken version of what you gave me in the larger version?

MS. KLEIN: It is. But I did want to show you that the difference is once you add the principal distribution amount --

THE COURT: Oh, okay.

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MS. KLEIN: -- what happens. So that's just -- the larger page is just what happens with the allocable share.

THE COURT: Right.

MS. KLEIN: If you assume, in May of 2016, you actually are adding it into the OC target amounts, now you'll see that the principal distribution amount under the Center Court interpretation is 7.3 million, but the principal distribution amount under the Tilden Park and Prosiris interpretation is only \$1.8 million. And, again, oh, my goodness, how great it is to be a one-and-one bondholder and this most senior bondholders are in trouble.

Finally, your Honor, we do believe that this is the most appropriate methodology. We do understand the trustee's argument that you're supposed to distribute pursuant to the PSA. This is, in fact, consistent with the settlement agreement and with the parties' interpretations. If you don't find that it should be properly write up first pay second as we agreed with the other 512 trusts, of course, we are amenable to a one-time adjustment for the over collateralization because we do believe this is the way that it should work. And, in any event, we would ask that your Honor limit your ruling to the 17 trusts such that --

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THE COURT: Absolutely.

Okay. Thank you very much.

I've heard from everyone. If I start with the rebuttals and sur-rebuttals and other rebuttals, we will be here till next Thursday.

So I appreciate very much everyone's very, very helpful, useful discussion today. I really need to think and take a lot of steps back. I'm going to go back. I think I have to look at the transcript of the hearing. I will see what the trial court -- I read Judge Kapnick's original decision, but I'm not really sure that either was particularly relevant to this.

But what I think what -- and here's the one thing I invite anyone to do, which is, that if anyone finds trial testimony during the first Article 77 proceeding that they think would shed light on what the parties intended the settlement agreement to mean and how it should function, if you will give me that in the next 30 days, that would be very useful and helpful to me. Please don't put in any argument. The only thing, if you are going to give me trial testimony, is a cover letter, Dear Scarpulla, here's some trial testimony, enjoy.

MS. KLEIN: Your Honor, may I ask that my demonstratives be put into the record?

THE COURT: All these demonstratives are going

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79 Proceedings 1 2 to be a part of the record. Okay. So thank you very much. I'm going to ask 3 all the parties, if they would, to get me a copy of the 4 transcript of today's hearing. When I get the 5 transcript, I'll mark the motion submitted or this part 6 of it submitted. 7 8 All right. Thanks very much. 9 MR. MOLO: Thank you, your Honor. ********** 10 CERTIFIED TO BE A TRUE AND ACCURATE TRANSCRIPT OF THE ORIGINAL STENOGRAPHIC MINUTES TAKEN OF THIS PROCEEDING. 11 12 VANESSA MILLER 13 Senior Court Reporter 14 15 16 17 18 19 20 21 22 23 24 25 26

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1 1 - Proceedings -2 SUPREME COURT OF THE STATE OF NEW YORK COUNTY OF NEW YORK - CIVIL TERM: PART 39 3 In the Matter of the Application of 4 THE BANK OF NEW YORK MELLON, in its 5 Capacity as Trustee of Indenture Trustee of 530 Countrywide Residential 6 Mortgage-Backed Securitization Trusts, 7 Petitioner, 8 -against-9 10 For Judicial Instructions under CPLR Article 77 on the Distribution of a Settlement Payment. 11 INDEX NO. 150973/2016 12 NEW YORK SUPREME COURT 13 60 CENTRE STREET NEW YORK, NEW YORK MARCH 15, 2016 14 15 BEFORE: 16 THE HONORABLE SALIANN SCARPULLA, Justice 17 18 APPEARANCES: 19 MAYER BROWN, LLP Attorneys for the Petitioner 20 1221 Avenue of the Americas New York, New York 10020 21 BY: MATTHEW D. INGBER, ESQ. BY: MICHAEL O. WARE, ESQ. 22 23 BOIES SCHILLER & FLEXNER, LLP Attorneys for Tilden Park and 24 Prosiris Capital Management 575 Lexington Avenue - 7th Floor 25 New York, New York 10022 BY: JAIME SNEIDER, ESQ. 26 William Cardenuto Senior Court Reporter

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2 1 - Proceedings -2 APPEARANCES 3 GIBBS & BRUNS, LLP Attorneys for Pimco, Blackrock, 4 Fannie Mae, Met Life, et al. 1100 Louisiana - Suite 5300 5 Houston, Texas 77002 BY: KATHY PATRICK, ESQ. 6 7 QUINN EMANUEL Attorneys for AIG 51 Madison Avenue - 22nd Floor 8 New York, New York 10010 9 BY: JORDAN A. GOLDSTEIN, ESQ. 10 HOLWELL SHUSTER & GOLDBERG, LLP 11 Attorneys for Federal Home Loan Mortgage Corp. 12 750 Seventh Avenue - 26th Floor New York, New York 10019 13 BY: MICHAEL S. SHUSTER, ESQ. 14 MCKOOL SMITH, PC 15 Attorneys for Center Court, LLC One Bryant Park 47th Floor 16 New York, New York 10036 BY: GAYLE R. KLEIN, ESQ. 17 18 19 20 21 22 23 24 25 26

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THE COURT: Okay. So, who is here now? I know there's a lot of people here. Apparently, there is a slight dispute. So, I ask that the attorneys for the people who filed a brief, I don't know if it's disputing, but discussing a different way to allocate the settlement proposal, that's Boies Schiller. Who is here?

MR. SNEIDER: Jaime Sneider.

THE COURT: And you're from AIG; correct?

MR. GOLDSTEIN: AIG.

MS. PATRICK: And I represent Pimco and Blackrock.

THE COURT: Everybody else who is here on this case, it's not that I don't want to hear from you, but I only have a few chairs at the table. So, anyone else who wants to speak, please, feel free, but you have to get my attention and give your name to the court reporter so that I have a good record.

So, I went through the answers to the petition and the replies, and it appears there's no issue with about five -- about 99 percent or maybe 92 percent of the trusts; is that correct?

MR. SNEIDER: No, your Honor. That's not correct.

THE COURT: Why don't you think that's correct?

MR. SNEIDER: So, we think that, one, with

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respect to a draft judgment that we were shown yesterday that there could be issues with the judgment, that the judgment that we saw appears to allow the trustee to rewrite the contracts that govern these securities, and we would --

THE COURT: Wait a second. I didn't see a draft judgment. I saw answers to the petition, most of which said that they agree with the proposition that the trustee put forth and how to distribute the funds concerning their trusts. You represent those 15 trusts out of, what is it, 550 something?

MR. SNEIDER: I represent 14 trusts.

THE COURT: 14. That don't agree with that proposition or rather -- I'm not sure whether you're saying my PSA is different from all the others or my PSA has some other thing that contradicts what the settlement says, in which case my PSA's control, but the other -- the rest of the people in the group want the money distributed a certain way. So --

MR. SNEIDER: Your Honor, my clients own approximately 100 of the covered trusts. Their submissions to date relate to 14. Those are the ones we wanted to be crystal clear about in connection with the trustee's proposal and petition. To the extent that the judgment goes beyond that petition in what it allows the

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trustee to do in distributing the funds, we might have additional objections based on the language in the judgment, and we believe based on the draft we saw that we will likely be in a position of having to object to it.

THE COURT: Let me just say this. I don't know what you're talking about. That wasn't something that was given to me. So, I can't say anything to it. I have nothing to say about it. I don't want to speculate. don't have to stand, please. My only suggestion, rather, is that the people who don't dispute how the money should be distributed should enter into another sort of agreement with the trustee. Yes, this is how we distribute, and then the money should be distributed to those people, and the money that is at issue with respect to your trusts, I think, should be set aside and litigated. I don't know -there's no issue with respect to everyone else. know about a document, but in terms of your right to object to the methodology, that time is now done or not done.

MR. SNEIDER: Your Honor, there was a new question raised by one of the submissions yesterday, and that question related to whether the allocable shares, when they are received by the trust, will be distributed as a subsequent recovery in the month that they are received or in some future month, and that question, all

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though it was raised in the context of our 14 trusts, that question implicates a lot of the trusts.

THE COURT: Well, no one else thinks so.

 $$\operatorname{MR.}$ SNEIDER: That question was raised for the first time yesterday by one of the interested persons who --

THE COURT: Who raised that issue?

MR. SNEIDER: Center Court raised that issue, we believe, as holders of approximately --

THE COURT: Who raised that issue yesterday?

MS. PATRICK: Center Court, your Honor.

THE COURT: Okay.

MR. SNEIDER: We believe that issue implicates other covered trusts that we own, and we would like to be able to brief that issue to ensure that the funds are not distributed in a way that we believe is inconsistent with the settlement agreement and PSA's.

THE COURT: Maybe what I should do is the following. Even in that case there are 400 trusts that just want their money. They are not interested in your battle. They don't care about your issues. They just want their money, and they are accepting the way that the trustee proposes to allocate to those trusts. So, maybe we should just have those 400 trusts -- you're saying it's actually 450 trusts out of -- you're saying out of a

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hundred of your trusts, you think, are affected, all of your trusts are affected?

MR. SNEIDER: We haven't had an opportunity since last night to go through the PSA's for all of the approximately hundred covered trusts that we own, but we believe many of them are implicated by this issue.

THE COURT: Why not let the trusts who don't believe there's any implication get their money, opt out of the rest of the suit, and you can litigate with the trustee. That's a much smaller question, and then the people who want their -- want to invest their money in something other than treasuries can do so.

Does anyone object to that?

MR. SHUSTER: Your Honor, may I be heard? I am Mike Shuster from Holwell, Shuster & Goldberg, LLP, for Freddie Mac.

THE COURT: Yes.

MR. SHUSTER: The only thing that concerns me about what I'm hearing is that there's now supposedly another hundred trusts that can't get their money until this issue which hasn't really been identified is resolved, and my problem is I don't know if any of Freddy Mac's trusts, investments are in any of those hundred trusts.

The issue about subsequent recoveries, the 14

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trusts that Tilden and Prosiris have identified where they say most of the money that is coming in via the settlement can't be treated as subsequent recoveries and goes through some other waterfall, great. That's their position. They specified that. That's as to the 14. As far as we know for all other trusts and certainly for the trusts in which we have investments, which are both overcollateralization trusts, 15 of those, 21 of those, and then 15 of the other trusts, for those they are treated as subsequent recoveries. That's what the settlement agreement calls for. That's what the PSA's, as far as we know, call for.

So, I object to creating an issue now. We thought we were down to just the 14 trusts, and they can fight about that to their heart's content, but I thought the whole purpose of the briefing process was to see if there's issues, if there's disputes, and if there are, to identify them with specificity so that we can get on with it.

Where we thought we were was as to the 515 or so trusts as to which there's no dispute, we have actually been trying to work out a proposed judgment that all these certificate holders can get on board with, that the trustee is prepared to sign on to, that we would then submit to the Court, you know, and within the next 24 hours or so, and then we were actually going to ask the

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Court to maybe take one of the two days next week, set aside for the escrow issues, which don't appear to be -- to require a hearing, and maybe resolve the proposed judgment and any other issues so that the 515 or so trusts as to which there's no now demonstrated real identified issue so that the certificate holders can get paid.

So, hearing now that there might be a whole other hundred trusts, that's disturbing to me, because it creates uncertainty, and I don't know if my clients are in there. I just don't think that's a solid, sound way to proceed at this point.

MR. GOLDSTEIN: Your Honor, may I be heard for AIG?

THE COURT: Yes.

MR. GOLDSTEIN: Consistent with what Mr. Shuster was saying, at the moment, AIG does not obviously know which of the hundred trusts that were referred to we hold certificates in, but to the point that Center Court has now raised an issue that wasn't previously raised, I think Center Court's position has been -- again, I don't represent Center Court. I believe --

THE COURT: Do you represent Center Court?

MS. KLEIN: I represent Center Court, your

Honor. Gayle Klein from McKool Smith.

THE COURT: We'll hear from you in a moment.

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MR. GOLDSTEIN: My point being only that I think Center Court's position was previously raised, and to the extent that Tilden Prosiris wanted to respond to it, they had the opportunity, and I think it is too late at this point to now hold payment of a hundred trusts back for an issue that everyone had an adequate chance to brief.

MS. KLEIN: Your Honor, I wholeheartedly agree with that. I think Center Court's position has been misrepresented. Our response that was filed yesterday was solely with respect to the 14 trusts and with respect to the timing of payment. We were responding to Tilden and Prosiris' argument that the timing that they were proposing based upon their proposed distribution only for those 14 trusts produces an absurd result that changes depending upon when the payment is made.

THE COURT: You're not objecting at all with respect to the trusts that you are representing to this proposed settlement?

MS. KLEIN: Correct, your Honor. We are joining in with the request that the 515 trusts be released and only responding --

MR. SNEIDER: Your Honor --

THE COURT: Fair enough.

MR. SNEIDER: -- the issue that they raised relates to whether the allocable shares will be

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distributed as available funds in the month they are received or some future month.

THE COURT: All you have to do is represent your trusts. Nobody else. You only represent 14 trusts; is that correct?

MR. SNEIDER: That's not true. We own and it said in our answer that we may --

THE COURT: Did you put in objections to all of your trusts?

MR. SNEIDER: The issue that she identified was raised for the first time yesterday.

THE COURT: That's not what Counsel is telling me. She's telling me that she responded to your answer and did not raise a new issue.

MR. SNEIDER: We did not raise the issue. We assumed that the allocable -- everyone assumed that the allocable shares would be distributed on the month they were received. That issue was never put into play by the petition, and the settlement agreement, we believe, is clear on that point.

THE COURT: So, wait a second. Is that correct, Counsel? What is your position on that?

MR. INGBER: I don't know who everyone is, because I don't think any other investor has suggested that these funds be distributed as of, in this case,

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February. 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; we need to invest these proceeds in the following manner until this issue is resolved. 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.

If the determination date is April 15th, we will distribute on the distribution date in April, and the proposed judgment that is being discussed contemplates that there is going to be a process for taking money out of escrow with respect to the so called, you know, undisputed trusts, and if the funds make it to the trustee by the determination date which in the proposed judgment, which I believe the investors plan to hand up to your Honor at some point, if they make it to the trustee by March 13th, I'm sorry, by the 13th of the month, then they will be distributed on the distribution date in that month.

So, if there's a judgment by a particular date

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in April, and the funds make their way out of escrow into the trustee by April 13th, for example, then on the distribution date in April, which is on or around April 25th, those funds will be distributed. 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.

MR. SNEIDER: Your Honor, we agree that the record date issue that he's talking about only applies with respect to our 14 trusts. No one else has raised it with respect to any of the other trusts. The issue I'm talking about is different. The issue that Center Court raised in their submission of yesterday relates to whether subsequent recoveries are held not for the month that they were received, but for some future month.

So, what Center Court is suggesting is that in the month that the allocable shares are received by a particular trust, it is going to be held for distribution in some future month. That issue implicates not just our 14 trusts, but it implicates more than a hundred trusts. We had no opportunity to address it.

THE COURT: One second. Is that what you're

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2 | suggesting, Counsel?

MS. KLEIN: No, your Honor. We were addressing the order of operations and --

THE COURT: So, Counsel is telling me that she's not arguing what you're saying, what you're talking about. So, I don't know what you're talking about. That's not her argument. So, why are you creating an issue where none exists?

MR. SNEIDER: It appears that it does exist if you look at her submission.

THE COURT: Counsel, are you disputing the way that the funds are going to be -- the date upon which the funds are being distributed according to the proposal of the trustee? Are you disputing anything about that?

MS. KLEIN: We are not disputing that the funds should be distributed on the distribution date pursuant to the PSA's.

MR. SNEIDER: Well, wait. Is that the month that they are received if it's prior to the determination date?

MS. KLEIN: With respect to the 14 trusts, we contend that subsequent recoveries must be written up before they are distributed, and we use the language in the PSA's to denote that, and it's only with respect to these 14 trusts that are at issue.

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THE COURT: You're only talking about the order of operation; correct?

MR. SNEIDER: Do you agree that the allocable share when received by a trust is distributed on the distribution date --

THE COURT: If you're looking at the woman back there, you can't get on the record, Counsel.

MR. SNEIDER: I don't think it's clear from what she said just then that she agrees that the funds, if received prior to the determination date, would be distributed on the distribution date of that particular month.

THE COURT: That's not at play. It's not an issue here.

MR. SNEIDER: Well, it was an issue that she raised yesterday.

THE COURT: Well, it's not going to be an issue with respect to the judgment in this 8.6 billion dollars that's going out. So, again, I really don't understand why you are creating an issue when none is there.

MR. SNEIDER: I did not create this issue. This was created by Center Court.

THE COURT: I will look at that. As far as I'm concerned, Counsel is telling me right now she has no issue, and I accept that.

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MR. SNEIDER: I don't believe that she has agreed with our position.

THE COURT: If you don't believe that, then you can figure out whatever you want to figure out. I hear what Counsel is telling me. With the 14 trusts that you put in an objection to, okay, you will deal with them separately.

MR. SNEIDER: We would still like to reserve our rights --

THE COURT: I'm not reserving any right. You had all the opportunity to put in whatever objection you wanted to what the trustee proposed in the petition. You put in an answer. Other people put in answers. The time within which to make specific objections has now passed.

MR. SNEIDER: Your Honor, to the extent the judgment gives the trustee powers to do things that relate to issues other than the interpretive issues that the trustee identified, we would like to reserve our rights to object before your Honor and to have an opportunity to address those specific issues.

THE COURT: Okay. Again, I haven't received any proposed judgment. So, I don't know what you're talking about. With respect to any answers or any objections that you have, your time to put them in is now done. You put them in. You preserved certain issues with respect to

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your 14 trusts. I get that, but everybody else here wants their money, and everyone else is willing to accept the way that the trustee proposes to set out the funds. So, I'm not going to stop them and neither are you. You're not going to stop the rest of the certificate holders from getting their money, and maybe not keeping them in treasuries, and doing what they want with them, and making more money with them, or burn the money. It doesn't matter. You may not with your 14 trusts and your 14 trusts objection hold everybody else up. That's my only point.

MR. SHUSTER: Your Honor, can we turn to the issue of submission of the proposed judgment?

THE COURT: I don't know what to say. I haven't seen it.

MR. SHUSTER: We would like the proposed one.

If the Court will welcome that and accept it, I think
that's something we can get to within 24 hours. We will
submit a proposed judgment that we believe and that I
think the trustee will believe will apply to 515 trusts.

It wants instructions, and I think we can submit something
to the Court that can constitute in the form of a judgment
those instructions.

MS. PATRICK: Yes.

THE COURT: Except that Counsel is saying that

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he represents more than 14 trusts, and so he may not -his hundred trusts may not sign off on the judgment. I
don't know what to say to that.

MS. PATRICK: May I be heard on that, your Honor?

THE COURT: Sure.

MS. PATRICK: Here's the distinction. In their brief when they were notified to make the Court aware of their argument, they argued, including in their responsive brief at Page 8, "There are fundamental distinctions between the trusts Center Court discusses and the submission and the 14th trusts." Elsewhere they seek only to establish that their 14 trusts are not implicated by the questions raised by the petition. So, we didn't come here idly understanding that the dispute was limited to 14. That's what Tilden and Prosiris told us.

So, what we did over the course of the last week was to work very hard with all of the certificate holders who had appeared to ascertain whether there was any issue with regard to, first, the non-overcollateralized trust. The answer is there is none, and, second, as to the 160 other overcollateralization trusts that are not held by Tilden Park, Prosiris, and there's one similar trust held by TIG, and the answer was there isn't. We have worked hard over the last several days to draft a proposed

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judgment. We sent copies of it. We told Tilden Park what we were trying to do was get the rest of them released. Their response was, well, I would like my trust released, To which the answer was, get it, but there's a dispute on yours; there's no dispute on these.

So, what we would suggest, your Honor, is that this can be solved very simply. Direct the trustee to settle the form of judgment today or tomorrow under 202. Use the hearing on Tuesday, the 22nd, to hear any objections to the form of the judgment. We think such objections should be limited to the 14 trusts as that was all that was notified by Tilden Park, but if they want to come in and say something about these other hundred trusts in which they notably claim to have interest, but don't say they own, and that's an interesting construct in the pleading, they have interest in these trusts, not necessarily ownership, whatever that is, we can come in on Tuesday morning, and people can be heard, and then we will be able to get 515 undisputed trusts, or if they persuade you there's an issue on these a hundred unnamed trusts, some of which are almost certainly non-overcollateralization trusts as to which there could not possibly be an issue, because they agree with us that the order of operations in the settlement agreement governs those rights, right, we'll be here on a much

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smaller universe after Tuesday if we can use that Tuesday date that you set aside for escrow to hear argument on the proposed form of judgment, and the trustee can file it today.

MR. SNEIDER: Your Honor, the petition raised only a few discrete issues. They raised an issue about the order of operations, and they raised an issue about how overcollateralization is calculated. The judgment that we were sent last night at 10:32 p.m. appeared to allow the trustee to modify the PSA's.

THE COURT: In what way?

MR. SNEIDER: It allowed them to modify them to prevent leakage of any kind, independent of whether it's related to overcollateralization, and the word "leakage" I'm using is from their petition. We don't believe that's a fair use of the word. It allowed them to basically engage in an ends oriented analysis of the trust and the distribution it's making to ensure that funds are not received by anyone but the super senior certificate holders.

That's not a final judgment. We have not seen a final judgment. We saw it for the first time yesterday. We believe it implicates issues that go beyond the interpretive issues identified by the trustee which is why we would still like an opportunity to submit written

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papers objecting to it.

THE COURT: I'm not going -- there's not going to be any papers to any judgment, but what I will say to you is that to the extent that you think the judgment affects your trusts that are not or didn't make specific objections here in this proceeding, but you feel that the judgment goes beyond and makes findings or decisions that were not brought in the proceeding, then you can object to the proposed judgment, and you may not have to sign it, and that little piece of it, which is separate and apart from what we are talking about here, can also be litigated, but I'm not even sure at this point that the trust that you're talking about agree with you that. whether they will want to hold up getting payment in the way that they think that they are going to get payment, and they knew because they didn't object to the settlement, and I'm not sure that you even had time to talk to your clients about that, and that, I think, is part of the problem. Maybe you're protecting your clients' right, and maybe they don't want their rights protected in that way. Maybe they just want their cash.

So, the problem, Counsel, is that I don't know -- I don't know that that can be done by March 22nd or March 23rd. I'm not sure what are your thoughts. me hear from both of you. Secondly, I will say that when

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I looked at the answers and no one objected to the way that I was holding the money, I gave those days away. So, if I have to, I would have to find days. Those days are not free.

MS. PATRICK: So, your Honor, I think that with respect to where we are, the only people we have to get on board, the judgment, the reference to leakage that Counsel referred to in the draft last night is no longer there.

We sent Counsel another draft this morning. Counsel is aware of that. So, I think there's no reason why we could not canvass in very short order. We can file this proposed judgment, and they can object. We can settle the judgment under the rules. They can object, and all we need is a hearing for their objection to be heard. We will certainly argue if they object on a hundred trusts now that those objections have been waived under the show cause order, but that's a different issue.

THE COURT: Right. Because I don't know if it's a different issue that wasn't raised by the petition and something new is put in the judgment. I don't know. I haven't seen it. This is the first I'm hearing.

MS. PATRICK: People will make their argument on the judgment. The point is this is an expeditious way if the Court were to order the trustee to settle the notice of judgment today on the draft that we have, which I

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recognize the Court hasn't seen, then everybody will be able to look at it, and Counsel can ascertain from his clients whether they object, and we can set a prompt hearing for the entry of the judgment and try to get all of these undisputed trusts out of here.

THE COURT: Why don't you let Counsel negotiate it, too, if he has a problem with some of the language.

MR. SNEIDER: That's a good question. We found out about this on Friday, and we found out yesterday that the trustee sent a draft that it was willing to accept to institutional investors that didn't include us. We feel a lot of discussions occurred behind our backs, even though we would be prepared to discuss these issues with them in advance.

THE COURT: I don't think it's purposeful.

Here's what I think. People want their money. It's a lot of money. They have been waiting a long time.

Litigation. Appeals. The money -- and just when they see that money coming, then an issue arises, and I get that.

So, don't take it personally. People just want their money. They don't want it held in treasuries. Treasuries doesn't make a lot of money. They want to go back and make some money on this money.

So, don't take it personally, but what I will instruct everyone to do is keep these hundred trusts in

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the loop. Hear what they have to say about the judgment. They don't have to settle the judgment today. Spend a day or a day and a half going back and forth with each other and try and work out something that 515 rather than 415 of the trusts can work with.

MR. PATRICK: Which trusts? Could they be instructed --

MR. SNEIDER: As an aside, I think that rule should apply to all the investors, the institutional investors. AIG has said that they own very few of our 14 trusts, even though there are papers from yesterday disputing all 14 with respect to the record date issue that we raise. Also, the institutional investors in the course of meeting and conferring have told us that they do not own all of the 14 trusts, and yet, Center Court, which has put in a response with respect to all of our 14 trusts, only owns one in common that they have identified. So, we believe this rule that we're happy to identify approximately a hundred trusts, we're working on that now, and we should be able to do that soon.

THE COURT: Well, how do you even know that your hundred trusts will object if you don't even know who they are?

MR. SNEIDER: Well, they are -- my clients hold interest in them. I don't know that I understand the

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question.

MR. GOLDSTEIN: May I respond, your Honor?

So, in terms of identifying which trusts AIG

holds of the 14, we've identified them in our submissions
in the footnote. We identified two. So, I don't think

there's any ambiguity.

In terms of this record date point which Counsel just raised, I do think that it might be useful, since your Honor considers the issue and potentially give some guidance at the next hearing, because to the extent your Honor agrees with AIG's position, and I think the trustee's position that Tilden and Prosiris' argument that everything should freeze as a hypothetical date that's not really the distribution date, it's not workable. It's not something the PSA permits that. Having a protracted fight over these trusts may not be in their best interest. To the extent that your Honor would give some guidance at the next hearing, that may have a salutary benefit in terms of this dispute and their interest to resolve it sooner rather than later.

MR. SNEIDER: We think our argument relates to the settlement agreement and what it says. We're prepared to be flexible on the record date issue if we believe we are going to be paid soon.

THE COURT: That's why I'm saying sit down and

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see if you can work something out. I don't think it's going to be an issue if you all just talk to each other and work out a proposed judgment, and, frankly, what that would involve is anyone who signs on to the proposed judgment releases any claim they have with respect to the settlement. So, it's not going to be I'm taking my money and then I'm coming back and thinking something else. Anybody who signed on to the judgment, I'm telling you right now, I'm not going to allow you to sign on unless you release. There's no upside for me of doing it any other way. All right?

MR. WARE: Mike Ware, Mayer Brown, for the petitioner/trustee. I want to cover up a couple of procedural pieces and process pieces. We collaborated with Ms. Patrick and would do the same for Prosiris. came to us and said, if the deal is "X," what do you guys need to make it work. If Prosiris wants machinery like that from us, we'll give it to them.

THE COURT: Why don't you tell them what your concerns are and then --

MR. WARE: But as to the concerns, we really would prefer that the investors -- we want to be neutral on the merits, and we would love to see them --

THE COURT: Work with the other investors. don't care who does it together. Just get together and

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get it done. It seems to me that 95 percent of this is in agreement except for your fear that there's something there that you haven't thought through, that you have to think about what the implications are, but I am here to tell you that the implications are not affecting the trusts that you have your objections to. The implications are to trusts that you don't have an objection to. So, I think you are acting in an abundance of caution, but this may be a red flag or not so much a red flag, but as an issue that doesn't materialize.

MR. WARE: I hope that will be so.

THE COURT: So, why don't we suggest -- I want to see everyone who's in the room who's here on Bank of New York, because I have another case here, too. The deal is that we'll get a proposed judgment. If you want to sign off on the proposed judgment, then you will release any claims that you have with respect to the settlement agreement, and you will get your money. You may not add additional objections to the methodology proposed in the petition. The time to do that has passed. 14 trusts have Those are the only 14 that we are going to have any further discussion about. If you have an objection to language in the judgment, that will be a separate issue that I don't know -- I have to figure out how to deal with I'm good. But I can't just off the cuff hear an that.

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objection and say, oh, yeah, let me just rule on it right I don't want to do it right now.

MR. WARE: Your Honor, we've asked the parties to use Uniform Rule 202.48(a), notice of settlement, and we have said that we want them to serve. We don't want to serve the proposed order, but once they serve it, we have offered to put it out through the DTC to make sure that people know what's going on. I don't know that it can be done in a week. The rule contemplates 10 days if you're not doing hand service, and it takes 12 to 13 to get meaningfully through the DTC. We would like to see it settled on 20 days notice.

THE COURT: And during that period of time anyone who has an objection to the judgment that didn't relate to the issues that were raised in the petition could put in an objection to the judgment.

MR. WARE: Well, and the rule contemplates a counter order.

THE COURT: Right. Exactly.

MR. WARE: You know, counter proposal.

THE COURT: Which might be useful.

MR. WARE: And not necessarily hearing if the Court doesn't need one, if the Court can look at the proposal and the counter proposal and sign one.

THE COURT: Here's the problem with that,

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If I sign an order that someone objects to, they though. are not going to release their claims with respect to the judgment; right?

Well, the judgment would be res MR. WARE: judicata.

THE COURT: That's not necessarily going to work.

MR. WARE: Someone can -- and I've done this when I've settled a counter order. I've put in a memorandum explaining the reasons and that's enabled the court to --

THE COURT: Let's do that. Why don't we, with respect to all the trusts that have not put in a specific objection in the petition to the proposed methodology by the trustee of distributing the funds, put together a joint -- a settlement or settle a judgment indicating which parties agree to the proposed settle judgment and which object. Those parties who object will be free to put in a counter judgment with a short memorandum explaining their objection, and then I will have a hearing Today is March 15. I would like the proposed judgment to be circulated and settled, filed, e-filed by March 31st. That would mean that any objections to the proposed judgment will come in and any proposed objections will come in by April 28th. Friday, May 6th at 9:30. All

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right? May 6th at 9:30. All right?

Now, with respect to the 14 trusts that have put in an objection, I'm not going to do anything on those trusts until this other issue is resolved, because I am on trial the entire month of April, and I will not have time to figure out how I want to proceed. Really, I have to think about it, and I will say this. Either there will be -- I'll issue a judgment on the petition or I will ask the parties in to hear testimony. I'm not sure. I've read the objection. It's not something that I can just think about in a half an hour and decide. I really have to think long and hard about it. I'm not prepared to take those 14 trusts on until after my trial and after the 500 or 400 trusts or however many you sign on to the judgment.

MR. SNEIDER: Your Honor, we would like to respond to the Center Count submission of yesterday. It raises certain issues that we would like to be able to address in terms of what the PSA's say.

THE COURT: You've made your arguments.

MR. SNEIDER: Because they were concurrent submissions, we didn't know exactly what arguments they would be raising with respect to our PSA's.

THE COURT: There were answers and reply times. Everyone had the opportunity to put in whatever they had. To the extent that there's a new issue that's raised, and

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Counsel keeps telling me, I don't recall your submission that carefully, but to the extent that I feel that I need further submissions, I'll let you know. Okay? I'm not sure that I need them. I think you made your point, and it's a point that I have to think about, and I'll tell you whether I want testimony or whether there's a dispute about it or whatever. Okay?

You know what I'm going to do. Here's what I will do. With respect to your 14 trusts, I will set a date in May for you to come in. At that time I will have had an opportunity to really think about it, and it will have to be an afternoon. Come in on May 12th at 2:15. By that time I will have re-reviewed your objections, and I will look at the submission and see whether or not I think that further briefing or further discussions need to be had. Okay?

Anyone have anything? Anyone on this matter have anything else that they want to put on the record today? All right. Fantastic. Thank you, Counsel.

> Thank you, your Honor. MR. INGBER:

Thank you, your Honor. MR. SHUSTER:

MS. PATRICK: Thank you Honor.

(End of proceedings.)

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- Proceedings -It is hereby certified that the foregoing is a true and accurate transcript of the proceedings. William Cardenuto Senior Court Reporter

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COUNTY OF NEW YORK	K	
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In the Matter of the Application of	:	
THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530	:	VERIFIED PETITION
Countrywide Residential Mortgage-Backed Securitization Trusts,	•	
Petitioner,	•	
For Judicial Instructions under CPLR Article 77	•	
on the Distribution of a Settlement Payment.	:	
	- A	

Petitioner The Bank of New York Mellon, in its capacity as trustee or indenture trustee ("Trustee") of the 530 residential mortgage-backed securitization ("RMBS") trusts identified in Exhibit A hereto (the "Covered Trusts"), as and for its Verified Petition for Judicial Instructions under CPLR Article 77 on the Distribution of a Settlement Payment, respectfully alleges:

- 1. This is a special proceeding pursuant to CPLR Article 77 to determine matters relating to express trusts, and in particular a matter relating to the proper distribution of an \$8.5 billion settlement payment ("Settlement Payment") that the Trustee expects to receive on or about February 10, 2016.
- 2. The Trustee has no economic stake or interest in the ultimate resolution of the contractual questions presented here, and files this proceeding solely to resolve competing interpretations of the relevant agreements that bear directly upon the proper distribution of the Settlement Payment to investors in the Covered Trusts (collectively, "Certificateholders").

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3. The Trustee serves as trustee or indenture trustee of the Covered Trusts, each of which is governed either by a pooling and serving agreement or by an indenture and related sale and servicing agreement (collectively, the "Governing Agreements").

JURISDICTION AND VENUE

- 4. The Bank of New York Mellon is a bank organized under the laws of the State of New York having its principal place of business at 225 Liberty Street, New York, New York 10286.
- 5. This Court has jurisdiction over the subject matter of this action pursuant to CPLR Articles 77 and 4 to entertain a special proceeding to determine matters relating to any express trust. The Covered Trusts are all express trusts within the scope of CPLR Article 77.
- 6. The laws of the State of New York govern the rights and obligations of the parties to the Governing Agreements, including the Trustee. The Trustee is domiciled and has its principal place of business in New York.
- 7. Venue is proper in New York County under CPLR 503 because the Trustee maintains its principal place of business in New York County.

THE SETTLEMENT AGREEMENT

8. On or about June 28, 2011, the Trustee entered into a settlement agreement ("Settlement Agreement" or "Settlement") with Bank of America Corporation and BAC Home Loans Servicing, LP (collectively, "Bank of America") and Countrywide Financial

Because the total volume of the Governing Agreements is thousands of pages, the Trustee is submitting to the Court a compact disc containing electronic versions of the Governing Agreements.

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Corporation and Countrywide Home Loans, Inc. ("Countrywide"). The Settlement Agreement is attached hereto as Exhibit B.

- 9. Following a special proceeding pursuant to CPLR Article 77 and an appeal to the Appellate Division, First Department, the Settlement was approved in all respects and the Trustee was found to have acted in good faith and reasonably in connection with the negotiation, evaluation and entry into the Settlement Agreement. *In re Bank of New York Mellon (Bank of New York Mellon v. Ret. Bd. of the Policemen's Annuity & Benefit Fund*), 127 A.D.3d 120 (1st Dep't 2015). Judgment was entered on April 27, 2015.
- 10. The Settlement Agreement requires Bank of America and/or Countrywide to pay the Settlement Payment into the Covered Trusts in exchange for releases of certain claims.
- 11. The Settlement Agreement also provided that, before the Settlement could go into effect, the Trustee was required to satisfy other conditions, including the receipt of certain approvals from the IRS and tax-related opinions of counsel. On October 13, 2015, having received the required court orders, IRS rulings and opinions of counsel, the Trustee notified Certificateholders of the occurrence of Final Court Approval of the Settlement.²
- 12. Pursuant to the Settlement Agreement, Final Court Approval triggered Bank of America and/or Countrywide's obligation to pay the Settlement Payment within 120 days, and the Trustee's obligation to engage a qualified financial advisor to calculate each Covered Trust's Allocable Share that is, the portion of the Settlement Payment allocable to each Covered Trust.

² Capitalized terms used but not defined herein have the meanings ascribed to them in the Settlement Agreement.

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13. On January 11, 2016, the Trustee received the financial advisor's calculation of each Covered Trust's Allocable Share. The financial advisor's report has been disclosed publicly on the Trustee's investor reporting website and is attached hereto as Exhibit C.

- 14. The Allocable Shares will constitute the most significant Subsequent Recovery (defined immediately below) in the history of many of the Covered Trusts. The average Allocable Share is \$16 million and the largest is \$109 million.
- 15. Upon payment of the Settlement Payment, the Settlement Agreement requires (with certain exceptions not relevant here) the Trustee to distribute each Covered Trust's Allocable Share to Certificateholders in accordance with the provisions of the Governing Agreements as though the Allocable Share was a "Subsequent Recovery," generally defined to mean unexpected funds received by the trust in connection with a particular mortgage loan that previously was written off. Historically, Subsequent Recoveries received by the Covered Trusts for distribution have been modest and often offset by new losses incurred by the trust. They are typically limited to funds such as proceeds of the sale of real estate owned properties and adjustments to payments on private mortgage insurance claims.
- 16. 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. They therefore present the classic case for judicial instructions.

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THE WRITE UP ISSUE

- The essential issue for which the Trustee seeks judicial instruction is how 17. the Trustee should apply the "write up" provisions of the Governing Agreements in respect of the Allocable Shares. The "write up" provisions concern the manner by which the principal balance of previously written down certificates is increased, or "written up," in connection with Subsequent Recoveries.
- 18. "Certificate Principal Balance" is a core concept that is used in the Governing Agreements, and in RMBS generally.³ Every interest-bearing Certificate issued by the Covered Trusts has a Certificate Principal Balance that decreases over time as principal is repaid and losses on mortgage loans are realized. Conversely, in the vast majority of the Covered Trusts, Certificate Principal Balance can also be increased, or "written up," when a trust is in receipt of a Subsequent Recovery that offsets a prior loss.
- 19. As noted above, the Settlement Agreement provides that each Covered Trust's Allocable Share will be distributed as though it were a Subsequent Recovery. Subparagraph 3(d)(ii) of the Settlement Agreement specifies two operations for the Trustee to perform in connection with the distribution of Allocable Shares – (i) payment of the Allocable Share to Certificateholders, and (ii) writing up certificates in the amount of the Allocable Share. The write up will be in the amount of the Allocable Share, or if the aggregate amount of all prior write downs is less than the Allocable Share, in such aggregate amount.

Some Covered Trusts use other terms, such as "Note Principal Balance," instead of "Certificate Principal Balance," but the concept is the same in all Covered Trusts. The nomenclature differences are immaterial for present purposes, and this Petition uses the term "Certificate Principal Balance" for ease of reference. For the same reasons, when referring to the relevant securities – which can be "certificates" or "notes" – this Petition uses the term "Certificates."

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20. Subparagraph 3(d)(ii) of the Settlement Agreement also specifies the *order* of those two operations – the Trustee is directed to pay the Allocable Share before writing up the Certificate Principal Balance (in other words, to pay the Allocable Share based on the prior period Certificate Principal Balance). This order of operations is consistent with the Trustee's longstanding practice of distributing Subsequent Recoveries in the Covered Trusts, a practice that could be gleaned from monthly remittance reports delivered by the Trustee to Certificateholders.

- 21. The Governing Agreements for all but six Covered Trusts also require both paying and writing up when Subsequent Recoveries are received. Unlike the Settlement Agreement, however, with only one exception the Governing Agreements do not specify – one way or the other – the order in which those operations are to be executed. Given the relatively modest size of Subsequent Recoveries received by the Covered Trusts until now, the Governing Agreements' silence on the order of operations has had no material impact. However, in preparing for the distribution of the Allocable Shares, the Trustee has observed that due to the unusually large amount of Subsequent Recoveries resulting from the Allocable Shares, the Trustee's practice of paying based on the prior period Certificate Principal Balance ("pay first and write up second") – which has been the Trustee's longstanding approach with regard to regular Subsequent Recoveries – results in certain contractual issues that affect the distribution of billions of dollars among Certificateholders.
- 22. This issue has the most pronounced effect among the Covered Trusts with an "overcollateralization" or "OC" structure (the "OC Trusts"). In approximately 122 of

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the 173 OC Trusts, the impact is more than \$1 million per trust; in some it exceeds \$10 million.

- 23. An OC Trust is designed to create credit enhancement, or protection, for more senior Certificateholders through a concept called overcollateralization. An OC Trust is overcollateralized when the principal balance of the underlying mortgage loans (the trust's assets) exceeds the Certificate Principal Balances of the Certificates issued by the OC Trust (the trust's liabilities). In a given month, principal distributions to Certificates below specified seniority levels (generally, "junior" or "subordinated" Certificates) are not permitted unless the trust as a whole has sufficient "overcollateralization" – that is, unless the balance of the underlying mortgage loans (the trust's assets) exceeds the Certificate Principal Balances (the trust's liabilities) by an amount specified in the Governing Agreements. If the overcollateralization falls short of the required "Overcollateralization Target Amount" - hereinafter referred to as the "OC Target" – then principal distributions cannot flow to "junior" or "subordinated" Certificateholders. 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.
- 24. Substantial losses over the years have resulted in the failure of each of the OC Trusts to meet its OC Target. In fact, many of the OC Trusts have no overcollateralization whatsoever, meaning that the principal balance of the mortgage loans in such trusts *equals* the aggregate Certificate Principal Balances of all the Certificates in these trusts. Even when funds are received into the OC Trusts in a given month – which would otherwise build collateralization – they are typically offset by losses on mortgage

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loans realized in that month. That has maintained the OC Trusts in balance, without any material movement toward meeting their OC Target. In fact, it is likely that the OC Trusts will never meet their OC Target again.

- 25. However, due to the unique size of the Allocable Shares, if the Trustee applies the distribution and write up provisions of the Governing Agreements in the OC Trusts as it has done historically (paying the Allocable Share to Certificateholders before writing up Certificate Principal Balances), in most of the OC Trusts substantial amounts of each Allocable Share will flow to less senior, subordinated Certificateholders even though overcollateralization in the OC Trust is far short of the OC Target.
- 26. That is because making the payment first will reduce the Certificate Principal Balance of the Certificates receiving the payment (in other words, those Certificates will be "paid down"), so the trust's liabilities will decline, but the trust's assets (the principal balance of the mortgage loans) remain the same. Therefore, the trust will have a temporary, and illusory, overcollateralization that exceeds the OC Target given the unprecedented amount of Subsequent Recoveries flowing into the OC Trusts. According to the Governing Agreements, once that occurs, funds must flow to subordinated Certificateholders as reimbursement for their previously allocated realized losses. Only after funds have "leaked" to subordinated Certificateholders is the Certificate Principal Balance increased or "written up" in the amount of the Allocable Share, returning the OC trust to zero overcollateralization (assets equal to liabilities). In other words, the OC Target is not satisfied before the distribution or after the distribution, but *during* the distribution process – in between step one (payment) and step two (write up) – the OC Target is temporarily, and artificially, met.

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27. This phenomenon can be illustrated. Assume a particular OC Trust has a \$35 million OC Target, an aggregate mortgage loan balance (assets) of \$450 million and an aggregate Certificate Principal Balance (liabilities) of \$450 million. Because the aggregate mortgage loan balance is equal to the aggregate Certificate Principal Balance, overcollateralization is currently at zero, meaning that the deal is \$35 million short of its OC Target. Now assume that the Allocable Share for the deal is \$90 million. Under the "pay first and write up second" order of operations, the Governing Agreements will apply the first \$35 million of the Allocable Share to reduce the Certificate Principal Balance (the liabilities) of the senior Certificates, thus bringing the deal, for a brief moment, to its OC Target. After that, most of the remaining \$55 million of the Allocable Share flows ("leaks") to less senior, subordinated Certificateholders (because the OC Trust appears to be meeting its OC Target). Payment having been completed, the second step is to "write up." Certificate Principal Balances of previously written down Certificates are written up (i.e., the trust's "liabilities" are increased) by \$90 million to account for the Subsequent Recovery – immediately wiping out the \$35 million in overcollateralization and putting the deal back to its pre-distribution state of non-compliance with its OC Target.

- 28. This payment to less senior, subordinated Certificateholders at the expense of more senior Certificateholders could be viewed as contrary to an essential purpose of the overcollateralization structure – protecting more senior Certificateholders from risk of loss.
- 29 As noted above, the Governing Agreements neither explicitly prohibit nor explicitly require any particular order of operations. Therefore, the Trustee could make an adjustment designed to avoid the "leakage" issue described above by calculating the overcollateralization in the OC Trusts in a manner that accounts for the expected write up

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of previously written down Certificates. That approach would avoid the temporary, and illusory, satisfaction of the OC Target.

- 30. Specifically, using the same illustrative numbers in the example above, the Trustee could simply adjust the Certificate Principal Balances (the trust's liabilities) from \$450 million to \$540 million (i.e., taking into account the \$90 million write up that will happen after the payment is made) solely for the purpose of determining the overcollateralization level of the OC Trust. In doing so, the entire Allocable Share would be payable to senior Certificateholders as principal, and no amounts would leak, because the amount required to reach the \$35 million OC Target would increase from \$35 million⁴ to \$125 million,⁵ an amount that exceeds the \$90 million Allocable Share. Under this adjustment, the payment of the Allocable Share to the senior Certificateholders would still be based on their respective Certificate Principal Balances *prior* to any write up, in keeping with the general "pay first and write up second" order of operations.
- 31. Alternatively, the Trustee could avoid leakage in the OC Trusts by changing its established order of operations for this settlement distribution (i.e., not simply adjust the overcollateralization measurement) to apply write ups first, and then pay the Allocable

The amount needed to reach the Target

⁼ the Target – the actual overcollateralization

^{= \$35} million – (\$450 million aggregate loan balance – \$450 million Certificate Principal Balance)

 $^{= $35 \}text{ million} - 0

^{= \$35} million.

With the adjustment, the amount needed to reach the Target

⁼ the Target – the actual overcollateralization

^{= \$35} million – (\$450 million aggregate loan balance – (\$450 million Certificate Principal Balance + \$90 million adjustment))

 $^{= $35 \}text{ million} - ($450 \text{ million} - $540 \text{ million})$

⁼ \$35 million + \$90 million

^{= \$125} million.

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Share. However, as discussed below, this alternative would have significant additional consequences that would affect the settlement distribution in the majority of the 530 Covered Trusts, including many of the non-OC Trusts.

- 32. Using the same illustrative numbers, under the "write up first and pay second" scenario, the Trustee would first write up the aggregate Certificate Principal Balances (the trust's liabilities) by \$90 million, from \$450 million to \$540 million. The aggregate mortgage loan balance (the trust's assets) would remain at \$450 million \$90 million less than the aggregate Certificate Principal Balance (i.e., there would be \$90 million *under* collateralization), with the trust then \$125 million short of the \$35 million OC Target. The Trustee would then pay \$90 million to the senior Certificates and reduce their Certificate Principal Balance by \$90 million, thus restoring the trust to an overcollateralization level of zero (*i.e.*, \$35 million short of the OC Target). At no time will the trust have met the OC Target.
- 33. Thus, changing the order of operations from "pay first and write up second" to "write up first and pay second" would avoid any "leakage" in the OC Trusts. However, that change would have other implications.
- 34. The "write up first and pay second" order of operations is inconsistent with Subparagraph 3(d)(ii) of the Settlement Agreement, albeit with the caveat that the Settlement Agreement, by its terms (Subparagraph 3(d)(v)), cannot amend or be construed as amending the Governing Agreements. In other words, the Settlement Agreement permits "write up first and pay second" only if the Governing Agreements of the OC Trusts are interpreted as directing the Trustee to "write up first and pay second."

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35. Changing the general order of operations also has the potential to materially alter the relative portion of the Allocable Shares that senior Certificateholders would receive in any Covered Trust – whether or not an OC Trust – in which senior Certificates have incurred losses to date. That is because distributions in many of the Covered Trusts are affected by the relative Certificate Principal Balances of all Certificates. Thus, a distribution based on a "write up first and pay second" order of operations in trusts where senior classes incurred losses to date would mean that less senior Certificates increase their Certificate Principal Balance in relation to more senior Certificates, potentially skewing the distribution in favor of less senior Certificates.

- 36. For example, for some Covered Trusts, principal payments to senior Certificateholders are made pro rata based on their relative Certificate Principal Balances, but any losses are allocated first to less senior Certificates. Therefore, if we assume that the original "A-1" (i.e., most senior) and "A-2" (i.e., less senior) Certificate Principal Balance is \$60 million each, but \$30 million of losses have been allocated to the A-2 Certificates, then at the time the Trustee distributes the Allocable Share the Certificate Principal Balance of A-1 Certificates would be \$60 million and of A-2 Certificates \$30 million. If the Trustee applies the "write up first and pay second" order of operations, then the A-2 class would first be written up to \$60 million and the A-1 and A-2 Certificates would divide the Allocable Share equally (for a \$66 million Allocable Share, \$33 million each).
- 37. Compare that with the outcome under a "pay first and write up second" order of operations. Under that order of operations, the A-2 balance would remain at \$30 million for the distribution, the A-1 certificates would receive \$44 million (\$66 million x

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\$60 million/\$90 million), and the A-2 certificates would receive only \$22 million (\$66 million x \$30 million/\$90 million).

- 38. In this single hypothetical, changing the Trustee's order of operations to "write up first and pay second" would shift \$11 million from A-1 Certificateholders to A-2 Certificateholders. Thus, while altering the order of operations may avoid the leakage in OC Trusts, it may also result in a substantial change in the distribution of settlement proceeds *within* the senior class of certificates.
- 39. Given this background, and the competing interpretations of the Governing Agreements reflected in investor correspondence and other industry participants (described below), the Trustee seeks the Court's direction whether:
 - (a) the Trustee should follow the Settlement Agreement and continue its practice of "pay first and write up second," but make an adjustment, described in this Verified Petition, to the overcollateralization calculation in order to prevent leakage; or
 - (b) the Trustee should follow the Settlement Agreement and continue its practice of "pay first and write up second," but make no adjustment to the overcollateralization calculation, thus permitting leakage; or
 - (c) the Trustee should change its general order of operations in the Covered Trusts to "write up first and pay second" notwithstanding Subparagraph 3(d)(ii) of the Settlement Agreement.
- 40. At bottom this proceeding is squarely about the interpretation of the Governing Agreements: if they must be interpreted as directing the Trustee to write up

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first, then the Trustee is required, both by the Governing Agreements and by Subparagraph 3(d)(v) of the Settlement Agreement, to follow the Governing Agreements and write up first notwithstanding contrary language in Subparagraph 3(d)(ii) of the Settlement Agreement. Conversely, if the Governing Agreements must be interpreted as directing the Trustee to pay first, then the Trustee is required to pay first, and the question is whether the Trustee should implement the adjustment to the calculation of overcollateralization described in Paragraphs 29-30 above. And finally, if the Governing Agreements neither prohibit nor require any particular order of operations and can reasonably be interpreted as permitting either, that presents a similar question: if the Trustee continues its practice of paying first, whether the Trustee should avoid leakage by calculating overcollateralization in the OC Trusts in a manner that accounts for the expected write up of previously written down Certificates.

- 41. For several reasons, these issues compel the Trustee to seek judicial instruction. First, there are competing views on these issues as they relate to the OC Trusts. The Trustee has received conflicting investor correspondence on this point, urging the Trustee to follow different orders of operation in light of, or notwithstanding, the overcollateralization issue.
- 42. Intex, a leading provider of cash flow models that are used and relied upon by investors throughout the structured fixed income industry, has modeled different OC Trusts based on different assumptions about the order of write ups and payments. Certain of the models appear to apply a "pay first and write up second" order of operations but appear to include a script to prevent leakage (Paragraph 39(a) above). Other models appear to use a "write up first and pay second" order of operations and thus show no

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leakage (Paragraph 39(c) above). These varied approaches in models available to Certificateholders is further evidence of the competing interpretations of the Governing Agreements.

- 43. The Trustee is also aware that in non-Countrywide deals that are unrelated to the Settlement, the agreements address the order of operations in three separate ways by requiring "pay first and write up second"; by requiring "write up first and pay second"; and by staying silent (like the Governing Agreements here) on the order of operations issue. In other words, the governing agreements for non-Countrywide deals provide no guidance on industry practice, because there is no consistency in how they treat the order of operations question.
- 44. Second, the resolution of this question has significant consequences for Certificateholders in the Covered Trusts, affecting the distribution of potentially billions of dollars.
- 45. And finally, judicial instructions are necessary where, as here, there is reasonable doubt about the powers or duties of the trusteeship or about the proper interpretation of trust provisions. The Trustee has no economic stake in the resolution of this question, but recognizes that investors holding different classes of Certificates may have different interests and therefore different interpretations of the Governing Agreements. This proceeding presents an opportunity for Certificateholders to be heard on this question before the Trustee makes any distributions of the Settlement Payment.

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PRAYER FOR RELIEF

WHEREFORE, petitioner The Bank of New York Mellon, as Trustee, respectfully requests that the Court:

- Instruct the Trustee by determining whether: (i)
- the Trustee should follow the Settlement Agreement and (a) continue its practice of paying first, but make an adjustment, described in this Verified Petition, to the overcollateralization calculation in order to prevent leakage; or
- (b) the Trustee should follow the Settlement Agreement and continue its practice of paying first, but make no adjustment to the overcollateralization calculation, thus permitting leakage; or
- (c) the Trustee should change its general order of operations in the Covered Trusts to "write up first and pay second" notwithstanding Subparagraph 3(d)(ii) of the Settlement Agreement.
- retain exclusive jurisdiction over this matter for the purposes of (ii) rendering such additional instructions as are necessary and/or appropriate in the administration of the Covered Trusts; and
- (iii) issue an order barring litigation of the questions raised herein outside the context of this proceeding; and

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(iv) grant the Trustee such other, further and different relief as the Court deems just and proper.

Dated: New York, New York February 5, 2016

MAYER BROWN LLP

By:

Matthew D. Ingber Michael O. Ware Christopher J. Houpt

1221 Avenue of the Americas New York, New York 10020 (212) 506-2500

Attorneys for Petitioner The Bank of New York Mellon, as Trustee of the Covered Trusts FILED: NEW YORK COUNTY CLERK 05/05/2017 12:10 PM

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VERIFICATION

STATE OF NEW YORK)	
)	SS.
COUNTY OF NEW YORK)	

LORETTA A. LUNDBERG, being duly sworn, deposes and says:

- 1. I am a Managing Director in the Corporate Trust Division at The Bank of New York Mellon.
 - 2. I have read the foregoing Verified Petition and know the contents thereof.

All statements of fact therein are true and correct to the best of my knowledge and belief.

Loretta A. Lundberg

Sworn to before me this 4th day of February, 2016

Notary Public

RAFAL BAR
NOTARY PUBLIC, State of New York
No. 01BA6293822
Qualified in Kings County
Commission Expires Dec. 16, 2017

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SUPREME COURT OF THE STATE OF NEW YORK COUNTY OF NEW YORK			
	X		
In the Matter of the Application of	:	Index No.	/2016
THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530	:		
Countrywide Residential Mortgage-Backed Securitization Trusts,	:		
Petitioner,	•		
For Judicial Instructions under CPLR Article 77	•		
on the Distribution of a Settlement Payment.	:		
	X		

MEMORANDUM OF LAW IN SUPPORT OF VERIFIED PETITION SEEKING JUDICIAL INSTRUCTION

Matthew D. Ingber Michael O. Ware Christopher J. Houpt MAYER BROWN LLP 1221 Avenue of the Americas New York, New York 10020 (212) 506-2500

Attorneys for Petitioner The Bank of New York Mellon

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Petitioner The Bank of New York Mellon, in its capacity as trustee or indenture trustee ("Trustee") of the 530 residential mortgage-backed securitization ("RMBS") trusts identified in Exhibit A to the Petition (the "Covered Trusts"), respectfully submits this memorandum of law in support of its concurrently-filed Verified Petition seeking judicial instruction.¹

PRELIMINARY STATEMENT

The Trustee seeks judicial instruction concerning the distribution of an \$8.5 billion Settlement Payment that the Trustee expects to receive on or about February 10, 2016 for the benefit of Certificateholders, because the relevant Governing Agreements that bear upon distribution are subject to competing interpretations. The Settlement Agreement directs the Trustee to distribute each Trust's Allocable Share of the Settlement Payment to Certificateholders in accordance with the relevant Governing Agreements, and more specifically to first remit each Allocable Share to Certificateholders and then to make a corresponding increase ("write up") to the principal balance of the Certificates. The Trustee has observed that due to the unusually large amount of the Allocable Share in each Covered Trust, which the Trustee is required to treat as a "Subsequent Recovery" for purposes of distribution, certain contractual issues have arisen that will affect the distribution of billions of dollars among Certificateholders. The Trustee has also received investor correspondence with competing interpretations of the Governing Agreements, and third-party distribution models incorporate different assumptions about the meaning of the Governing Agreements, appearing to confirm that there are meaningful questions about

Unless otherwise noted herein, defined terms will take on the meaning ascribed to them in the Verified Petition.

how to interpret the contracts. The resolution of these contractual issues will dictate how – and to whom – the Allocable Shares of the Covered Trusts are distributed.

The Trustee has no economic interest in the outcome of this action. It merely requests judicial instruction in order to discharge its obligation to distribute the Settlement Payment fairly and equitably, in the face of competing interpretations and interests, and to allow Certificateholders the opportunity to be heard.

STATEMENT OF FACTS²

The Trustee is the trustee or indenture trustee of each Covered Trust. In that capacity, on or about June 28, 2011, the Trustee entered into a Settlement Agreement with Bank of America and Countrywide. *See* Verified Petition, Exhibit B. Following a special proceeding pursuant to CPLR Article 77 and an appeal to the Appellate Division, First Department, the Settlement was approved in all respects, and the Trustee was found to have acted in good faith and reasonably in connection with the negotiation, evaluation and entry into the Settlement Agreement. *In re Bank of New York Mellon (Bank of New York Mellon v. Ret. Bd. of the Policemen's Annuity & Benefit Fund*), 127 A.D.3d 120 (1st Dep't 2015). Judgment was entered on April 27, 2015.

Before the Settlement could go into effect, the Trustee was required to satisfy other conditions, including the receipt of certain approvals from the IRS and tax-related opinions of counsel. On October 13, 2015, having received the required court orders, IRS rulings and opinions of counsel, the Trustee notified Certificateholders of the occurrence of Final Court Approval of the Settlement. Pursuant to the Settlement Agreement, Final Court Approval triggered Bank of America and/or Countrywide's obligation to pay the

The relevant facts are presented here in abbreviated form. A more comprehensive recitation of the facts is set forth in the Verified Petition.

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Settlement Payment within 120 days, and the Trustee's obligation to engage a qualified financial advisor to calculate each Covered Trust's Allocable Share – that is, the portion of the Settlement Payment allocable to each Covered Trust.

On January 11, 2016, the Trustee received the financial advisor's calculation of each Covered Trust's Allocable Share. *See* Exhibit C to Verified Petition. Upon payment of the Settlement Payment, the Settlement Agreement requires (with certain exceptions not relevant here) the Trustee to distribute each Covered Trust's Allocable Share to Certificateholders in accordance with the provisions of the Governing Agreements as though the Allocable Share was a "Subsequent Recovery" – generally defined in the Governing Agreements to mean funds received by the trust unexpectedly in connection with a mortgage loan that previously had been written off. Historically, Subsequent Recoveries received by the Covered Trusts for distribution have been modest and often offset in the same month by new losses incurred by the trust. They are typically limited to funds such as property tax rebates received after foreclosure and adjustments to payments on private mortgage insurance claims.

The essential issue for which the Trustee is seeking Court instruction is how the Trustee should apply the "write up" provisions of the Governing Agreements in respect of the Allocable Shares. The "write up" provisions concern the manner by which the principal balance of previously written down certificates is increased, or "written up," in connection with Subsequent Recoveries. Every interest-bearing Certificate issued by the Covered Trusts has a Certificate Principal Balance that *decreases* over time as principal is repaid and losses on mortgage loans are realized. Conversely, in the vast majority of the

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Covered Trusts, Certificate Principal Balance can also be *increased*, or "written up," when a trust is in receipt of a Subsequent Recovery that offsets a prior loss.

The Settlement Agreement specifies two operations for the Trustee to perform in connection with the distribution of Allocable Shares – (i) payment of the Allocable Share to Certificateholders, and (ii) writing up certificates in the amount of the Allocable Share. The write up will be in the amount of the Allocable Share, or if the aggregate amount of all prior write downs is less than the Allocable Share, in such aggregate amount. The Settlement Agreement also specifies the *order* of those two operations – the Trustee is directed to pay the Allocable Share before writing up the Certificate Principal Balance (in other words, to pay the Allocable Share based on the prior period Certificate Principal Balance). This order of operations is consistent with the Trustee's longstanding practice of distributing Subsequent Recoveries in the Covered Trusts, a practice that could be gleaned from monthly remittance reports delivered by the Trustee to Certificateholders.

Like the Settlement Agreement, the Governing Agreements for all but six Covered Trusts require the Trustee to both pay and write up when it receives Subsequent Recoveries. But unlike the Settlement Agreement, with only one exception, the Governing Agreements do not specify – one way or the other – the order in which those operations are to be executed. Given the relatively modest size of Subsequent Recoveries received by the Covered Trusts until now, the Governing Agreements' silence on the order of operations had no material impact. However, in preparing for the distribution of the Allocable Shares to Certificateholders, the Trustee has observed that due to the unusually large amounts of Subsequent Recoveries resulting from the Allocable Shares, the Trustee's practice of paying based on the prior period Certificate Principal Balance ("pay first and write up

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second") – which is required by the Settlement Agreement and has been the Trustee's longstanding approach with regard to regular Subsequent Recoveries – results in certain contractual issues that affect the distribution of billions of dollars among Certificateholders.

This issue has the most pronounced effect among the Covered Trusts with an "overcollateralization" or "OC" structure (the "OC Trusts"). An OC Trust is designed to create credit enhancement, or protection, for more senior Certificateholders through a concept called overcollateralization. An OC Trust is overcollateralized when the principal balance of the underlying mortgage loans (the trust's assets) exceeds the Certificate Principal Balances of the Certificates issued by the OC Trust (the trust's liabilities). In a given month, principal distributions to securities below specified seniority levels (generally, "junior" or "subordinated" Certificates) are not permitted unless the trust as a whole has sufficient "overcollateralization" – that is, unless the balance of the underlying mortgage loans exceeds the Certificate Principal Balances by an amount specified in the Governing Agreements. If the overcollateralization falls short of the required "Overcollateralization Target Amount" – hereinafter referred to as the "OC Target" – then principal distributions cannot flow to less "junior" or "subordinated" Certificateholders. 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.

Substantial losses over the years have resulted in the failure of each of the OC Trusts to meet its OC Target. In fact, many of the OC Trusts have no overcollateralization

In approximately 122 of the 173 OC Trusts, the impact is more than \$1 million per trust; in some it exceeds \$10 million.

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whatsoever, meaning that the principal balance of the mortgage loans in such trusts *equals* the aggregate Certificate Principal Balances of all the Certificates in these trusts. Even when funds are received into the OC Trusts in a given month – which would otherwise build collateralization – they are typically offset by losses on mortgage loans realized in that month. That has maintained the OC Trusts in balance, without any material movement toward meeting their OC Target. In fact, it is likely that the OC Trusts will never meet their OC Target again.

However, due to the unique size of the Allocable Shares, if the Trustee pays the Allocable Share to Certificateholders *before* writing up Certificate Principal Balances (as is specified by the Settlement Agreement and consistent with the Trustee's historical practice), in most of the OC Trusts substantial amounts of each Allocable Share will flow to less senior, subordinated Certificateholders even though overcollateralization in the OC Trust is far short of the OC Target. That is because making the payment first will reduce the Certificate Principal Balance of the Certificates receiving the payment (in other words, those Certificates will be "paid down"), so the trust's liabilities will decline, but the trust's assets (the principal balance of the mortgage loans) remains the same. Therefore, the trust will have a temporary, and illusory, overcollateralization that exceeds the OC Target given the unprecedented amount of Subsequent Recoveries flowing into the OC Trusts. The Governing Agreements provide that, once that occurs, funds must flow to subordinated Certificateholders as reimbursement for their previously-allocated realized losses. Only after funds have "leaked" to subordinated Certificateholders is the Certificate Principal Balance increased or "written up" in the amount of the Allocable Share, returning the OC Trust to zero overcollateralization (assets equal to liabilities). In other words, the OC

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Target is not satisfied before the distribution or after the distribution, but *during* the distribution process – in between step one (payment) and step two (write up) – the OC Target is temporarily, and artificially, met.

The Governing Agreements neither explicitly prohibit nor explicitly require any particular order of operations. Therefore, the Trustee could make an adjustment designed to avoid the "leakage" issue described above by calculating the overcollateralization in the OC Trusts in a manner that accounts for the expected write up of previously written down Certificates. That approach would avoid the temporary, and illusory, satisfaction of the OC Target.

Alternatively, the Trustee could avoid the leakage in the OC Trusts by changing its established order of operations for this settlement distribution (*i.e.*, not simply adjust the overcollateralization measurement) to apply *write ups* first, and then pay the Allocable Share. The "write up first and pay second" order of operations, however, is inconsistent with Subparagraph 3(d)(ii) of the Settlement Agreement, albeit with the caveat that the Settlement Agreement, by its terms (Subparagraph 3(d)(v)), cannot amend or be construed as amending the Governing Agreements. In other words, the Settlement Agreement permits "write up first and pay second" only if the Governing Agreements of the OC Trusts are interpreted as directing the Trustee to "write up first and pay second."

This alternative would affect the settlement distribution in the majority of the 530 Covered Trusts, including many of the non-OC Trusts. For example, changing the general order of operations has the potential to materially alter the relative portion of the Allocable Shares that senior Certificateholders would receive in any Covered Trust – whether or not an OC Trust – in which senior Certificates have incurred losses to date. That is because

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distributions in many of the Covered Trusts are affected by the relative Certificate

Principal Balances of all Certificates. Thus, a distribution based on a "write up first and pay second" order of operations in trusts where senior classes incurred losses to date would mean that less senior Certificates increase their Certificate Principal Balance in relation to more senior Certificates, potentially skewing the distribution in favor of less senior Certificates.

The Trustee has received conflicting investor correspondence on this point, advancing different interpretations and urging the Trustee to follow different orders of operation in light of, or notwithstanding, the overcollateralization issue. Intex, a leading provider of cash flow models that are used and relied upon by investors throughout the structured fixed income industry, has modeled different OC Trusts based on different assumptions about the order of write ups and payments. Certain of the models appear to apply a "pay first and write up second" order of operations but appear to include a script to prevent leakage. Other models appear to use a "write up first and pay second" order of operations and thus show no leakage. These varied approaches in models available to Certificateholders and other market actors confirm that there is disagreement concerning the proper interpretation of the contracts.

The Trustee is also aware that in non-Countrywide deals that are unrelated to the Settlement, the agreements address the order of operations in three separate ways – by requiring "pay first; write up second"; by requiring "write up first; pay second"; and by staying silent (like the Governing Agreements here) on the order of operations issue. In other words, the governing agreements for non-Countrywide deals provide no guidance on

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industry practice, because there is no consistency in how they treat the order of operations question.

Given this background and the potential impact of these questions on the distribution of billions of dollars, the Trustee brings this action to obtain judicial direction on the proper method of distributing the Settlement Payment.

ARGUMENT

I. The Court Is Authorized to Issue Judicial Instructions.

The Court has authority to provide judicial instructions to the Trustee regarding the distribution of the Settlement Payment to the Covered Trusts. Section 7701 of the CPLR provides, with certain exceptions not relevant here, that "[a] special proceeding may be brought to determine a matter relating to any express trust." This section is "broadly construed to cover any matter of interest to trustees, beneficiaries or adverse claimants." In re Greene v. Finley, Kumble, Wagner, Heine & Underberg, 88 A.D.2d 547, 548 (1st Dep't 1982). New York courts have recently applied Article 77 to RMBS trusts in several cases, including in *In re The Bank of New York Mellon*, Index No. 651786/2011, the case that approved the Trustee's negotiation, evaluation and entry into the Settlement Agreement.

The substantive relief that the Trustee seeks – construction of trust-related agreements – is a longstanding equitable remedy. See In re Trusteeship Created by American Home Mortg. Inv. Trust 2005-2, No. 14 Civ. 2494 (AKH), 2014 WL 3858506, at ¶¶ 91, 179 (S.D.N.Y. July 24, 2014) (allowing reformation of Indenture due to scrivener's error to "reflect[] the intent of the contracting parties"); Petition of Percy, 191 Misc. 1052, 1054 (Sup. Ct. N.Y. Cty. 1948) (interpreting the indenture provision governing the disbursement of the trust fund); In re The Bank of New York Mellon, No. 651786/11, 2014

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WL 1057189 (N.Y. Sup. Ct. Jan. 31, 2014) (approving settlement in Article 77 proceeding brought by The Bank of New York Mellon); In re Scarborough Props. Corp., 25 N.Y.2d 553, 555 (1969) (granting Article 77 petition by "trustees of various trusts" concerning decision to sell trust assts); see also Restatement (Second) of Conflict of Laws § 267 cmt. a (1971) ("A proceeding may be brought by the trustee or by the beneficiaries for instructions as to his powers and duties. Application may be made to the court to direct or permit the trustee to deviate from the terms of the trust where unanticipated exigencies have arisen.").

Moreover, as "the court first assuming jurisdiction over property," this Court "may maintain and exercise that jurisdiction to the exclusion of [other courts]." *United States v.* Bank of New York & Trust Co., 296 U.S. 463, 477 (1936) (noting that principle applies "where suits are brought to ... administer trusts."). There is no question that New York courts have jurisdiction over the trusts (governed by New York law), the Trustee (a New York corporation administering trusts governed by New York law), and the trust beneficiaries (investors in trusts governed by New York law). See Restatement (Second) of Trusts § 220 cmt. c (1959) ("Where a trust is administered under the supervision of the courts of a State, those courts have jurisdiction to determine the interests of all claimants, resident or non-resident, with respect to the administration of the trust.").

II. **Competing Interpretations of Distribution Provisions in the Governing Agreements Require Judicial Instruction.**

The Trustee is required to distribute the Settlement Payment to Certificateholders, but how the distribution provisions of the Governing Agreements interact with the distribution provisions of the Settlement Agreement are subject to multiple, competing interpretations by Certificateholders and industry participants.

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Where, as here, conflicting interpretations of trust documents affect the administration of a trust, judicial instruction is warranted to protect the beneficiaries and confirm the trustee's obligations. See In re Bankers Trustee Co., Index No. 604336/1996 (N.Y. Sup. Ct. N.Y. Cty. July 24, 1997); In the Matter of the Trusteeships Created by Tropic CDO I Ltd., 92 F. Supp. 3d 163 (S.D.N.Y. 2015) (seeking judicial confirmation that trustee correctly interpreted trust indentures and properly distributed proceeds where investors advanced contrary interpretation). In *In re Bankers Trustee*, the court granted a trustee's request for judicial instructions regarding the enforcement of a promissory note, which the trustee believed had the potential to cause a conflict among trust beneficiaries. In ruling that it had authority to issue judicial instructions, the Court pointed out one of the essential purposes of an Article 77 proceeding: "the judicial instructions will permit conflicts relating to priorities among [trust beneficiaries] to be resolved in one proceeding instead of in piecemeal in a number of proceedings." *Id.* at 6; see also In re Bankers *Trustee Co.*, Index No. 114077/1998, at 2-3 (N.Y. Sup. Ct. N.Y. Cty. Mar. 8, 1999) (granting trustee's request, pursuant to Article 77, for judicial instructions regarding the disposition of certain trust funds that were the subject of conflicting letters of direction from trust beneficiaries).

Judicial instructions are particularly necessary where, as here, there is reasonable doubt about the powers or duties of the trusteeship or about the proper interpretation of trust provisions. See Petition of Percy, 191 Misc. at 1054 (interpreting the indenture provision governing the disbursement of the trust fund); see also In re Estate of Fales, 106 Misc. 2d 419, 422 (Sur. Ct. N.Y. Cty. 1980) (providing instructions regarding trustee conduct that was the subject of conflicting requests from trust beneficiaries); Restatement

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(First) of Trusts § 170 (1935), cmt. q (proper for court to provide instructions where trust beneficiaries express conflicting interests).

Here, as discussed, the Trustee has received conflicting investor correspondence regarding the distribution of the Settlement Payment; Intex has modeled the distributions in different OC Trusts based on different assumptions about the order of write ups and payments; and agreements in non-Countrywide deals provide no guidance on industry practice. This presents the classic case for judicial instruction.

Escrow of Settlement Funds Is Required to Preserve the Status Quo. III.

The Court has discretion to order the escrow of the Settlement Payment "to maintain the status quo pending a hearing on the merits." See 630 West 11th LLC v. ACG Credit Co. II, LLC, 46 A.D.3d 367, 367 (1st Dep't 2007); Ficus Invs. Inc. v. Private Capital Mgmt., LLC, 61 A.D.3d 1, 11-12 (1st Dep't 2009) ("The escrow order properly preserved the status quo... [t]he equitable relief was appropriate because the assets constituted a specific res that is 'the subject of the action'") (internal citations omitted).

An order to place the Settlement Payment in escrow is urgent and essential to maintain the status quo in the instant case. The purpose of this proceeding – to obtain the Court's direction on the method of distributing the Settlement Payment (i.e., "the subject of the action") – would be frustrated if the Trustee immediately routed the incoming cash to Certificateholders, as the relevant agreements would otherwise require. Immediate distribution of the Settlement Payment using any of the possible distribution methods discussed above would irreversibly alter the status quo, as it would be impracticable for the Trustee to claw back and redistribute the \$8.5 billion Settlement Payment in the face of a contrary judicial instruction.

The Trustee therefore proposes the execution of an Escrow Agreement and the initial appointment of The Bank of New York Mellon (in its non-trustee capacity) as escrow agent (the "Escrow Agent"). *See* Affidavit of Michael O. Ware ("Ware Aff."), Exhibit 1.⁴ The Escrow Agent receives no benefit from this arrangement; indeed, it will accept *no fees, interest or other compensation* as escrow agent. The proposed Escrow Agreement provides as follows:

Compensation. The Escrow Agent shall not be entitled to any fees or other compensation for the Escrow Agent's services hereunder; <u>provided</u>, <u>however</u>, that the Escrow Agent shall be entitled to reimburse itself out of Escrow Earnings in the Escrow Account for such reasonable out of pocket expenses, disbursements, charges, advances and other amounts incurred by it in connection with its services hereunder, if any, that the A77 Court may approve from time to time.

Ware Aff., Exhibit 1 at $\P 9.5$

IV. The Trustee's Notice Program Satisfies Due Process.

The Trustee has proposed a notice program to inform all Certificateholders and other Interested Parties that this Article 77 proceeding has been filed. It includes, within seven (7) business days of the entry of the Proposed Order, (a) mailing the Notice and the

It does so for two reasons. First, because the filing of this proceeding may have constituted material non-public information with the potential to affect the value of the Certificates, the Trustee was unable to disclose its contemplated action before filing this proceeding. The Trustee could not, therefore, have "shopped" for an outside escrow agent to handle the funds during the pendency of this action. Second, given the size and time value of the Settlement Payment, the Trustee is seeking to avoid delay in the investment of the Settlement Payment. The Trustee was able to customize an escrow agreement with the Escrow Agent, tied to the outcome of this action, and develop an investment strategy for the funds that it could implement immediately.

Nor does the Trustee benefit from this arrangement. None of the Trustee's fees in connection with this proceeding will be paid from the Settlement Payment or any escrow earnings.

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initial papers filed herein (other than the compact disc containing electronic copies of the Governing Agreements) to Certificateholders listed on the Certificate Registry for each of the Covered Trusts and to the general counsel of each monoline insurance company that insures any part of any of the Covered Trusts; (b) transmission of the Notice electronically to The Depository Trust Company ("DTC"), which will post the Notice to Certificateholders in accordance with DTC's established procedures; and (c) posting the Notice on the Trustee's investor reporting website.

This notice program is based on a program recently approved by Justice Ramos in another Article 77 proceeding concerning the distribution to investors of the proceeds of an RMBS settlement. See In re Bank of New York Mellon (GE-WMC 2006-1), Index. No. 653558/2015 (Sup. Ct. N.Y. Cty. Oct. 27, 2015). It is also substantially more robust than even the Governing Agreements require: notice through DTC alone is the only form of notice provided for in the Governing Agreements for all Trustee-to-investor communications, in part because the Trustee has no way of knowing the identities of the beneficial owners of book-entry (i.e., DTC-registered) certificates.

It is well established that due process does not require that every interested party actually receive direct notice from the Trustee. Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950). Due process requires only "notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." Mullane, 339 U.S. at 314. The notice program here easily comports with due process.

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CONCLUSION

For all the foregoing reasons, The Bank of New York Mellon, as Trustee, respectfully requests that the Court grant the relief requested in the Verified Petition.

Dated: February 5, 2016 New York, New York

Respectfully submitted,

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Attorneys for Petitioner The Bank of New York Mellon, as Trustee of the Covered Trusts FILED: NEW YORK COUNTY CLERK 08/09/2017 02:40 PM

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SUPREME COURT OF THE STATE OF NEW YORK COUNTY OF NEW YORK In the matter of the application of THE BANK OF NEW YORK MELLON, in its Index No. 150973/2016 Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed Assigned to: Scarpulla, J. **Securitization Trusts BRIEF OF CERTAIN** Petitioner, **INSTITUTIONAL INVESTORS CONCERNING THE** For Judicial Instructions under CPLR Article 77 REMAINING DISPUTED On the Distribution of a Settlement Payment. **TRUSTS**

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The undersigned investors submit this brief concerning the 17 Remaining Trusts that are the subject of the objections lodged by Tilden Park Capital Management LP ("Tilden Park") and Prosiris Capital Management LP ("Prosiris") (collectively, the "Disputed Trusts"). The undersigned investors hold one or more of the super-senior certificates issued by each of the 17 Disputed Trusts except CWALT 2006-OA7 and submit this brief with respect to each Disputed Trust they hold.

STANDARD OF REVIEW

Article 77 Proceedings are summary in nature. In an Article 77 proceeding, the Court must examine the Trustee's Verified Petition (as well as any other evidence filed), after which it "shall make a summary determination upon the pleadings, papers and admissions to the extent that no triable issues of fact are raised."

SUMMARY OF ARGUMENT

For the Disputed Trusts, the Trustee seeks judicial instruction from this Court as to whether it should distribute the Settlement Payment in a manner that leads to what the Trustee calls "leakage," in which settlement proceeds will be siphoned away from the super-senior certificates to deeply discounted junior certificates like those held by Tilden Park and Prosiris. The Pooling and Servicing Agreements ("PSAs") and Prospectus Supplements (collectively, the "Governing Agreements") require the Trustee to distribute the Settlement Payment in a manner that *avoids* leakage to those junior certificates. That result is not only required by the text of the Governing Agreements, it is also consistent with the basic intent of the subordination and overcollateralization structures and provisions in the Disputed Trusts: to allocate losses from the bottom of the waterfall up, with the senior-most certificates incurring losses only in the event

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¹ N.Y.C.P.L.R. 409.

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that junior certificates are unable to absorb such losses. Distributing the Settlement Payment as Tilden Park and Prosiris propose does violence to those structures, exposing the senior-most certificates to a risk of loss they were never intended to incur. The Governing Agreements therefore cannot be interpreted, consistent with their purpose, in a manner that perversely *flips* the structure of the Trusts by allowing tens of millions of dollars to leak to deeply discounted junior certificates, while dramatically increasing the risk of loss to the senior-most certificates in the months and years following the distribution of the Settlement Payment.

- I. THE GOVERNING AGREEMENTS REQUIRE THE TRUSTEE TO DISTRIBUTE THE SETTLEMENT PAYMENT IN A MANNER THAT AVOIDS LEAKAGE TO JUNIOR CERTIFICATES.
 - A. The Court Should Read the PSAs Together with the Prospectus Supplements, Which Together Form the Contract Among the Parties.

Under New York law, which governs each of the Disputed Trusts, all writings forming part of a single transaction must be read together. *See, e.g., This Is Me, Inc. v. Taylor*, 157 F.3d 139, 143 (2d Cir. 1998); *PETRA CRE 2007-1 CDO, Ltd. v. Morgans Grp. LLC*, 84 A.D.3d 614, 615 (1st Dep't 2011) ("Agreements executed at substantially the same time and related to the same subject matter are regarded as contemporaneous writings and must be read together as one."). A prospectus supplement is one of the "instruments disclosing all material terms and conditions" of a security like those issued by the Disputed Trusts. *In re Trusteeship Created by Am. Home Mortg. Inv. Trust 2005-2*, 14-cv-2494, 2014 WL 3858506, at *20 (S.D.N.Y. July 24, 2014). As such, the prospectus supplement reflects the "reasonable understanding of all potential investors." *Id.* at *21. New York courts have therefore held that agreements like PSAs must be read in conjunction with prospectus supplements to ascertain the actual intent of the parties. *See id.*; *see also Wells Fargo Bank, N.A. v. Fin. Sec. Assur. Inc.*, 504 Fed. App'x 38, 40

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(2d Cir. 2012); *Bank of N.Y. Mellon v. WMC Mortg.*, *LLC*, 12-cv-7096, 2015 WL 4597540, at *8 (S.D.N.Y. July 30, 2015).

This is especially true where the PSAs "explicitly reference[] and incorporate[] the Prospectus." *In re Trusteeship*, 2014 WL 3858506, at *20. The PSAs at issue here did just that. For example, Section 10.01 of the CWALT 2006-OA14 PSA states that the PSA can be amended *without the consent of certificateholders* "to conform [the PSA] to the Prospectus and Prospectus Supplement provided to investors in connection with the initial offering of the Certificates." It is thus both appropriate and necessary for the Court to consider the Prospectus Supplements for the Disputed Trusts to ascertain the agreement among, and reasonable expectations of, the parties. The PSAs, together with the Prospectus Supplements, are therefore referred to below as the "Governing Agreements."

B. The Text and Intent of the Governing Agreements Require That the Settlement Payment Be Distributed in a Manner That Avoids Leakage.

The Governing Agreements should be interpreted in a manner that is consistent with the intent of the parties. *See, e.g., Novak & Co., Inc. v. N.Y. Convention Center Dev. Corp.*, 202 A.D.2d 205, 206 (1st Dep't 1994) ("in a matter where parties seek enforcement of a contract, the court has the responsibility of effectuating the true intent of the parties" (quoting *Furgang v. Epstein*, 106 A.D.2d 609 (2d Dep't 1984))). The Governing Agreements cannot be read in a manner that "would defeat and contravene the purpose of the agreement[s]." *Reape v. N.Y. News, Inc.*, 122 A.D.2d 29, 30 (2d Dep't 1986). "Single clauses cannot be construed by taking them out of their context and giving them an interpretation apart from the contract of which they

² The PSA for CWALT 2006-OA14 is attached as Exhibit B to the Affidavit of David M. Sheeren, filed herewith (the "Sheeren Aff.").

³ A compilation of the key provisions of the Prospectus Supplements is included as Exhibit A to the Sheeren Affidavit. The full Prospectus Supplements and Pooling and Servicing Agreements for the Disputed Trusts, which are voluminous, are being delivered to the Court on a portable storage device.

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are a part." Richard Feiner & Co. v. Paramount Pictures Corp., 95 A.D.3d 232, 239 (1st Dep't 2012) (internal quotations omitted). "The ultimate aim" of these interpretive rules, of course, "is to realize the parties' reasonable expectations through a practical interpretation of the contract language." Gessin Elec. Contractors, Inc. v. 95 Wall Assocs., LLC, 74 A.D.3d 516, 518 (1st Dep't 2010); see also Frye v. Brown, 189 A.D.2d 1031, 1033 (3d Dep't 1993) ("Undoubtedly, the ultimate goal in contract interpretation is realization and effectuation of the parties' intent.").

Overcollateralization Exists to Protect Senior Certificates from 1. Losses.

The basic purpose of overcollateralization is to insulate the senior certificates from the risk of loss. In the Trustee's words,

An OC Trust is designed to create credit enhancement, or protection, for more senior Certificateholders through a concept called overcollateralization. An OC Trust is overcollateralized when the principal balance of the underlying mortgage loans (the trust's assets) exceeds the Certificates Principal Balances of the Certificates issued by the OC Trust (the trust's liabilities). In a given month, principal distributions to Certificates below specified seniority levels (generally, "junior" or "subordinated" Certificates) are not permitted unless the trust as a whole has sufficient "overcollateralization"—that is, unless the balance of the underlying mortgage loans (the trust's assets) exceeds the Certificate Principal Balances (the trust's liabilities) by an amount specified in the Governing Agreements. If the overcollateralization falls short of the required "Overcollateralization Target Amount"—hereinafter referred to as the OC Target—then principal distributions cannot flow to "junior" or "subordinated" holders.

The Prospectus Supplements describe how Verified Pet. ¶ 23 (emphasis added). overcollateralization protects the senior-most certificates as follows:

On any distribution date, the amount of overcollateralization (if any) will be available to absorb the losses from liquidated mortgage loans if those losses are not otherwise covered by excess cashflow (if any) from the mortgage loans. The required level of overcollateralization may change over time.

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Prospectus Supp. for CWALT 2006-OA10, S-19 (emphasis added).⁴

Subordination Exists to Protect Senior Certificates from Suffering 2. Losses.

Even if the overcollateralization of a Trust is depleted, the senior-most certificates benefit from a second level of protection through subordination, a related type of "credit enhancement" described in the Prospectus Supplements. As set out in the Prospectus Supplements, subordination protects the senior-most certificates through the issuance of junior certificates, which are designed to absorb losses so they are not suffered by the senior-most certificates. In the Trustee's words, "[t]his senior-subordinate structure means that, as a general matter, subordinated Certificates are riskier than senior Certificates " Verified Pet. ¶ 28. This basic tradeoff of risk and return can be seen throughout the Governing Agreements, including in the Prospectus Supplements, which describe the purpose of subordination as follows:

The issuance of senior certificates and subordinated certificates by the issuing entity is designed to increase the likelihood that senior certificateholders will receive regular distributions of interest and principal.

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Subordination is designed to provide the holders of certificates having a higher distribution priority with protection against losses realized when the remaining unpaid principal balance of a mortgage loan exceeds the proceeds recovered upon the liquidation of that mortgage loan. In general, this loss protection is accomplished by allocating the realized losses on the mortgage loans first, among the subordinated certificates, beginning with the subordinated certificates with the lowest distribution priority, and second to the senior certificates in accordance with the priorities set forth above under "- Allocation of Losses."

Prospectus Supp. for CWALT 2006-OA10, S-19 (emphasis added).⁵

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Similar provisions appear in each of the Prospectus Supplements for the Disputed Trusts and are set out in Exhibit A to the Sheeren Affidavit.

⁵ *Id*.

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Consistent with the basic purpose of subordination, the Prospectus Supplements confirm that once the Trusts' overcollateralization is depleted, realized losses must be allocated *first* to the most junior class of certificates then outstanding, until its certificate balance is written down to zero, at which point realized losses are then allocated to the *next* most junior class of certificates, and so on, as follows:

After the credit enhancement provided by excess cashflow and overcollateralization (if any) has been exhausted, collections otherwise payable to the subordinated classes will comprise the sole source of funds from which credit enhancement is provided to the senior certificates. Realized losses will be allocated in the following order of priority:

- to the subordinated certificates, beginning with the class of subordinated certificates with the lowest distribution priority, until the class certificate balance of that subordinated class has been reduced to zero, and
- concurrently, to the senior certificates (other than the notional amount certificates), pro rata, based on the aggregate class certificate balances of the group 1 senior certificates, the group 2 senior certificates, the group 3 senior certificates and the group 4 senior certificates as follows: (a) with respect to the group 1 senior certificates, sequentially, to the Class 1-A-3, Class 1-A-2 and Class 1-A-1 Certificates, in that order, until their respective class certificate balances are reduced to zero;

Id. at S-18 (emphasis added).⁶ As this language shows, holders of the Class 1A1 Certificates—the super-senior certificates—are only supposed to suffer realized losses *after* realized losses have entirely depleted the more junior certificates, including the Class 1A2 Certificates like those held by Tilden Park and Prosiris. *Id.*

In plain terms, overcollateralization and subordination together form an asset cushion that provides protection to the senior-most certificates against the risk of loss. The first level of protection for the senior-most certificates is overcollateralization. Once the Trusts' overcollateralization is depleted, however, the Trusts' subordination structure continues to

⁶ *Id*.

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protect the senior-most certificates from suffering losses. The junior certificates bear a greater risk of loss and are compensated for that greater risk with a higher coupon rate than the rate paid to the safer, senior-most certificates. This basic structure is set out plainly in the Governing Agreements and is one to which all Certificateholders bound themselves when they purchased their certificates.

3. Tilden Park's Misinterpretation of a Single, Isolated Provision of the Governing Agreements Ignores Other Provisions of the Governing Agreements and Their Essential Purpose and Would Lead to Absurd Results.

Properly interpreted, the Governing Agreements require that the Settlement Payment be distributed in a manner that effectuates their essential purpose by protecting the senior-most certificates from the risk of loss. Because allowing part of the Settlement Payment to leak to junior certificates would perversely *increase* the risk of loss to the senior-most certificates, the Settlement Payment should be distributed in a way that prevents leakage. In arguing for leakage to their junior certificates, Tilden Park and Prosiris violate several basic rules of contract construction by misinterpreting a single, isolated provision of the Governing Agreements and ignoring contrary provisions of the Governing Agreements and the essential purpose of the Trusts' overcollateralization and subordination structures.

The Settlement Agreement requires the Trustee to distribute the Settlement Payment "as though it was a Subsequent Recovery available for distribution on that distribution date." Settlement Agr. § 3(d)(i). In each of the Disputed Trusts, Subsequent Recoveries are included in the "Principal Remittance Amount." As the Trustee has explained, Subsequent Recoveries have historically been "modest" and are "typically limited to funds such as proceeds of the sale of real estate owned properties and adjustments to payments on private mortgage insurance claims."

⁷ See PSA for CWALT 2006-OA14 § 1.01 (Definitions) (attached as Ex. B to the Sheeren Aff.).

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Verified Pet. ¶ 15. Therefore, Subsequent Recoveries have historically been included <u>in full</u> in the "Principal Distribution Amount," which is generally distributed to senior certificates based on their respective certificate balances.⁸ Indeed, with respect to the 512 Trusts that have already received their share of the \$8.5 billion Settlement Payment, 100% of each Trust's Allocable Share was treated as a Subsequent Recovery and distributed as part of the Principal Distribution Amount to the senior certificates based on their respective certificate balances.

Tilden Park argues, however, that with respect to the 17 Disputed Trusts, only *part* of the Allocable Shares can be included in the "Principal Distribution Amount" because, by its definition, the Principal Distribution Amount is "cap[ped]" by the sum of (i) regular monthly principal payments received from borrowers; (ii) regular monthly proceeds from the liquidation of mortgage loans; and (iii) the Overcollateralization Target Amount (which is defined as a fixed, dollar amount). Based on this single, isolated provision of the Governing Agreements, Tilden Park and Prosiris argue that only the portion of the Allocable Share *up to* the Overcollateralization Target Amount can be paid as part of the Principal Distribution Amount.

Tilden Park and Prosiris then argue that the portion of the Allocable Share that *exceeds* the Overcollateralization Target Amount must be distributed pursuant to a later provision of the PSAs that reimburses certificates for their past realized losses.¹⁰ As their argument goes, because the vast majority of past realized losses have been suffered by deeply discounted (and often entirely written off) *junior* certificates like those held by Tilden Park and Prosiris, the

⁸ See, e.g., id. § 1.01 (definition of "Principal Distribution Amount") & § 4.02(a)(5)(A)(1) (distribution method for "Principal Distribution Amount").

⁹ See Tilden Park's Mem. of Law in Support of Respondent's Verified Answer to the Verified Pet. (Docket No. 32) at 9-10, 14-15.

¹⁰ *Id.* An example of this provision for the reimbursement of losses is Section 4.02(a)(6)-(7) of the PSA for CWALT 2006-OA14 (attached as Ex. B to the Sheeren Aff.).

junior certificates should receive most (and sometimes all) of the amount by which the Allocable Share exceeds the Overcollateralization Target Amount.¹¹

In the Trustee's own words, however, diverting the bulk of the Settlement Payment "to less senior, subordinated Certificateholders at the expense of more senior Certificateholders could be viewed as *contrary to an essential purpose of the overcollateralization structure—protecting more senior Certificateholders from risk of loss.*" Verified Pet. ¶ 28 (emphasis added). New York courts do not endorse a reading of contract language if it "would defeat and contravene the purpose of the agreement." *Reape*, 122 A.D.2d at 30; *see also Frye*, 189 A.D.2d at 1033 ("Undoubtedly, the ultimate goal in contract interpretation is realization and effectuation of the parties' intent."). But that is just the sort of reading that Tilden Park and Prosiris invite the Court to embrace. The Court should reject the invitation.

In advocating for the bulk of the Allocable Shares to be paid to their deeply discounted junior certificates, Tilden Park and Prosiris have taken a single clause out of the context of the overall contract and given it an interpretation at odds with the contract of which it is a part, violating one of the basic rules of contract interpretation under New York law. *See, e.g., Richard Feiner & Co.*, 95 A.D.3d at 239. Tilden Park and Prosiris's interpretation that the "Principal Distribution Amount" should be capped at the Overcollateralization Target Amount cannot be reconciled with either the text of the Governing Agreements as a whole or the basic purpose of the Trusts' subordination and overcollateralization structures: to insulate the senior-most certificates from the risk of loss.

¹¹ See Tilden Park's Mem. of Law in Support of Respondent's Verified Answer to the Verified Pet. (Docket No. 32) at 9-10, 14-15.

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Tilden Park and Prosiris's reading is particularly problematic because, once the Allocable Shares are diverted to the junior certificates, they will never return to the Trusts through the creation of increased overcollateralization or subordination. ¹² As a result, when underlying mortgages default and lead to realized losses in the future, the senior-most certificates will be far more likely to bear those realized losses under Tilden Park and Prosiris's (mis)reading of the Governing Agreements. In this way, their reading would eviscerate the Trusts' subordination and overcollateralization structures and force the senior-most certificates to bear losses before they are borne by junior certificates. This result is plainly "in tension with the descriptions" in the Prospectus Supplements and fails to "give independent force and effect to each provision of the . . . critical documents responsible for placing the loans into the RMBS trust." Bank of N.Y. Mellon, 2015 WL 4597540, at *8 (adopting a "more holistic reading" of a PSA to account for the language in the prospectus).

In any event, under Tilden Park and Prosiris's reading, the only reason their junior certificates would receive a windfall is that the Allocable Shares exceed the Overcollateralization Target Amounts for their Trusts because of the "unprecedented amount of Subsequent Recoveries" flowing into the Trusts. Verified Pet. ¶ 26. Like many of the OC Trusts, however, any overcollateralization in the Disputed Trusts has already been depleted, and as the Trustee indicated in the Petition, "it is likely that the OC Trusts will never meet their OC Target again."

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¹² In many instances, the distribution of the Settlement Payment according to Tilden Park and Prosiris's preferred method would cause the Trusts to become undercollateralized as a result of the Settlement Payment. Under Tilden Park and Prosiris's preferred distribution method, whenever the portion of the Allocable Share to be distributed to the junior certificates as reimbursement of losses exceeds those certificates' outstanding principal balances—as is often the case, given that many of the junior certificates have already been written down to zero or are deeply discounted—the post-distribution "write-up" mandated by Section 3(d)(ii) of the Settlement Agreement will cause the trusts' outstanding certificate balances to exceed the Trusts' outstanding collateral balances, leading to the creation of undercollateralization as a result of the Settlement Payment. That outcome makes no sense under the contracts and would leave the Trusts structurally unsound.

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As the Trustee further explained in the Verified Petition, any purported overcollateralization created by the Settlement Payment itself is "illusory," "temporar[y]," and "artificial[]." Id. ¶ 26, 29. Even under Tilden Park and Prosiris's reading of the contracts, the Settlement Payment itself cannot create real overcollateralization—such that the Trusts' outstanding collateral balances exceed the Trusts' outstanding certificate balances. Despite this, their entire argument hinges on the "illusory," "temporar[y]," and "artificial[]" achievement of the Overcollateralization Target Amount during the distribution of the Allocable Shares—simply because the Subsequent Recoveries are large. There is no "reasonable" or "practical" rationale, see Gessin Elec. Contractors, Inc., 74 A.D.3d at 518, for diverting the bulk of the Settlement Payment to deeply discounted junior certificates based on the *illusion* that the Disputed Trusts' Overcollateralization Target Amounts are met. Therefore, the Court should not permit it.

The absurd and commercially unreasonable results of Tilden Park and Prosiris's interpretation can be shown in an example for one of the Disputed Trusts: CWALT 2006-OA14. The Allocable Share for that Trust is \$38,887,771.¹³ The Overcollateralization Target Amount for that Trust is equal to the "OC Floor," which is now fixed at \$4,771,950.14 The outstanding certificate balances and realized losses below are drawn from the Trust's most recent remittance report¹⁵:

¹³ The Allocable Shares for each Trust and Loan Group are available on the Trustee's settlement website (http://cwrmbssettlement.com/notice.php). As shown there, the Settlement Payment is split among each of the three groups in this Trust as follows: Group 1 (\$13,864,960); Group 2 (\$12,744,897); and Group 3 (\$12,277,914).

The OC Floor is calculated as 0.5% of the Trust's Cut-off Date Pool Principal Balance of \$954,390,021.53.

¹⁵ See Ex. C to the Sheeren Aff. Certificates not at issue here are not shown in the table.

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Class	Certificate Balance	Cumulative Realized Losses	Held by Tilden Park or Prosiris?	
1A1	\$74,489,454	\$1,005,245		
1A2	\$0	\$47,683,715	Yes	
1A3	\$0	\$17,968,331		
2A1	\$54,630,919	\$701,107		
2A2	\$0	\$40,545,147	Yes	
2A3	\$0	\$16,586,201		
3A1	\$67,048,052	\$30,589,865		
3A2	\$0	\$34,212,851		

As the above table shows, the senior-most certificates (1A1, 2A1, 3A1) have already begun suffering realized losses, and the junior certificates held by Tilden Park and Prosiris (1A2, 2A2) have already been completely written off (i.e., they now have a certificate balance of zero dollars), and they have suffered realized losses of over \$47 million and \$40 million, respectively. Under Tilden Park and Prosiris's reading of the Governing Agreements, the Principal Distribution Amount would be "capped" by the Overcollateralization Target Amount of \$4,771,950, which would leave \$34,115,821 to distribute under the later provision of the PSA that generally reimburses certificates for past realized losses 16:

Total Allocable Share for CWALT 2006-OA14	\$38,887,771
Less Overcollateralization Target Amount Paid to Senior-Most Certificates	(\$4,771,950)
Remaining Allocable Share to Be Distributed As Reimbursement of Losses	\$34,115,821

Next, under Tilden Park and Prosiris's (mis)interpretation, the senior-most certificates would be reimbursed for their past realized losses, but because the 1A1 and 2A1 Certificates have only recently begun suffering realized losses, those amounts would not be significant for

¹⁶ See supra notes 7-10 for examples of these provisions.

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the 1A1 and 2A1 Certificates.¹⁷ In total, Intex's modeling shows that under Tilden Park and Prosiris's reading of the Governing Agreements—reflected in Intex's "After Distribution" Method—approximately \$19 million of the total \$38.9 million settlement payment would "leak" to the junior certificates held by Tilden Park and Prosiris and would never return to the Trusts in the form of increased overcollateralization or subordination for the benefit of the senior-most certificates.¹⁸ This outcome cannot be reconciled with the text or intent of the Governing Agreements. It serves no rational economic purpose and provides the junior certificates a massive windfall for which they did not bargain, and therefore could not and should not have expected, given the requirements of the contracts and the central purpose of the subordination and overcollateralization provisions they contain.

Furthermore, because Tilden Park and Prosiris's interpretation would divert the bulk of the Allocable Shares to deeply discounted junior certificates, and would not build an asset cushion in the form of subordination or overcollateralization, the senior-most certificates' risk of loss would perversely *increase* in the future. For example, Intex's modeling shows that under the "After Distribution" Method preferred by Tilden Park and Prosiris, the super-senior 1A1 certificate would suffer realized losses almost six years earlier than it would under Intex's "Standard" Method, and the 2A1 certificate would suffer realized losses over eight years earlier than it would under Intex's "Standard" Method, assuming the Allocable Share was paid in September 2016¹⁹:

¹⁷ The reimbursement of losses for the 3A1 certificate, however, would be significant, but Tilden Park and Prosiris do not hold that certificate or the 3A2 certificate which is more junior to it.

¹⁸ See Sheeren Aff. ¶ 5.

¹⁹ See id. ¶ 6.

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G	Date on Which Super Sesume Suffering	Acceleration of Realized	
Super Senior Certificate	Tilden Park / Prosiris Distribution Method (i.e., Intex's "After Distribution" Method)	Intex's "Standard" Method	Losses Suffered by Senior- Most Certificates Under Tilden Park / Prosiris Distribution Method
1A1	December 2016	August 2022	5 years, 8 months
2A1	September 2017	November 2025	8 years, 2 months

Permitting \$19 million of the Allocable Share to "leak" out to entirely written off junior certificates just months before the senior-most certificates would begin incurring significant realized losses is an absurd, commercially unreasonable result. It turns the overcollateralization and subordination structures in this Trust upside down by allocating the risk of losses to the senior-most certificates instead of to the junior certificates.

Finally, another hypothetical demonstrates the absurdity of Tilden Park and Prosiris's argument: If the Allocable Share of \$38,887,771 for CWALT 2006-OA14 was distributed in eight monthly installments equal to the OC Target of \$4,771,950 and a ninth installment of \$712,171, then even under Tilden Park and Prosiris's reading of the Governing Agreements, the senior-most certificates would receive 100% of the Allocable Share because the OC Target—the alleged "cap" on the Principal Distribution Amount—would never be exceeded in any given month. It makes no sense under the Governing Agreements for the senior-most certificates to be made substantially worse off if the Allocable Share was paid sooner rather than later, but that perverse result is required under Tilden Park and Prosiris's reading of the contract.

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II. INDUSTRY PARTICIPANTS UNDERSTOOD AND EXPECTED THAT THE SETTLEMENT PAYMENT WOULD BE DISTRIBUTED IN A MANNER THAT AVOIDS LEAKAGE TO JUNIOR CERTIFICATES.

Because Tilden Park and Prosiris's interpretation of the Governing Agreements is so contrary to their meaning and intent, industry participants have long expected that the Settlement Payment would be made to the senior-most certificates in a manner that avoids leakage to junior certificates. These market expectations have manifested in several ways.

A. Intex's "Standard Method" Does Not Provide for Leakage to Junior Certificates Like Those Held by Tilden Park and Prosiris.

First, as the Trustee itself noted in the Verified Petition, Intex, "a leading provider of cash flow models that are used and relied upon by investors throughout the structure fixed income industry," has modeled the distribution of the Settlement Payment in the Disputed Trusts.²⁰ Intex's "Standard" Method, which serves as the *default* distribution method for each of the Disputed Trusts, *see* Aff. of Intex Solutions, Inc. ¶ 5, App. A.,²¹ does not provide for leakage of the Settlement Payment to junior certificates like those held by Tilden Park and Prosiris.

Intex has testified that it began modeling how the Settlement Payment would flow under Tilden Park and Prosiris's preferred method only at the request of certain unnamed investors. *See id.* ¶ 6. The earliest date on which Intex appears to have added a so-called "toggle" to allow investors to see the impact of distributing the Allocable Shares under Tilden Park's theory was September 5, 2014 for CWALT 2007-OA3—over *three years after* the Settlement Agreement was posted on the Trustee's website in July 2011 and approximately *10 months after* the first Article 77 trial ended in November 2013. *Id.* Both Tilden Park and Prosiris hold the 1A2 and

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²⁰ Verified Pet. ¶ 42.

²¹ See Exhibit E to the Sheeren Aff.

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to Junior Certificates.

requested that Intex add the "toggle."

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2A2 junior certificates in that Trust. Intex has not disclosed the identity of the investors who

В. The Settlement Agreement Itself and Trial Testimony in the Prior Article 77 Proceeding Confirm That the Settlement Payment Was Not Intended to Leak

Finally, both the Settlement Agreement itself and trial testimony in the first Article 77 confirm that it was never intended that significant amounts of the Settlement Payment would be diverted to deeply discounted junior certificates like those held by Tilden Park and Prosiris, to the detriment of the senior-most certificates.

By requiring a "write up" of certificate balances in Section 3(d)(ii) of the Settlement Agreement in an amount that would completely *offset* the amount by which the Allocable Shares would otherwise "pay down" the certificate balances under Section 3(d)(i), the Settlement Agreement makes clear that the Settlement Payment was not intended to alter the level of collateralization in the Trusts:

(ii) In addition, after the distribution of the Allocable Share to Investors pursuant to Subparagraph 3(d)(i), the Trustee will allocate the amount of the Allocable Share for that Covered Trust in the reverse order of previously allocated Realized Losses, to increase the Class Certificate Balance, Component Balance, Component Principal Balance, or Note Principal Balance, as applicable, of each class of Certificates or Notes (or Components thereof) (other than any class of REMIC residual interests) to which Realized Losses have been previously allocated, but in each case by not more than the amount of Realized Losses previously allocated to that class of Certificates or Notes (or Components thereof) pursuant to the Governing Agreements For the avoidance of doubt, this Subparagraph 3(d)(ii) is intended only to increase Class Certificate Balances . . . as provided for herein, and shall not affect the distribution of the Settlement Payment provided for in Subparagraph 3(d)(i).

(Emphasis added.) However, under Tilden Park and Prosiris's interpretation, the entirely written off junior certificates they hold would both (i) receive the bulk of the Settlement Payment as reimbursement of their past realized losses and (ii) receive a "write up" in the full amount of the

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Settlement Payment they receive.²² In that case, however, the "write up" of their certificate balances under Section 3(d)(ii) would necessarily *exceed* the amount by which their certificate balances are "paid down" under Section 3(d)(i) – because it is impossible to "pay down" a certificate balance *below* zero. As a result, under Tilden Park and Prosiris's (mis)interpretation, the Settlement Payment would cause the Trusts' outstanding certificate balances to exceed the Trusts' outstanding collateral balances, which is the very definition of *under* collateralization. That outcome cannot be reconciled with the plain intent of the Settlement Agreement not to alter the level of collateralization in the Trusts.

Testimony in the original Article 77 proceeding also confirms that it was never intended that the Settlement Payment would be distributed to holders of deeply discounted junior certificates; to the contrary, the testimony confirms that the intention was that the Settlement Payment would be distributed consistently with the text and intent of the Trusts' overcollateralization and subordination structures, so that the senior-most certificates would be insulated from the risk of loss and the existing overcollateralization of the Trusts (whatever it was) would be unaltered by the settlement. As Jason Kravitt, the lead negotiator for BNY Mellon, testified on cross-examination:

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. The way the cash is distributed would restore the face amount of some of this—or the face amount or the partial portion of the face amount of any lower seniority tranche, it might get some interest in a future period it might not otherwise get. **But the recovery goes**

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The same logic applies not only to entirely written off junior certificates, but also to deeply discounted junior certificates like the ones Tilden Park and Prosiris hold. *See supra* note 12.

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first in line to the senior holders and then the next level and so on down to the bottom.²³

The testimony continued as follows:

Q: You are aware of the waterfall that is being proposed?

A: The waterfall is the distribution that is set out within the trust documents themselves. All we did is characterize how the payments would be—is characterize the payments within the various defined terms in the agreement and then the agreement tells you how to use those, and we also set in some rules to make sure that subordinate tranches didn't get money before senior tranches.

Q: That is my next point. You are aware that in all likelihood many tranches of investors, certificate holders in the lower tranches, will get nothing?

A: Correct. Well, I wouldn't say "likelihood." I'm aware of the reasonable possibility that that will happen.²⁴

This testimony only further confirms that the settlement distribution method advocated by Tilden Park and Prosiris is not only inconsistent with the text and intent of the Governing Agreements and the purpose of the overcollateralization and subordination structures, it is also inconsistent with the intent of the Settlement Agreement. The Court should reject it.

CONCLUSION

For the reasons set forth above, the undersigned investors respectfully request that the Court direct the Trustee to distribute the Allocable Shares to the Disputed Trusts by employing Intex's "Standard" Method, whereby the Trustee should calculate the Principal Distribution Amount in the Disputed Trusts based upon the "written-up" certificate principal balances, but

²³ See Trial Transcript for July 12, 2013 at 1878:2-16, attached as Ex. D to Sheeren Aff. (emphasis added).

²⁴ *Id.* at 1879:5-18 (emphasis added).

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distribute each Trust's Allocable Share among particular tranches based upon the pre-distribution certificate principal balances.²⁵

Dated: New York, New York

August 12, 2016

WARNER PARTNERS, P.C.

By: /s/ Kenneth E. Warner

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²⁵ The undersigned investors also join in the Trustee's and AIG's arguments opposing the creation of an artificial "Record Date" for the distribution as of February 2016.

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SUPREME COURT OF THE STATE OF NEW YORK

In the Matter of the Application of Index No. 150973/2016

IAS Part 39 THE BANK OF NEW YORK MELLON, in its Justice Scarpulla

Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed

Securitization Trusts,

COUNTY OF NEW YORK

AMERICAN Petitioner, INTERNATIONAL GROUP,

Mot. Seq. 001

INC.'S MEMORANDUM OF For Judicial Instructions under CPLR Article 77 LAW ON ALLOCATION OF

on the Distribution of a Settlement Payment. THE SETTLEMENT

PAYMENT

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I. PRELIMINARY STATEMENT

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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"). Both the June 28, 2011 Settlement Agreement, 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.

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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, "

(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

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(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." 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 \P 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.

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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." Likewise, RMBS expert James K. Finkel has concluded, "[T]he Standard Intex Method is the most commerciallyreasonable 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.

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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**

Α. **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.

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В. **Structure Of Disputed Trusts**

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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. 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.").

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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.

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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). 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 writtendown). 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 &}quot;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 \P 3(c)(i) (Ex. A).

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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*.

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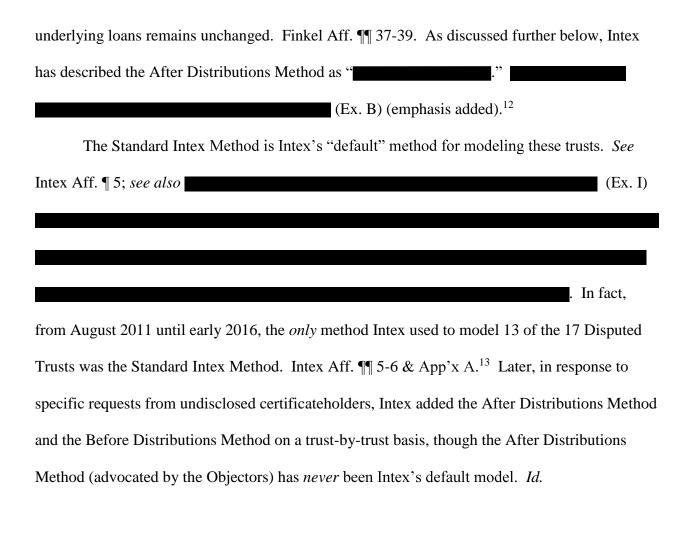
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By contrast, under Intex's default "Standard" method for the 17 Disputed Trusts, the Settlement Payment would flow primarily or entirely to the super-senior tranches (as intended). Again using the example of Loan Group 4 of the CWALT 2006-OA10 trust, 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

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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.

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III. **ARGUMENT**

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- 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

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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

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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, (Ex. K). By contrast, (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

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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).

> The Undisputed Intent Of The Settlement Agreement Was To Distribute 2. 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

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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.

- Market Participants Share The Trustee's Understanding That Super-Senior 3. Bonds Should Receive All Or Most Of The Settlement Payment.
 - Course Of Dealings Is Relevant To Interpreting The Settlement (a) 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

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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 $\P \, 2.^{14} \,$ 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.*

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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

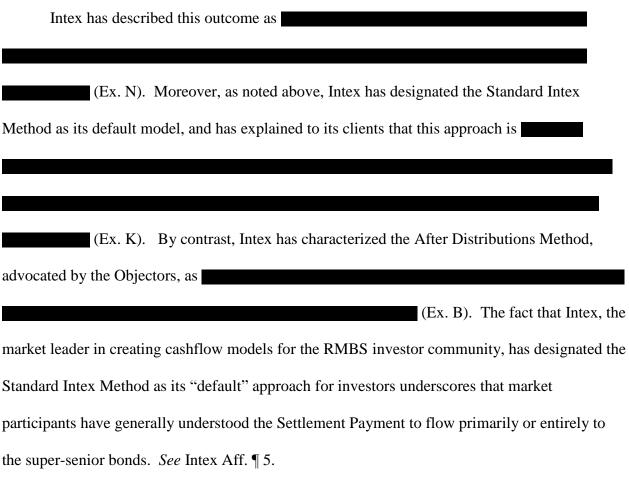
(Ex. N)

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.

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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.



The Objectors' Preferred Distribution Method Would Result In An Unjust 4. 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

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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.

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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).

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 supersenior certificateholders in the above tranches, as compared to using the After Distributions Method. Finkel Aff. ¶¶ 32-36.

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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.

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В. 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).

The Allocable Shares Should Be Allocated Among Certificates In The AIG C. 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

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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

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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 predistribution Class Certificate Balances (with the Principal Distribution Amount calculated per the prior sentence).

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Dated: New York, New York August 12, 2016

QUINN EMANUEL URQUHART & SULLIVAN, LLP

By: /s/ Jordan A. Goldstein

Michael B. Carlinsky
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SUPREME COURT OF THE STATE OF NEW YORK NEW YORK COUNTY

In the Matter of the Application of

THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed Securitization Trusts,

Petitioner,

For Judicial Instructions under CPLR Article 77 on the Distribution of a Settlement Payment.

Index No. 150973/2016

IAS Part 39

Hon. Saliann Scarpulla

SUPPLEMENTAL BRIEF OF TILDEN PARK CAPITAL MANAGEMENT LP AND PROSIRIS CAPITAL MANAGEMENT LP

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August 26, 2016

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INTRODUCTION

A group of institutional investors – AEGON, AIG and Blackrock – ask this Court to re-

write the terms of heavily negotiated commercial contracts because they do not like what they

say. The 17 trusts at issue expressly compensate certificateholders with realized losses upon

receipt of a "Subsequent Recovery," as opposed to paying more senior certificateholders without

realized losses. This structure is common in structured finance and was employed here through

the efforts of several leading structured finance underwriters advised by top deal lawyers. It

encourages investors to buy AAA-rated Senior Support Certificates – near the top of the debt

structure – that, as it turns out here, experienced losses. These institutional investors are attempt-

ing to deny the rights of the Senior Support Certificates set forth in the contracts.

The institutional investors stood silent while the Settlement Agreement was negotiated

and through the extensive Article 77 proceeding that adjudicated its fairness. AEGON and

Blackrock now seek to override the contracts' express language, contending that the trusts should

not have been structured the way they were. AIG, in turn, looks to a third party software provid-

er to support rewriting the contracts. Granting the institutional investors' request would give

them a windfall and would harm the contractual certainty that is essential to the structured

finance market. The Court should enforce the contracts as written.

First, res judicata bars their claim. The method of payment was already decided in the

prior Article 77 proceeding.

Second, the institutional investors are estopped from challenging the Settlement's pay-

ment terms because they earlier argued that the prior proceeding had res judicata effect.

Third, the plain text of the contracts is unambiguous, and the institutional investors can-

not show and have not shown the contracts are "absurd" or should be rewritten.

Fourth, the loss compensation structure, far from being "structurally unsound," is com-

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mercially reasonable and consistent with the essential purposes of *these* contracts. In the words of industry expert James H. Aronoff: "In my experience, a payment priority that limits certain cash flow distributions to senior bonds, as is the case in the trusts at issue, is not at all unusual or unique. Such a waterfall, which distributes excess funds in any given month to the senior-most junior bonds with realized losses, may make those junior bonds more attractive investments." ¹

Fifth, the parol evidence – which is inadmissible because the contracts are unambiguous
refutes, rather than supports, the institutional investors' arguments.

In addition, another investor, Center Court LLC ("Center Court"), makes a textual argument that is barred by *res judicata*, opposed by the other senior investors, and wrong.

This Court should instruct the Trustee to implement the Settlement Agreement and the PSAs for these trusts as written. And, because the institutional investors delayed this proceeding to divert payments to themselves, the Court should make payments as of February 25, 2016.

BACKGROUND

I. THE POOLING AND SERVICING AGREEMENTS

Respondents Prosiris Capital Management LP ("Prosiris") and Tilden Park Capital Management LP ("Tilden Park") hold certificates in 14 trusts in this case.² Those trusts were underwritten between 2005 and 2007 by multiple global financial institutions advised by sophisticated Wall Street deal lawyers.³ Prosiris and Tilden Park's bonds were defined (with one exception) as

¹ Aronoff Aff. ¶ 9.

² The trusts are: CWALT 2005-61; CWALT 2005-69; CWALT 2005-72; CWALT 2005-76; CWALT 2005-IM1; CWALT 2006-OA3; CWALT 2006-OA7; CWALT 2006-OA8; CWALT 2006-OA10; CWALT 2006-OA14; CWALT 2007-OA3; CWALT 2007-0A8; CWMBS 2006-3; and CWMBS 2006-OA5. Dkt. #31 (answer) at 4-5.

³ See, e.g., Ellis Decl. Ex. A (CWALT 2005-61 Prospectus Supplement) at S-91 (UBS, Sidley Austin Brown & Wood, LLP, and McKee Nelson LLP); *id.* Ex. B (CWALT 2007-OA3 Prospectus Supplement) at S-111 (Banc of America); *id.* Ex. L (CWALT 2005-76 Prospectus Supplement) at 16 (Deutsche Bank); *id.* Ex. D (CWALT 2005-IM1 Prospectus Supplement) at S-92 (Thacher Proffitt & Wood LLP and Sidley Austin).

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"Senior Support Certificates" and originally rated AAA. As their name suggests, the "Senior Support Certificates" are far from junk bonds – for most trusts, they are the second-most-senior of all tranches and are the senior-most tranches that have suffered losses.⁵

Each of the Trusts has the same basic payment procedure (or "waterfall") – negotiated by bankers and lawyers, set forth in the contracts, and structured similar to other deals – that uses Subsequent Recoveries to compensate *investors with losses*. Subsequent Recoveries are paid as "Available Funds." The waterfall sets out a specific order for distributing "Available Funds:" They go first to pay interest; then to pay principal "up to" a defined "Principal Distribution Amount;" then any excess after principal is paid goes to *certificates that have incurred losses*. After paying down certificates, the Trustee "writes up" principal balances.⁸

The definition of "Principal Distribution Amount" expressly limits payments to the "Senior Certificates" held by AIG, AEGON, and Blackrock. If a Subsequent Recovery makes Available Funds exceed the Principal Distribution Amount, the excess goes to the most senior bonds with losses - here, the "Senior Support Certificates" held by Prosiris and Tilden Park.9 Importantly, the "Principal Distribution Amount" is based on balances "immediately prior" to

⁴ Dkt. #31 (answer) ¶¶ 14-15. The exception is CWALT 2005-61, which is defined as a "Mezzanine Certificate" and originally rated AA+, one notch below AAA. See id. ¶ 14 n.1; Ellis Decl. Ex. A (CWALT 2005-61 Prospectus Supplement) at S-2.

⁵ See Ellis Decl. Ex. J (CWALT 2005-69 PSA) at 8 (priority of A-2 bonds); id. Ex. M (CWALT 2005-IM1 PSA) at 9 (A-2 bonds); id. Ex. N (CWALT 2006-OA3 PSA) at 6 (1-A-2 bonds); id. Ex. P (CWALT 2006-OA8 PSA) at 6 (1-A-2 bonds); id. Ex. R (CWALT 2006-OA14 PSA) at 6 (1-A-2 bonds); id. Ex. S (CWALT 2007-OA3 PSA) at 6-7 (1-A-2 bonds); id. Ex. T (CWALT 2007-OA8 PSA) at 8 (1-A-2 bonds); id. Ex. U (CWMBS 2006-OA5 PSA) at 11-12 (1-A-2 bonds); see, e.g., CWALT 2005-61 PSA § 4.02(a)(3)(B)(i) (Class 1-A-2 bonds receive principal pro rata with Class 1-A-1 bonds); Dkt. #31 (Prosiris / Tilden Park answer) at 4-5 (listing holdings); Smith Aff. ¶ 25.

⁶ See, e.g., Ellis Decl. Ex. E (CWALT 2005-61 PSA) art. I at 16 (defining "Available Funds" to "includ[e] any Subsequent Recoveries").

See, e.g., id. § 4.02(a).

⁸ See, e.g., id. § 4.02(j).

⁹ Smith Aff. ¶ 25. Notably, if a "Senior Certificate" has incurred losses, that certificate gets its losses compensated before the "Senior Support Certificates." See, e.g., Ellis Decl. Ex. E (CWALT 2005-61 PSA) at § 4.02(a)(4) (listing the order of priorities in which losses are compensated).

the Distribution Date, and thus excludes write-ups occurring on the Distribution Date. 10

The structure of these 14 heavily-negotiated trusts is not – as the institutional investors paint it – an aberration. So-called "leakage" is, in fact, intentional loss compensation. As explained in the affidavits of two leading structured-finance experts, other trusts have a similar waterfall in which less senior holders *with* losses are compensated before more senior holders *without* losses. Underwriters design deals with loss compensation structures to encourage investors to buy less senior bonds. 13

The Trustee has applied the loss-compensation methods of these trusts before. In October 2010, the Trustee paid out part of a Subsequent Recovery for the CWALT 2007-OA10 trust, *owned by AIG*, to less senior classes – including one that had been entirely written off – instead of paying the senior-most holders.¹⁴ A 2010 Credit Suisse analyst note reported this payout.¹⁵

II. THE SETTLEMENT AGREEMENT AND PRIOR ARTICLE 77 PROCEEDING

The Trustee signed the Settlement Agreement and sought its approval in June 2011.¹⁶ That agreement laid out a clear "pay-first, write-up-second" method for paying Allocable Shares.¹⁷ First, the Trustee "shall distribute" funds "in accordance with the distribution provisions of the Governing Agreements . . . as though it was a Subsequent Recovery available for

¹⁰ See, e.g., Ellis Decl. Ex. E (CWALT 2005-61 PSA) art. I at 41-42.

¹¹ Aronoff Aff. ¶¶ 5-6.

¹² Aronoff Aff. ¶ 8; Smith Aff. ¶ 14.

¹³ Smith Aff. ¶¶ 12, 19; *see* Aronoff Aff. ¶ 8 (describing how underwriters "craft[] the waterfall provision[s]" of PSAs to "meet the cash flow needs of a specific investor"). This deal structure is different from other Countrywide trusts in which the Principal Distribution Amount is defined by reference to an "Overcollateralization Amount" that prevents loss compensation. *See* Dkt. #34 (comparing deal structures for the trusts in this case).

¹⁴ Smith Aff. ¶ 24. This disproves AEGON and Blackrock's claim that "Subsequent Recoveries have historically been included in full in the 'Principal Distribution Amount.'" Dkt. #96 at 8.

¹⁵ Ellis Decl. Ex. W (analyst note).

¹⁶ Dkt. #3 (Settlement Agreement); Verified Petition, *In re Bank of N.Y. Mellon*, at 10-13, No. 651786/2011, Dkt. #1 (Jun. 29, 2011).

¹⁷ Dkt. #3 (Settlement Agreement) § 3(d).

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distribution on that distribution date." 18 Second, "after the distribution of the Allocable Share to Investors pursuant to Subparagraph 3(d)(i), the Trustee will allocate" the remainder to increase certificate balances. 19

The original Article 77 proceeding was thoroughly litigated. *In re Bank of N.Y. Mellon*, 42 Misc. 3d 1237(A), 2014 WL 1057187, at *12-14 (Sup. Ct. N.Y. Cnty. Jan. 31, 2014) (recounting procedural history). Numerous investors intervened, including AIG, BlackRock, and AEGON.²⁰ No party objected to the Settlement Agreement's payment methods.

The trial court approved the Settlement Agreement in January 2014. *Bank of N.Y. Mellon*, 2014 WL 1057187, at *20-21. Numerous respondents, including AIG, Blackrock, and AEGON, took appeals.²¹ Again, no one questioned the Settlement Agreement's payment terms. The First Department affirmed. *In re Bank of N.Y. Mellon*, 127 A.D.3d 120 (1st Dep't 2015).

III. THIS PROCEEDING

Final approval of the Settlement triggered a detailed process for making payments.²² After experts calculated the "Allocable Shares" due on January 11, 2016, the Trustee was set to receive the Settlement funds on February 10, 2016.²³ The Trustee was then required to distribute Allocable Shares on the next Distribution Date: February 25, 2016.²⁴

Rather than distribute payments, the Trustee filed this action seeking instructions on Feb-

¹⁸ *Id.* § 3(d)(i) (emphasis added). The Settlement Agreement also disclaimed amending the PSAs. *See id.* § 3(d)(v). ¹⁹ *Id.* § 3(d)(ii) (emphasis added).

See Verified Petition to Intervene, In re Bank of N.Y. Mellon, No. 651786/2011, Dkt. #131 (Sup. Ct. N.Y. Cnty. Aug. 10, 2011) (AIG); Verified Petition to Intervene, In re Bank of N.Y. Mellon, No. 651786/2011, Dkt. #14 (Sup. Ct. N.Y. Cnty. June 29, 2011) (intervention of BlackRock and AEGON entities, among others).
 In re Bank of N.Y. Mellon, No. 651786/2011, Dkt. #1103 (Sup. Ct. N.Y. Cnty. Mar. 21, 2014) (AIG notice of

²¹ In re Bank of N.Y. Mellon, No. 651786/2011, Dkt. #1103 (Sup. Ct. N.Y. Cnty. Mar. 21, 2014) (AIG notice of appeal); In re Bank of N.Y. Mellon, No. 651786/2011, Dkt. #1094 (Sup. Ct. N.Y. Cnty. Mar. 6, 2014) (Blackrock/AEGON notice of appeal). AIG ultimately withdrew its appeal. See Decision and Order, In re Bank of N.Y. Mellon, No. 651786/2011, Dkt. #1135 (Sup. Ct. N.Y. Cnty. Sept. 2, 2014) (granting withdrawal motion).

²² Dkt. #1 (petition) ¶¶ 10-13.

²³ *Id.* ¶¶ 1, $\bar{1}$ 3.

²⁴ See Dkt. #3 (Settlement Agreement) § 3(d)(i) (an Allocable Share should be distributed "as though it was a Subsequent Recovery *available for distribution on that Distribution Date*" (emphasis added); see, e.g., Ellis Decl. Ex. E (CWALT 2005-61 PSA) art. I at 22 (defining the "Distribution Date" as the 25th of each calendar month).

ruary 5, 2016.²⁵ The Trustee acknowledged that "the Settlement Agreement . . . specifies the *order* of operations – the Trustee is directed to pay the Allocable Share *before* writing up the Certificate Principal Balance." But unnamed investors had apparently asked the Trustee to disregard the terms of the Settlement Agreement and the governing contracts (the "PSAs").²⁷ The Trustee also noted that Intex, a software provider, offered multiple models for predicting Settlement payments.²⁸

Prosiris and Tilden Park answered the Trustee's petition, arguing that it should follow the Settlement Agreement's and PSAs' unambiguous terms.²⁹ Institutional investors, including AIG, Blackrock, and AEGON, did the same: They requested that the Trustee "distribute the settlement payment immediately to all 530 Covered Trusts under the 'pay first, write-up second' formulation set forth in the Settlement Agreement and Final Judgment."³⁰ By contrast, Center Court argued that, for one trust only, certificates should be written up first and paid out second.³¹

Significantly, the institutional investors argued that the Settlement Agreement was "res judicata" and "bars certificateholders from asserting any claim that was or could have been litigated in the CW Article 77 proceeding pertaining to the Settlement Agreement." They also admitted that for "Overcollateralization Target Trusts" – including the 14 trusts at issue here – there is no risk of "temporary or illusory overcollateralization" as raised in the Trustee's peti-

²⁵ Dkt. #1.

 $^{^{26}}$ *Id.* ¶ 20.

 $^{^{27}}$ Id. ¶ 41 (stating investors had expressed "competing views" and had sent "conflicting investor correspondence" that "urge[d] the Trustee to follow different orders of operation").

 $^{^{28}}$ Id. ¶ 42.

²⁹ Dkt. #31; see Ellis Decl. Ex. E, J-V (PSAs for Prosiris / Tilden Park trusts).

³⁰ Dkt. #34 at 16.

³¹ Dkt. #47 (Center Court memorandum of law) at 1-2.

³² Dkt. #34 at 5.

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tion.³³ In a later filing, they again urged the Court to "follow the 'pay first, write-up second' order of operations required under the Settlement Agreement."³⁴ The Court entered a partial final judgment ordering the Trustee to adhere to the Settlement Agreement, including the payfirst "order of operations."³⁵

The Court set argument on the remaining trusts for July 13.³⁶ But in June, AIG, for the first time, asked for discovery into Intex, even though Intex had been mentioned months prior in the Trustee's petition.³⁷ The Court granted AIG's request but asked to "keep the July 13 date" and to complete discovery by July 8.³⁸ AIG's negotiations with Intex dragged out until July 25, when AIG again changed course and withdrew its subpoena in exchange for an affidavit from Intex.³⁹ This delay hardly seems coincidental: AIG earns roughly \$400,000 on one trust alone at the expense of other certificateholders each month that this proceeding continues.⁴⁰

On August 11, the institutional investors changed course again. Even though they had previously argued that *res judicata* barred challenging this settlement, AIG, Blackrock, and AEGON now all argue that the Court should *rewrite* the contracts, thus giving them millions of

The institutional investors identified 9 of the 14 trusts at issue as "Overcollateralization Target Trusts." Dkt. #39 (listing "Overcollateralization Target Trusts," including CWALT 2005-61, CWALT 2005-69, CWALT 2005-72, CWALT 2005-IM1, CWALT 2006-OA3, CWALT 2006-OA7, CWALT 2006-OA8, CWMBS 2006-3, and CWMBS 2006-OA5). For those trusts, overcollateralization "is not affected *at all* by the distribution of the Settlement Payment and certainly does not and cannot change *during* a distribution." Dkt. #34 (answer) at 12. The remaining five trusts at issue have identical language. *See* Ellis Decl. Ex. L (CWALT 2005-76 PSA) art. I at 32-33 (defining "Overcollateralization Target Amount" as a fixed percentage of the "Stated Principal Balance"); Ellis Decl. Ex. Q (CWALT 2006-OA10 PSA) art. I at 39 (same); Ellis Decl. Ex. R (CWALT 2006-OA14 PSA) art. I at 33-34 (same); Ellis Decl. Ex. S (CWALT 2007-OA3 PSA) art. I at 30 (same); Ellis Decl. Ex. T (CWALT 2007-OA8) art. I at 34 (same); *compare* Dkt. #1 (Petition) ¶ 26 (raising "temporary, and illusory, overcollateralization").

³⁴ Dkt. #60 at 3.

³⁵ Dkt. #78 at 7.

³⁶ See Ellis Decl. Ex. F (transcript of June 22, 2016 hearing) at 17.

³⁷ Dkt. #79 ("status update and request for discovery"); Dkt. #1 (petition) ¶ 42.

³⁸ Ellis Decl. Ex. F (transcript) at 17.

³⁹ Ellis Decl. Ex. G (Intex affidavit).

⁴⁰ Ellis Decl. Ex. F (transcript) at 15. Overall transfers are in the millions of dollars per month. See Smith Aff. ¶ 49.

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dollars more than allowed under the PSAs' plain language. 41

ARGUMENT

The Settlement Agreement disposes of this case. The order approving that Agreement is res judicata and requires, first, that the Trustee pay the Settlements before writing up balances and, second, that the Settlement be paid as a Subsequent Recovery per the terms of each PSA. The institutional investors, which made that very argument in this case, are estopped from changing course. Further, the PSAs' unambiguous text should not be rewritten. Compensating the Senior Support Certificates for losses and not paying Senior Certificates without losses adheres to the PSA's plain, carefully-negotiated terms requiring loss compensation. Finally, the Court should also order payment as of February 25, 2016 to preserve the status quo and prevent a windfall to the parties bringing this challenge.

I. THE TRUSTEE SHOULD ENFORCE THE SETTLEMENT AGREEMENT

The Settlement Agreement is Res Judicata A.

A "party may not litigate a claim where a judgment on the merits exists from a prior action between the same parties involving the same subject matter." In re Hunter, 4 N.Y.3d 260, 269 (2005). In particular, for "judicially settled accounting decrees" like instruction proceedings, the "decree is conclusive and binding with respect to all issues raised and as against all persons over whom [the court] obtained jurisdiction." Id. at 270; see also In re Morgan Guaranty Tr. Co., 28 N.Y.2d 155, 161-64 (1971) (in Article 77 proceeding, granting preclusive effect to prior judgment). Preclusion covers all "issues that were decided as well as those that could have been raised in the accounting." Hunter, 4 N.Y.3d at 270 (emphasis added).

As the institutional investors have argued, these principles preclude any challenge to the

 $^{^{41}}$ Dkt. #103 (AIG brief) at 4; Dkt. #96 (AEGON/Blackrock brief) at 18; see also Dkt. #108 (Finkel Aff.) \P 10.

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Settlement's payment methods.⁴² They were parties to the prior proceeding. They could have objected then to the PSAs' loss-compensation structure or proposed alternatives; they did not. They chose not to, knowing that the Settlement was final and binding, even if facts or circumstances changed.⁴³ Center Court also could have objected; it did not. *Bank of N.Y. Mellon*, 2014 WL 1057187, at *2. Because they had "a full and fair opportunity to litigate [their] claim[s]," they "should not be allowed to do so again." *Hunter*, 4 N.Y.3d at 269.

Giving trust-instruction proceedings *res judicata* effect serves an important goal: The purpose of such proceedings is to "protect trustees" from "uncertainty" and future liability. *See City Bank Farmers' Tr. Co. v. Smith*, 263 N.Y. 292, 295-96 (1934). That "right to rely upon the finality of the results of previous litigation" is also a "core principle of *res judicata*." *People ex rel. Spitzer v. Applied Card Sys., Inc.*, 11 N.Y.3d 105, 124 (2008). The Settlement is final for *all* parties and protects both the Trustee and investors against needless future disputes. The other investors cannot re-litigate issues they chose not to raise in the first Article 77 proceeding.⁴⁴

B. The Institutional Investors Are Estopped from Challenging the Payment Method

The institutional investors not only failed to challenge the Settlement Agreement or the PSAs in the Article 77 proceeding. They actually argued to this Court that certificateholders were *precluded* from challenging the Settlement's payment terms: "[T]he Final Judgment," they noted, "bars certificateholders from asserting any claim that was or could have been litigated in the CW Article 77 proceeding pertaining to the Settlement Agreement." Yet that is *exactly* what they are doing now: They ask the Court to ignore the PSAs and use Intex's "Standard Intex

⁴² See Answer of Certain Institutional Investors, Dkt. #34, at 6.

⁴³ See Dkt. #3 (Settlement Agreement) § 18.

⁴⁴ It is of no consequence that the prior judgment simply approved a settlement agreement. "[S]ettlement agreements [are] entitled to *res judicata* effect." *People ex rel. Spitzer v. Applied Card Sys.*, 11 N.Y.3d 105, 124 (2008). ⁴⁵ Dkt. #34 at 5.

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Method" instead. 46 Having set out a position, the institutional investors are bound by it.

Judicial estoppel "precludes" a party "from inequitably adopting a position directly contrary to or inconsistent with an earlier assumed position in the same proceeding." Maas v. Cornell Univ., 253 A.D.2d 1, 5 (3d Dep't 1999); Lorenzo v. Kahn, 100 A.D.3d 1480, 1482-83 (4th Dep't 2012) (same). It precludes parties from "playing fast and loose with the courts" by changing their positions "simply because [their] interests have changed." Tozzi v. Long Is. R.R. Co., 170 Misc. 2d 606, 612 (Sup. Ct. Nassau Cnty. 1996) (quotation marks omitted).

The institutional investors are doing just that here. In the prior Article 77 case, they did not object to the payment terms.⁴⁷ When the Trustee filed this petition, they again did not object. Instead, they urged that any challenge to those terms – as to any trust – was precluded by res iudicata. 48 This Court agreed and ordered the Trustee to distribute funds to these "Initial Release Trusts,"⁴⁹ thereby benefitting the institutional investors holding bonds in those trusts.⁵⁰

The institutional investors' answer advocating res judicata secured them a benefit – the partial final judgment. With that benefit, they are precluded from adopting a contrary position.

C. The Text and Structure of the Contracts Require Loss Compensation for the **Senior Support Certificates**

The unambiguous text of the PSAs and the Settlement Agreement control. "If a contract is complete, clear and unambiguous, it must be enforced according to its plain meaning." Littleton Constr. Ltd. v. Huber Constr., Inc., 27 N.Y.3d 1081, 1081 (2016). This rule "applies with even greater force [in] commercial contract[s] negotiated at arm's length by sophisticated,

⁴⁶ Dkt. #103 (AIG) at 25 (asking the Court to distribute Allocable Shares "pursuant to the Standard Intex Method"); Dkt. #96 (Blackrock / AEGON) at 15 (similar).

⁴⁷ See Dkt. #35 (affidavit of Robert Madden).

⁴⁸ Dkt. #34 at 5-7.

⁴⁹ Dkt. #77.

⁵⁰ See Dkt. #60 at 1.

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counseled businesspeople." *Bank of N.Y. Mellon v. WMC Mortg., LLC*, 136 A.D.3d 1, 6 (1st Dep't 2015) (citation omitted). "Courts may not by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties under the guise of interpreting the writing." *Id.* (citations omitted).

Central to the dispute is whether the PSAs' "Principal Distribution Amount" limits the amount due to Senior Certificates held by the institutional investors. It does – it requires that funds be paid according to the PSAs' terms.⁵¹ The waterfalls of the PSAs limit principal payments to Senior Certificates by calculating the "Principal Distribution Amount" those certificates are owed before balances are written up.⁵² As a result, any amount above the "Principal Distribution Amount" goes to bonds with losses – here, the "Senior Support Certificates" held by Prosiris and Tilden Park.⁵³ Importantly, the "Principal Distribution Amount" is based on balances "*immediately prior*" to the Distribution Date, and thus excludes write-ups occurring *on* the Distribution Date.⁵⁴ This means the Principal Distribution Amount is capped.

The institutional investors ignore the PSAs' text. Instead, they ask the Court to rewrite the PSAs to fit the "Standard Intex Method" under which the "Principal Distribution Amount" is calculated using *post*-writeup balances.⁵⁵ Their arguments fail:

1. The Principal Distribution Amount Definition Is Not "Out of Context"

The institutional investors argue that the Principal Distribution Amount's cap on distribu-

⁵¹ Dkt. #3 (settlement agreement) § 3(d)(i).

⁵² Smith Aff. ¶ 21; *see*, *e.g.*, CWALT 2005-61 PSA § 4.02(a)(3)(A) (payment in an amount "up to the Principal Distribution Amount").

⁵³ Smith Aff. ¶ 25. Notably, if a "Senior Certificate" has incurred losses, that certificate gets its losses compensated *before* the "Senior Support Certificates." *See, e.g.*, CWALT 2005-61 PSA § 4.02(a)(3)(B)(4) (listing the order of priorities in which losses are compensated).

⁵⁴ See, e.g., id.

⁵⁵ See Dkt. #103 (AIG brief) at 25 n.20 (describing how the "Standard Intex Method" requires the Trustee to "calculate the Principal Distribution Amount based upon the 'written-up' certificate balances").

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tions to Senior Certificates should not control when the PSAs are read in "context." But that is not the law. "An interpretation that gives effect to all the terms of an agreement is preferable to one that ignores terms or accords them an unreasonable interpretation." *Ruttenberg v. Davidge Data Sys. Corp.*, 215 A.D.2d 191, 196 (1st Dep't 1995); *see Laba v. Carey*, 29 N.Y.2d 302, 308 (1971) (similar). None of the institutional investors actually cite a provision that conflicts with the definition of "Principal Distribution Amount." Instead, their "context" argument seeks, in effect, to impermissibly delete the Principal Distribution Amount definition from the contract.

2. The Payment Terms May Not Be Rewritten

AIG also cites part of the rule that "[t]o carry out the intention of a contract, words may be transposed, rejected, or supplied, to make its meaning more clear." AIG leaves out the rest: "Such an approach is appropriate only in those limited instances where some absurdity has been identified or the contract would otherwise be unenforceable either in whole or in part." Wallace v. 600 Partners Co., 86 N.Y.2d 543, 547-48 (1995) (emphasis added); see Jade Realty LLC v. Citigroup Commercial Mortg. Trust 2005-EMG, 20 N.Y.3d 881, 884 (2012) (similar).

AIG cannot meet this test: It does not argue that the contracts are unenforceable, and it cannot prove that they are absurd. "[T]he Court of Appeals has set a high bar for declaring a contract absurd." *Warberg Opportunistic Trading Fund, L.P. v. GeoResources, Inc.*, 112 A.D.3d 78, 83-84 (1st Dep't 2013) (collecting cases). Even if the payment "terms might be 'novel or unconventional,' that, by itself, does not render the result here absurd." *Jade Realty LLC*, 20 N.Y.3d at 884. It is hardly "absurd" that, for Subsequent Recoveries, Senior Support Certificates

⁵⁶ Dkt. #96 (AEGON/Blackrock) at 9; see Dkt. #103 (AIG) at 3-4.

⁵⁷ Blackrock cites a case that refers to a "holistic reading" of a PSA. Dkt. #96 at 10 (citing *Bank of N.Y. Mellon v. WMC Mortg.*, *LLC*, No. 12 Civ. 7096, 2015 WL 4597540, at *8 (S.D.N.Y. July 30, 2015)). But Blackrock cites only *part* of that sentence: The court stated only that "[a] more holistic reading of [the PSA] *that gives force and effect to all provisions* contained in the three transaction documents is available." *Bank of N.Y. Mellon*, 2015 WL 4597540, at *8 (emphasis added). A "holistic" reading is no license to *remove* terms from a contract.

⁵⁸ Dkt. #103 (AIG) at 22 (citing *Castellano v. N.Y.*, 43 N.Y.2d 909, 911 (1978)).

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with losses might get priority over Senior Certificates without losses. While other contracts may have different terms, that does not make these contracts "absurd."

different termis, that does not make week terminets account.

the instrument was negotiated between sophisticated, counseled business people negotiating at

New York's limits on the absurdity doctrine "ha[ve] even greater force where, as here,

arm's length." Jade Realty LLC v. Citigroup Commercial Mortg. Trust 2005-EMG, 83 A.D.3d

567, 568 (1st Dep't 2011), aff'd, 20 N.Y.3d 881 (2012) (quotations omitted). The PSAs and the

Settlement Agreements were negotiated between sophisticated global institutions.

In fact, where "there is no issue . . . of unequal bargaining power" or of "some unfair advantage," "it is not for the court to save [a party] from the results of his own agreement—absurd or not." Crowman v. Wacholder, 2 A.D.3d 140, 145 (1st Dep't 2003) (emphasis added); U.S. Bank N.A. v. Fed. Home Loan Bank of Boston, No. 652382/2014, Dkt. #593, slip op. at 32-33 (Sup. Ct. N.Y. Cnty. Aug. 12, 2016). In U.S. Bank, N.A., another RMBS Article 77 proceeding, an investor complained that the waterfall was "inconsistent with the expectations of investors." Slip op. at 32. The Court disagreed. Because the "waterfall provision in [each] of the PSAs" dictates payment priorities, "[h]aving nonetheless decided to invest, [the objector] cannot

So too here. Each respondent bought these certificates freely; they are all sophisticated, counselled investors who had plenty of opportunity to read the PSAs. The Court should not save them from their own investment decisions.

now be heard to argue that the settlement deprives it of the benefit of its bargain." *Id.* at 33.

D. The PSAs and Settlement Agreement Are Commercially Reasonable

AIG, AEGON/Blackrock, and Center Court all argue that, unless the Court rewrites the PSAs and Settlement Agreements to favor their position, those contracts are commercially

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unreasonable.⁵⁹ That is not the law. "[A]n inquiry into commercial reasonableness is only

warranted where a contract is ambiguous." Fundamental Long Term Care Holdings, LLC v.

Cammeby's Funding LLC, 20 N.Y.3d 438, 445 (2013). Because the PSAs are unambiguous,

arguments about "commercial reasonableness" all fail.

Regardless, there is nothing "commercially unreasonable" about enforcing the contracts.

It is common to structure RMBS deals so that less senior holders with realized losses get paid in

the event of a Subsequent Recovery. 60 Such payment structures are no fluke; the "waterfall" of

each PSA is carefully negotiated to provide investors with the risk and returns that they seek.⁶¹

Even if these trusts were "novel or unconventional, this does not warrant an excursion beyond

the four corners of the document." Wallace, 86 N.Y.2d at 548.

AEGON and Blackrock claim that the PSAs are commercially unreasonable because they

somehow "increase the risk of loss to the senior-most certificates." They note that overcollat-

eralization and subordination generally protect senior holders and assert that, if the PSAs are

applied as written, senior certificates would suffer losses sooner than if the PSAs were rewrit-

ten. 63 AIG likewise argues that the contracts create an "unjust windfall" because they compen-

sate realized losses before insuring the institutional investors against future losses.⁶⁴ And Center

Court urges that "overcollateralized trusts are designed to insulate senior certificateholders from

losses, and operate to afford payment to the most-senior classes before the less-senior classes."65

⁵⁹ Dkt. #65 at 9-14; Dkt. #96 at 7-14; Dkt. #103 at 19-22.

⁶⁰ Smith Aff. ¶¶ 14, 19; *see also* Aronoff Aff. ¶ 8-9 ("In my experience, a payment priority that limits certain cash flow distributions to senior bonds, as is the case in the trusts at issue, is not at all unusual or unique. Such a waterfall, which distributes excess funds in any given month to the senior-most junior bonds with realized losses, may make those junior bonds more attractive investments.").

⁶¹ Aronoff Aff. ¶¶ 5-6; Smith Aff. ¶ 11.

⁶² Dkt. #96 at 7.

⁶³ Dkt. #96 at 13-14.

64 Dkt. #103 at 19-20.

⁶⁵ Dkt. #65 at 10-11.

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All that is beside the point. Whether or not overcollateralization and subordination are generally designed to protect senior holders, these PSAs do not insulate the institutional investors' bonds against all losses for all time. Rather, the contracts were designed to compensate holders with losses already incurred.⁶⁶ Tilden Park's and Prosiris' certificates are entitled to payments because they are the most senior holders who have *already* suffered losses.⁶⁷ The institutional investors are only entitled to the distributions and the overcollateralization and subordination provided by the contracts' plain text.

AIG also argues that the Court should apply the Intex Standard Method because doing so is more "commercially reasonable" than Intex's "After Distributions" model.⁶⁸ AIG claims that the "After Distributions" model could be "structurally unsound" because it would leave the trusts undercollateralized, while the "Standard Intex Method" would not do so. 69 So what? Intex's "After Distribution" model does not follow the PSAs. 70 When the PSAs are modelled as written - including the proper calculation of balances - no undercollateralization results.⁷¹ Regardless, undercollateralization is not fatal to these PSAs; each waterfall has explicit terms for adjusting certificate balances if undercollateralization occurs.⁷²

The Institutional Investors' "Essential Purpose" Arguments Fail Ε.

AIG, AEGON, and Blackrock also argue for rewriting the PSAs to further the "essential

⁶⁶ Smith Aff. ¶ 19.

⁶⁷ Smith Aff. ¶ 25.

⁶⁸ Dkt. #103 at 12-16.

⁶⁹ *Id.*; *see also* Finkel Aff. ¶¶ 27, 53.

⁷⁰ Ellis Decl. Ex. H (INTEX798); Smith Aff. ¶ 27.

⁷¹ Smith Aff. ¶¶ 30-40, 47.

⁷² See, e.g., Ellis Decl. Ex. Q (CWALT 2006-OA10 PSA) art. I at 18 (defining "Applied Realized Loss Amount[s]" as "the amount, if any, by which, the aggregate Class Certificate Balance . . . exceeds the aggregate Stated Principal Balance"); id. § 4.02(i) ("On each Distribution Date, the Trustee shall allocate any Applied Realized Loss Amount" to reduce certificate balances in a specified order).

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purpose" of protecting senior holders from future losses.⁷³ They misstate the law. Frustration of purpose is a *defense* a contract party can raise to excuse nonperformance. *Jack Kelly Partners LLC v. Zegelstein*, 140 A.D.3d 79, 85 (1st Dep't 2016). It is *not* a license to "rewrite the parties' agreement and provide an affirmative" term "they never agreed to." *In re Dayton Seaside Assocs. No. 2, L.P.*, 257 B.R. 123, 139 (Bankr. S.D.N.Y. 2000) (applying New York law).

The institutional investors also cannot possibly prove a frustration of purpose. "The doctrine applies 'when a change in circumstances makes one party's performance *virtually worthless* to the other, frustrating his purpose in making the contract." *PPF Safeguard, LLC v. BCR Safeguard Holding, LLC*, 85 A.D.3d 506, 508 (1st Dep't 2011) (emphasis added). "[T]he frustrated purpose must be so completely the basis of the contract that, as both parties understood, without it, *the transaction would have made little sense*." *Warner v. Kaplan*, 71 A.D.3d 1, 6 (1st Dep't 2009) (emphasis added). A contract's purpose is *not* frustrated just because it has become "financially disadvantageous;" otherwise, "all commercial contracts" would be in "jeopardy." *407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 282 (1968).

Applying the contracts' bargained-for payment methods do not render them "virtually worthless." The parties to the Settlement Agreement and the PSAs have received exactly what they bargained for – payment streams in a specified order. These multi-billion-dollar transactions hardly "ma[ke] little sense" just because senior holders with losses might receive relatively more Settlement funds than senior holders without losses. The institutional investors' complaint is, in essence, that they *will receive less money* than they want. That is not enough to scrap the contracts. 407 E. 61st Garage, Inc., 23 N.Y.2d at 282.

Their remedy – to rewrite the contracts in their favor – in fact threatens truly essential

⁷³ Dkt. #103 at 12 (AIG); Dkt. #96 at 9 (AEGON/Blackrock).

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purposes of structured finance and the bond market generally: certainty and predictability.⁷⁴ Investors and underwriters cannot reliably bargain for the cash flows they desire if bondholders can later upend that structure later for purported "structural" reasons. Aronoff Aff. ¶ 11.⁷⁵

F. Though Inadmissible, Parol Evidence Supports Loss Compensation

AIG, AEGON, and Blackrock also try to introduce parol evidence about Intex's modelling software and third parties who had run that software. Those attempts fail as a matter of law. Because the contracts are unambiguous, extrinsic evidence "may not be considered." Teitelbaum Holdings, Ltd. v. Gold, 48 N.Y.2d 51, 56 (1979). In particular, when an "agreement is in plain and unambiguous language, there is no need to resort to consideration of the subsequent course of dealings of the parties." In re Moyer, 286 A.D.2d 611, 612 (1st Dep't 2001) (citing Gottlieb v. 180 Hartsdale Assocs., 119 A.D.2d 542, 544 (2d Dep't 1986)). This Likewise, "it is a basic tenet of contract law that custom and practice cannot alter the unambiguous terms of a contract." Singapore Recycle Ctr. Pte. Ltd. v. Kad Int'l Mktg., Inc., No. 06 Civ. 4997, 2009 WL 2424333, at *6 (E.D.N.Y. Aug. 6, 2009) (applying New York law).

In any event, the relevant parol evidence supports enforcing the PSAs as written. The Trustee has paid principal before writing up balances in these very trusts, even when it would

⁷⁴ Aronoff Aff. ¶ 6; Smith Aff. ¶ 13; Jason Kravitt, Securitization of Financial Assets § 5.03 (2016 rev.) (describing the "ever present need for certainty and predictability . . . in securitization transactions").

⁷⁵ In a supplemental authority letter, AEGON and Blackrock cited the JPMorgan Article 77 case to imply that the "expectations of senior investors in the Trust" weighed more heavily than Tilden Park's and Prosiris' expectations. Dkt. #120 at 1 (citing id. at 32). They read that opinion out of context. There, the senior investors' expectations were that the waterfall should be followed as written. Id. at 33 (describing how "the waterfall provision in section 6.01 of the PSAs memorializes the senior certificates' priority").

⁷⁶ Dkt. #103 (AIG) at 16-23; Dkt. #96 (AEGON/Blackrock) at 15-18.

⁷⁷ AIG cites an unpublished Second Circuit summary order to claim that course of dealing can modify an unambiguous contract. Dkt. #103 at 17 (citing Ward v. Nat'l Geographic Soc'y, 284 F. App'x 822, 2008 WL 2595181, at *2 (2d Cir. June 27, 2008)). That is not New York law. See Moyer, 286 A.D.2d at 612; Gottlieb, 119 A.D.2d at 544. Moyer and Gottlieb are binding on this Court, not unpublished decisions of a lower federal court. McCabe v. St. Paul Fire & Marine Ins. Co., 25 Misc. 3d 726, 734 (Sup. Ct. Erie Cnty. 2009), aff'd, 79 A.D.3d 1612 (4th Dep't 2010) ("[W]hile the decisions of the lower Federal courts on questions of New York law are not without precedential value, they are not binding on this court, certainly not in the same sense and to the same extent as decisions of the Appellate Division").

cause losses to be repaid to less senior tranches. The Trustee followed the PSA as written and paid out part of a Subsequent Recovery in October 2010 for the CWALT 2007-OA10 trust to more junior holders to recoup their losses instead of paying the senior-most holders. Likewise, while the institutional investors cite testimony from the Trustee's counsel, Jason Kravitt, who negotiated the Settlement, his testimony *supports* enforcing the PSAs: "The way we wrote the Settlement Agreement," he stated, "is that it's the tranches who are most senior *who suffered losses who get the cash first*." Prosiris and Tilden's bonds are the most senior with losses.

AIG, AEGON, and Blackrock make much of parol evidence about how *Intex* might model the Settlement. They observe that, when users requested it for a given trust, Intex programmed its software to provide a toggle offering three options for modelling Subsequent Recoveries.⁸¹ One of these models – the "Standard Intex Method" – pays the institutional investors more.⁸² They claim this somehow proves that "market participants have generally understood the Settlement Payment to flow primarily or entirely to the super-senior bonds."⁸³ They then tack on evidence from two third parties that ran Intex to model the Settlement: (1) a retained expert, James Finkel; and (2) an analyst note written the same day this petition was filed.⁸⁴ According to the institutional investors, this shows that the Trustee should apply the "Standard Intex Method" instead of the PSAs.⁸⁵ Nonsense.

⁷⁸ Smith Aff. ¶ 24; Dkt. #32 at 19.

⁷⁹ Dkt. #101 (excerpt of trial testimony) at 1878:2-16 (emphasis added).

⁸⁰ Smith Aff. ¶ 25. Notably, if the "Super Senior" certificates have incurred losses, *they* will have priority to Subsequent Recoveries over "Senior Support Certificates" like Tilden Park's and Prosiris' bonds. *See*, *e.g.*, CWALT 2005-61 PSA § 4.02(a)(3)(B)(4) (listing the priority different tranches have for loss compensation).

⁸¹ Ellis Decl. Ex. G (Intex Aff.) ¶¶ 4-5.

⁸² Dkt. #103 (AIG) at 20-21 (citing Finkel Aff. ¶ 10).

⁸³ Dkt. #103 (AIG) at 19 (citing Intex Aff. ¶ 5).

⁸⁴ Dkt. #108 (Finkel Aff.); Dkt. #109 (JPMorgan Chase analyst note).

⁸⁵ Dkt. #96 (AEGON/Blackrock) at 18-19; Dkt. #103 (AIG) at 25 & n.20. AIG also tries to paint Prosiris and Tilden Park as supporting Intex's "After Distributions model." Dkt. #103 at 12. That is wrong: Tilden Park and Prosiris ask the Court to apply *the PSAs*. *See* Smith Aff. ¶ 27 (the "After Distributions" model does not reflect the PSAs).

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First, Intex denies knowing how Subsequent Recoveries should be paid:

• Intex's models "did not reflect Intex's opinion or belief that either the 'Standard Intex Method' or one or the other models is the correct or best way to distribute the Settlement Payment." 86



• Intex offers no "assurances as to how a trustee, securities administrator, or other relevant transaction party will or should pay any given deal." 88



Second, "[a] party who seeks to use trade usage to define language or annex a term to a contract must show either that the other party was actually aware of the trade usage, or that the usage was so notorious in the industry that a person of ordinary prudence in the exercise of reasonable care would be aware of it." Last Time Beverage Corp. v. F & V Distrib. Co., LLC, 98 A.D.3d 947, 951-52 (2d Dep't 2012) (citing Reuters Ltd. v. Dow Jones Telerate, 231 A.D.2d 337, 343 (1st Dep't 1997)) (emphasis added). All parties must know of a trade usage for it to govern a contract: "That one party had knowledge of the usage, and supposed that it would enter into the contract, is not sufficient." Reuters Ltd., 231 A.D.2d at 344 (citing Schlanger v. Heyman, 185 A.D. 599, 600 (1st Dep't 1918)).

There is no proof that *all* parties to the PSAs knew how Intex might model Subsequent Recoveries. Nor could they have known: Intex did not create the "Standard Intex Method" until an unknown client requested it in August 2011, *after* the Settlement Agreement and *five years*

⁸⁶ Ellis Decl. Ex. G (Intex Aff.) ¶ 6 (emphasis added).

⁸⁷ Ellis Decl. Ex. I (INTEX258) (client email stating that

Ellis Decl. Ex. G (Intex Aff.) ¶ 3 (emphasis added).

⁸⁹ Ellis Decl. Ex. H (INTEX798).

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after the PSAs. 90 One cannot interpret the contracts by a "trade usage" that did not yet exist.

Both AIG's expert and the analyst note are irrelevant because they merely run *Intex*'s model; they do not actually model the PSAs. 91 In any event, Intex is plainly wrong: Its models fail to account for the PSAs' definition of "Principal Distribution Amount" that mandates loss compensation. 92 Intex can be a useful tool for modelling RMBS cash flows. It is *not* a substitute for the contracts' plain text. The Court should not rewrite the PSAs to conform to third-party software that contains mistakes and is subject to investor manipulation. 93

Center Court's Write-Up-First Argument Fails G.

For the CWALT 2005-61 trust only, Center Court argues that the Trustee should write up first and pay second. Center Court, like all objectors, is barred by res judicata. Regardless, Center Court's arguments are at war with the Settlement Agreement's and PSA's text:

Subsequent Recoveries Are Not "Amount[s] Held for Future Distribution" 1. Center Court claims that Subsequent Recoveries for the CWALT 2005-61 trust are not "Available Funds," but rather "Amount[s] Held for Future Distribution" to be paid out the month after receipt. 94 That ignores the Settlement Agreement: The "Allocable Share" must be paid "as though it was a Subsequent Recovery available for distribution on that distribution date."95 The Settlement Agreement requires Allocable Shares to be paid out the month they are received.

Moreover, the Prospectus Supplement for that trust shows that write-ups do not occur before payment: Balances for a given Distribution Date are increased "by the amount of Subse-

⁹⁰ Ellis Decl. Ex. G (Intex Aff.) ¶ 5; Dkt. # 3 at 48 (execution date of June 28, 2011).

⁹¹ Dkt. #108 (Finkel Aff.) ¶ 8 (Finkel's assignment was to model the Settlement "under the three scenarios laid out in the Trustee's February 5, 2016 Verified Petition, and modeled by Intex Solutions, Inc."); Dkt. #109 (analyst note) at 2-4 (comparing the three Intex scenarios).

⁹² Smith Aff. ¶ 27.

 $^{^{93}}$ See, e.g., Intex Aff. ¶ 5 (noting that Intex changes its models upon investor requests).

⁹⁴ Dkt. #65 at 5-9; see, e.g., CWALT 2005-61 PSA art. I at 16-17 ("Available Funds" do not include the "Amount Held for Future Distribution").

⁹⁵ Dkt. #3 (Settlement Agreement) § 3(d)(i) (emphasis added).

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quent Recoveries (if any) . . . collected during the period beginning on the second day of the calendar month preceding the calendar month in which such Distribution Date occurs."96

> 2. The Definition of "Certificate Balance" Does Not Support a Delayed Distribution Date

Center Court argues that write-ups should happen first because "Principal Distribution Amounts" are a function of a "Certificate Balance," which reflects prior write-ups and which can be calculated "at any date." Center Court reads the PSA out of context. The "Certificate Balance" only reflects "any increase to the Certificate Balance of such Certificate pursuant to Section 4.02 due to the receipt of Subsequent Recoveries."98 And write-ups pursuant to Section 4.02 happen, explicitly, "[o]n each Distribution Date." The definition of "Certificate Balance" does not change the fact that write-ups occur on the Distribution Date, while the Principal Distribution Amount is calculated "*immediately prior*." Likewise, that the Certificate Balance reflects the "maximum dollar amount of principal to which the Holder thereof is then entitled", 101 is irrelevant, because each holder is only entitled to what the waterfalls dictate.

> 3. Paying First Does Not Render The Write-Up Provisions Meaningless

Center Court asserts that paying first would render the write-up provision meaningless. They claim that, because the loss-compensation rules of the waterfall do not refer to certificate balances, if certificates were paid first, their balances could not be written up. 102 Not so. The

⁹⁶ Ellis Decl. Ex. A (CWALT 2005-61 Prospectus Supplement) at S-52 (emphasis added); see In re Trusteeship Created by Am. Home Mortg. Inv. Trust 2005-2, No. 14 Civ. 2494, 2014 WL 3858506, at *20 (S.D.N.Y. July 24, 2014) (reading a RMBS indenture in light of a prospectus). In fact, writing up certificate balances as Center Court suggests would in fact make those certificates undercollateralized, requiring Center Court's bonds to be written down. As a result, Center Court does not benefit even if its argument were correct.

⁹⁷ Dkt. #65 at 9-10 (citing CWALT 2005-61 PSA art. I at 17).

⁹⁸ CWALT 2005-61 PSA art. I at 17 (emphasis added).

 $^{^{99}}$ See, e.g., CWALT 2005-61 PSA \S 4.02(j) (emphasis added).

¹⁰⁰ CWALT 2005-61 PSA art. I at 40-41 (emphasis added).

¹⁰¹ Dkt. #64 (Center Court) at 6-7.

¹⁰² Dkt. #65 at 11-12.

decrease of balances is simply handled in a *different* part of the PSAs. By definition, *any* payment of principal to a certificate decreases its Certificate Balance.¹⁰³ Because "Subsequent Recoveries" are distributed as principal, paying Certificate Balances will by definition cause certificate balances to be written down.¹⁰⁴ The certificates are then written back up after distribution by "the amount of the Subsequent Recoveries, if any."¹⁰⁵ As a result, there is no conflict between writing up and paying down, and paying down first per the terms of the PSA does not render the write-up provision "meaningless."

4. Center Court's "Anomaly" Argument Fails

Center Court complains that a large Subsequent Recovery is a "one-time anomaly." ¹⁰⁶ That is no reason to rewrite the PSA. "[P]resent dissatisfaction with the results of the deal" does not entitle a party to "rewrite the agreements" just because something "unforeseen" has happened. *RJE Corp. v. Northville Indus. Corp.*, 198 F. Supp. 2d 249, 269 (E.D.N.Y. 2002) (citing *Kel Kim Corp. v. Central Markets, Inc.*, 70 N.Y.2d 900, 902 (1987)). Center Court may not rewrite the PSAs because it did not expect the settlement to be as large as it turned out to be.

5. Center Court's Absurdity Argument Fails

Finally, Center Court claims that, for four trusts, ¹⁰⁷ paying first would be absurd because it might "result in disproportionate payments" to junior "Subordinated Certificates." Center Court notes that "Unpaid Realized Losses" for those four trusts are defined only "[f]or any Class

¹⁰³ See, e.g., CWALT 2005-61 PSA art. I at 17 ("Certificate Balance" is defined as "the amount of principal to which the Holder thereof is entitled . . . minus the sum of (i) all distributions of principal previously made with respect to that Certificate . . .") (emphasis added).

¹⁰⁴ See CWALT 2005-61 PSA art. I at 16 ("Available Funds" include "Subsequent Recoveries").

 $^{^{105}}$ See CWALT 2005-61 PSA \S 4.02(j).

¹⁰⁶ Dkt. #65 at 11.

¹⁰⁷ The trusts identified by Center Court are CWALT 2005-61, CWALT 2005-69, CWALT 2005-72, and CWALT 2005-76

¹⁰⁸ Dkt. #65 at 12-13.

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of Subordinated Certificates,"¹⁰⁹ even though, as Center Court admits, the PSAs require that "both Subordinated Certificates and Senior Certificates" be written up based on realized losses. ¹¹⁰ Center Court is wrong: The waterfalls clearly allocate realized losses to senior classes. ¹¹¹ Further, the Prospectus Supplement explicitly states that "Unpaid Realized Loss Amounts" apply to "any class of certificates." ¹¹² See Am. Home Mortgage Inv. Trust 2005-2, 2014 WL 3858506, at *20 (trust agreements should be read in light of a prospectus). Properly read in context, the PSAs offer no support for Center Court's claim. ¹¹³

II. PAYMENTS SHOULD BE MADE AS OF FEBRUARY 25, 2016

The Court should fix February 25, 2016 as the Distribution Date. The Trustee received the Settlement funds on or about February 10, 2016. The Agreement required the Trustee to distribute those funds on the next available Distribution Date – February 25, 2016. Because the Trustee instead filed this proceeding, and because the accrual of realized losses changes the relative income each certificateholder receives, Prosiris and Tilden have lost money each month the case is pending. The Court should undo that result and place Prosiris and Tilden in the same position as they would have been had this suit not been filed.

"The power of courts, whether of law or equity, to make entries of judgments or decrees nunc pro tunc in proper cases and in furtherance of the interests of justice, is one which has been

¹⁰⁹ *Id.* (citing CWALT 2005-61 PSA art. I at 13).

¹¹⁰ Id. at 13 (citing CWALT 2005-61 PSA § 4.02(j)).

¹¹¹ See, e.g., CWALT 2005-61 PSA § 4.02(i) (requiring the Trustee to "allocate any Applied Realized Loss Amount" to classes 1-A-1 through 1-A-3); *id.* Art. I at 8 ("Senior Certificates" include classes 1-A-1 through 1-A-3).

¹¹² Ellis Decl. Ex. A (CWALT 2005-61 ProSupp) at S-66 (emphasis added)

¹¹³ If Center Court finds the definition of "Unpaid Realized Losses" absurd because limited to "Subordinated Certificates," it can ask the Court to fix this supposed scrivener's error and state, as the Prospectus Supplement does, that "Unpaid Realized Losses" cover all certificates. *See Wallace v. 600 Partners Co.*, 205 A.D.2d 202, 210 (1st Dep't 1994), *aff'd*, 86 N.Y.2d 543 (1995) (courts can correct scrivener's errors to avoid absurd results). But there is no reason to rewrite *other* PSA terms to give Center Court higher priority than it would have otherwise.

¹¹⁴ Dkt. #1 (Petition) ¶ 1.

¹¹⁵ See, e.g., CWALT 2005-61 PSA art. I at 21 (defining the "Distribution Date" as the 25th of each month).

¹¹⁶ See Ellis Decl. Ex. F (transcript) at 15; Smith Aff. ¶ 49.

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recognized and exercised for a long time as a part of their jurisdiction." Jewett v. Schmidt, 108 A.D. 322, 325 (1st Dep't 1905), aff'd, 184 N.Y. 608 (1906). In equitable proceedings like this one, courts "regard[] as done that which should have been done." Simonds v. Simonds, 45 N.Y.2d 233, 240 (1978); In re Salkin, 9 Misc. 2d 708, 710 (Sup. Ct. N.Y. Cnty. 1957), aff'd, 6 A.D.2d 1011 (1st Dep't 1958) (the "inherent nature" of an instruction proceeding "is in equity").

Courts do not hesitate to retroactively enforce judgments. For example, in U.S. v. American Cyanamid Co., 598 F. Supp. 1516 (S.D.N.Y. 1984), after a defendant failed to comply with a judgment requiring it to buy a certain amount of chemicals annually from a competitor, the court ordered it to submit a purchase order equal to the amount it would have used in that year. Id. at 1523-1524. "Observ[ing] that equity deems done that which should have been done," the court ordered the defendant to "perform the Judgment fully through the date of its termination." Id. at 1525. Likewise, when the state failed to comply with a habeas judgment requiring a parole hearing, the Second Circuit cited the same maxim to deem that the prisoner was granted parole as of the prior judgment. U.S. ex rel. Schuster v. Vincent, 524 F.2d 153, 161 (2d Cir. 1975).

Retroactive relief is especially appropriate here because the same parties that caused delay in this case stand to gain from that delay. A party in litigation "may not profit from its own delay." Heil Grinding & Mfg. Co. v. Glasgow, Inc., 236 A.D.2d 813, 814 (4th Dep't 1997). The only reason why the funds were not paid out on February 25 was the delay of this litigation – most notably, AIG's month-long effort to seek irrelevant discovery on Intex. That delay benefits the institutional investors: Each month a final payment is put off, AIG will earn more money from realized losses compared to Prosiris and Tilden Park. 117 AIG should not profit in that way.

AIG claims Allocable Shares should be delayed because they are treated "as though [they

¹¹⁷ See Ellis Decl. Ex. F (transcript) at 17; Smith Aff. ¶ 49.

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were] a Subsequent Recovery available for distribution on that distribution date." AIG is wrong. The funds were "available for distribution" when the Trustee received them in February 2016. Likewise, AIG's argument that, in one PSA, the definition of "Certificate Balance" refers to the amount to which a "Holder thereof is then entitled," 119 is irrelevant: It is the Settlement Agreement that should be enforced retroactively, not the PSAs. Regardless, because the Settlement Agreement required that funds be paid out on February 25, Tilden Park and Prosiris were

Finally, AIG blames Tilden Park and Prosiris, claiming that any delay is "caused by their decision to single out their Disputed Trusts as 'unique.'" Not so. It is *the contracts' text* that is different. AIG wasted months trying to avoid that plain text from being applied. The Court should enforce the Settlement as of February 2016, when it should have been enforced.

CONCLUSION

This Court should grant the relief requested in Prosiris' and Tilden Park's Verified Answer and instruct the Trustee, first, to distribute Allocable Shares as Subsequent Recoveries before writing up certificate balances, second, to distribute Subsequent Recoveries according to the PSAs without any alteration or one-time adjustment, and, third, to distribute Allocable Shares as of February 25, 2016.

entitled to those funds then. 120

¹¹⁸ Dkt. #103 at 24.

¹¹⁹ Dkt. #60 (AIG brief) at 6 (citing CWALT 2006-OA10 PSA art I. at 17).

¹²⁰ In a supplemental authority letter, AEGON and Blackrock cite the JPMorgan Article 77 case to claim that the Court could not "roll back the clock." Dkt. #120 at 1. That case has no bearing here. In U.S. Bank, the funds had not yet been received by the Trustee, and there was no "provision in the Governing Agreements" supporting earlier payment. Dkt. #120 at 30. Here, by contrast, the Trustee already has the Settlement funds, and the Settlement Agreement would have required payment on February 25 but for this petition.

¹²¹ Dkt. #103 at 25.

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Dated: August 26, 2016

New York, New York

/s/ Steven F. Molo Steven F. Molo Justin M. Ellis Laura K. Jereski MoloLamken LLP 540 Madison Avenue New York, NY 10022 Tel: (212) 607-8160 Fax: (212) 607-8161

Attorneys for Respondents Tilden Park Capital Management LP and Prosiris Capital Management LP FILED: NEW YORK COUNTY CLERK 08/05/2018 02:20 PM

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

In the Matter of the Application of

THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed Securitization Trusts,

Petitioner.

For Judicial Instructions under CPLR Article 77 on the Distribution of a Settlement Payment.

Index No. 150973/2016 (Scarpulla, J.)

BLUE MOUNTAIN PARTIES'
MEMORANDUM OF LAW ON
ALLOCATION OF THE SETTLEMENT
PAYMENT

BlueMountain Credit Alternatives Master Fund L.P., BlueMountain Guadalupe Peak
Fund L.P., BlueMountain Montenvers Master Fund SCA SICAV-SIF, BlueMountain Kicking
Horse Fund L.P., BlueMountain Logan Opportunities Master Fund L.P., BlueMountain Foinaven
Master Fund L.P., and BlueMountain Credit Opportunities Master Fund I L.P. (collectively,
"BlueMountain"), by their undersigned counsel, submit this memorandum of law in response to
submissions of American International Group, Inc., Aegon and Blackrock Financial
Management, Inc. concerning distribution of the portion of the \$8.5 billion Bank of America
settlement payment (the "Settlement Payment") relating to the CWALT 2007-OA3 trust (the
"OA3 Trust").

PRELIMINARY STATEMENT

BlueMountain adopts the arguments of Respondents Prosiris Capital Management LP and Tilden Park Capital Management LP. BlueMountain writes separately very briefly to address two fundamental flaws in the senior tranche-holders' arguments.

First, the explicit and unambiguous terms of the Settlement Agreement and the PSA for the OA3 Trust mandate the distribution of the Settlement Payment advocated by BlueMountain, Prosiris, and Tilden. As a matter of law, this should end the Court's inquiry.

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Second, the Settlement Agreement and the PSA compensate bondholders for losses realized by the trusts in a fair and reasonable manner that respects the senior tranche holders' position in the payment waterfall. To the extent senior tranche holders have suffered realized losses, they will be compensated for those losses before the more junior bondholders.

ARGUMENT

The Settlement Agreement unambiguously mandates that the Settlement Payment be treated as a "Subsequent Recovery" and, under the pooling and servicing agreement ("PSA") governing the OA3 Trust, Subsequent Recoveries unambiguously must, among other things, be used to compensate bondholders for realized losses. (See, e.g., AIG Br. at 8; OA3 Trust PSA § 4.02.) As matter of law, this should end of the Court's analysis.

The Settlement Agreement and the PSA are unambiguous and, in such a circumstance, the Court should reject the senior tranche holders' invitation to ignore those unambiguous terms in favor of supposed evidence of the general structure of the trusts, the senior tranche holders' intent, course of dealings and practice in the industry. See, e.g., R/S Assoc. v. New York Job Dev. Auth., 98 N.Y.2d 29, 32, 744 N.Y.S.2d 358, 360 (2002) ("[W]hen parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms."); Greenfield v. Philles Records, Inc., 98 N.Y.2d 562, 569 - 570 (2002) ("if the agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity"); W.W.W. Associates, Inc. v. Giancontieri, 77 N.Y.2d 157, 162, 65 N.Y.S.2d 440, 443 (1990) ("A familiar and eminently sensible proposition of law is that, when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is

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generally inadmissible to add to or vary the writing."); Varsity Transit, Inc. v. Bd. of Educ. of City of New York, 300 A.D.2d 38, 40, 752 N.Y.S.2d 603, 605 (1st Dep't 2002) (holding that a party "may not ask that the court resort to evidence of a subsequent course of dealing" when a contract is unambiguous).

To the extent the Court chooses to look beyond the unambiguous text of the Settlement Agreement and the PSA—and it should not—the senior tranche holders' appeals to fairness and avoiding unintended "leakage" ignores that the distribution required by the Settlement Agreement and the PSA is entirely fair.

The point of the Settlement Payment is to compensate trust beneficiaries for losses inflicted on the trusts. All BlueMountain seeks—and what the Settlement Agreement and the PSA require—is that the Settlement Payment be used to compensate bondholders for losses realized by the trusts. They do this in a completely fair and reasonable manner that respects the senior tranche holders' position in the payment waterfall. To the extent senior tranche holders have suffered realized losses, they will be compensated for those losses before the more junior bondholders.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in the submission by Prosiris, and Tilden, the Court should the hold that the Settlement Payment should be paid by distributing the Allocable Shares prior to writing-up certificate principal balances.

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Dated: New York, New York August 26, 2016

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

In the matter of the application of

THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed Securitization Trusts,

Petitioner,

For Judicial Instructions under CPLR Article 77 on the Distribution of a Settlement Payment.

Index No. 150973/2016

Hon. Saliann Scarpulla Part 39

Motion Sequence No. 1

CENTER COURT, LLC'S RESPONSE TO PROSIRUS AND TILDEN PARK'S OPENING SUBMISSION

McKool Smith PC One Bryant Park, 47th Floor New York, NY 10016

Attorneys for Center Court, LLC

Dated: March 14, 2016

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INTRODUCTION

Center Court, LLC ("Certificateholder") has joined in the Response of Certain Investors to Opening Submissions (the "Joint Response"). As is noted therein, Prosirus Capital Management LP and Tilden Park Capital Management LP (collectively, "Respondents") introduced certain issues in their Answer to the Verified Petition and memorandum of law in support thereof (Dkt. 31, 32) that raise a triable issue of fact as to the fourteen trusts in which Respondents are certificateholders. Certificateholder, therefore, files this response to address certain of the arguments raised by Respondents.¹

Respondents' tortured interpretations of the PSAs not only are contrary to the plain language thereof but also results in absurd, commercially unreasonable distributions that are contrary to the reasonable expectations of investors. Indeed, Respondents' memorandum of law makes clear that the "leakage" to Senior Support Certificates that they propose is heavily dependent on the unusually large amount of Subsequent Recoveries and the timing of when those funds are received by the fourteen trusts. Under Respondents' theories, the mere passage of time significantly affects the funds received by classes of certificateholders. Such wild swings in recovery are not contemplated by the Settlement Agreement or the Governing Documents. Accordingly, the Court should reject Respondents' contention and order distribution of the Allocable Shares pursuant to the unambiguous terms of the PSAs and the Settlement Agreement.

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¹ As is noted in the Joint Response, Respondents have raised an issue that was not raised in the Trustee's Verified Petition. (Joint Response at 5.) Certificateholder therefore supports the request in the Joint Response for additional time in which to brief Respondents' issue and reserves the right to amend or supplement this response should the Court grant that request.

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ARGUMENT

I. The Text And Structure Of The PSAs For The Fourteen Trusts Compel A Write-Up Prior To Any Distribution Of Subsequent Recoveries.

Respondents argue that the text and structure of the PSAs compel the distribution of funds prior to any write-up. (See Memorandum of Law in Support of Respondents' Verified Answer to the Verified Petition, Dkt. 32 ("Resp. Mem. of Law"), at 13-17.) However, in so arguing, Respondents selectively cite to a few sentences in certain provisions of the PSAs. A review of the PSAs that gives meaning and effect to all of the relevant sections and sentences reveals that write-up prior to any distribution is mandated by the fourteen PSAs.

A. Subsequent Recoveries Are Held For Future Distribution Pending Write-Up Prior To Being Distributed As "Available Funds."

Respondents contend that because "Subsequent Recoveries" are distributed as "Available Funds," the PSAs require payment of Subsequent Recoveries prior to any write-up. They are wrong. Certificateholder agrees that Subsequent Recoveries are distributed as Available Funds under the PSAs for the fourteen trusts identified by Respondents. (Resp. Mem. of Law at 8.) However, a careful reading of the definition of Available Funds, related definitions, and the section delineating priorities of distribution of funds supports that Subsequent Recoveries must be used to write-up the Certificate Principal Balances before distribution.

Importantly, Available Funds does not include <u>all</u> funds in a trust's Certificate Account. Available Funds is more limited and is defined in the PSAs as follows:

Available Funds: As to any Distribution Date and each Loan Group, the sum of (a) the aggregate amount held in the Certificate Account at the close of business on the related Determination Date, including any Subsequent Recoveries, in respect of such Mortgage Loans net of the related Amount Held for Future **Distribution** and net of Prepayment Charges and amounts permitted to be withdrawn from the Certificate Account pursuant to clauses (i) - (viii) of Section 3.08(a) in respect of such Mortgage Loans and amounts permitted to be withdrawn from the Distribution Account pursuant to clauses (i) - (iii) of Section 3.08(b) in respect of such Mortgage Loans, (b) the amount of the related Advance

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and (c) in connection with Defective Mortgage Loans in such Loan Group, as applicable, the aggregate of the Purchase Prices and Substitution Adjustment Amounts deposited on the related Distribution Account Deposit Date.

(See, e.g., CWALT 2005-61 PSA at p. 2; CWALT 2006-OA3 PSA at p. 2 (emphasis added).)² Therefore, calculating Available Funds begins with all funds in the trust's Certificate Account as of the 22nd of a month, but it *excludes* any Amount Held for Future Distribution.

Subsequent Recoveries that are received in the same month as a Distribution Date are excluded from Available Funds because they are included in the Amount Held for Future Distribution. The PSAs define "Amount Held for Future Distribution" as follows:

Amount Held for Future Distribution: As to any Distribution Date and each Loan Group, the aggregate amount held in the Certificate Account at the close of business on the related Determination Date on account of (i) Principal Prepayments received after the related Prepayment Period and Liquidation Proceeds and Subsequent Recoveries received in the month of such Distribution Date relating to such Loan Group and (ii) all Scheduled Payments due after the related Due Date relating to such Loan Group.

(See, e.g., CWALT 2005-61 PSA at p. 1; CWALT 2006-OA3 PSA at p. 1 (emphasis added).) Therefore, although Respondents are correct that Subsequent Recoveries are not segregated into a separate account for distribution, they are not distributed as Available Funds if they are received the same month as the Distribution Date. Rather, the only way to give meaning and effect to both definitions of Available Funds and Amount Held for Future Distributions is to hold back Subsequent Recoveries from distribution on the Distribution Date in the month in which they are received, and then distribute them in the immediately *following* month. In the month following receipt, Subsequent Recoveries no longer qualify as an Amount Held for Future Distributions by definition, and instead are included as Available Funds for distribution.

² The Distribution Date is defined as the 25th of each month (see, e.g., CWALT 2005-61 PSA at p. 7), and the related Determination Date is generally the 22nd of each month (see, e.g., id.).

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Despite the fact that Subsequent Recoveries are not Available Funds during the month in which they are received (and thus are not distributed in the month of receipt), the PSAs nonetheless require Subsequent Recoveries to be allocated to increase certificate principal balances on the Distribution Date in the month in which they are received. Section 4.02 states that "on each Distribution Date, the Trustee shall allocate the amount of the Subsequent Recoveries for [each Loan Group], if any, to increase the Class Certificate Balance of the [respective Loan Group's Certificates] to which Applied Realize Loss Amounts have been previously allocated, sequentially," to the senior certificates and then to the junior certificates. (See, e.g., CWALT 2005-61 PSA § 4.02(j); CWALT 2006-OA3 PSA § 4.02(i).)³ "Subsequent Recoveries" are defined as all unexpected amounts on any Distribution Date received by the Master Servicer, including Subsequent Recoveries received that month:

Subsequent Recoveries. As to any Distribution Date and Loan Group, with respect to a Liquidated Mortgage Loan in that Loan Group that resulted in a Realized Loss in a prior calendar month, unexpected amounts received by the Master Servicer (net of any related expenses permitted to be reimbursed pursuant to Section 3.08) specifically related to such Liquidated Mortgage Loan after the classification of such Mortgage Loan as a Liquidated Mortgage Loan.

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³ The CWALT 2006-OA3 PSA provides: "Application of Subsequent Recoveries. On each Distribution Date, the Trustee shall allocate the amount of the Subsequent Recoveries, if any, to increase the Class Certificate Balance of the Classes of Certificates to which Applied Realized Loss Amounts have been previously allocated, first, pro rata based on the Applied Realized Loss Amounts previously allocated the Group 1 Senior Certificates and Group 2 Senior Certificates, a) sequentially, to the Class 1-A-1, Class 1-A-2 and Class 1-A-3 Certificates, in that order, in each case by not more than the amount of the Unpaid Realized Loss Amount for such Class and (b) sequentially, to the Class 2-A-1, Class 2-A-2 and Class 2-A-3 Certificates, in that order, in each case by not more than the amount of the Unpaid Realized Loss Amount for such Class, and second, sequentially, to the Class M-1, Class M-2, Class M-3, Class M-4, Class M-5, Class M-6 and Class M-7 Certificates, in that order, in each case by not more than the amount of the Unpaid Realized Loss Amount of such Class." (CWALT 2006-OA3 PSA § 4.02(i) (emphasis added).)

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(See, e.g., CWALT 2005-61 PSA at p. 33; CWALT 2006-OA3 PSA at p. 34) (emphasis added). Consequently, these PSAs require a write-up to Certificate Balances before distributing the

corresponding Subsequent Recoveries.

For example, assuming that the Court renders a decision the last week of this month and that the Allocable Share for CWALT 2005-61 is deposited into the Certificate Account on April 1, 2016, the Trustee must write-up the Certificate Balances relating to the receipt of those Subsequent Recoveries on April 25, 2016, which is the Distribution Date for the month in which those funds were received. But those same Subsequent Recoveries should be held for future distribution until May 25, 2016, which is the Distribution Date for the month after the receipt of those funds. (*Id.*; *see also id.* at pp. 17 (definition of "Amount Held for Future Distribution"), 18 (definition of "Available Funds").)

In this manner, the PSAs maintain the purpose of the overcollateralization and subordination inherent in the structure of the trusts: the protection of the senior certificates. First, on the April 25 Distribution Date, the Allocable Share is a Subsequent Recovery received that month, and thus is an Amount Held for Future Distribution. On April 25, the Allocable Share is applied to write up the Certificate Balances of the Certificates that have Applied Realized Loss Amounts. On the May 25 Distribution Date, the Allocable Share is included in Available Funds as it is no longer an Amount Held for Future Distribution. Available Funds, as Respondents describe, are used to pay Current Interest first, and then the Principal Distribution Amount, and then are used to pay Unpaid Realized Loss Amounts. *However*—and this is where Respondents' analysis falls short—the Principal Distribution Amount *includes* the Allocable Share. (*See, e.g.*, CWALT 2005-61 PSA at p. 11.) The Principal Distribution Amount equals the aggregate Class Certificate Balances minus the excess of the Stated Principal Balance of the

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Mortgage Loans over the Overcollateralization Target Amount. As Respondents state, the Allocable Share does not alter the Stated Principal or the Overcollateralization Target Amount; these remain static. But the Class Certificate Balances have increased by the amount of the Allocable Share because Subsequent Recoveries (including the Allocable Share) were required to be applied on the April 25 Distribution Date to increase Class Certificate Balances by the amount of Applied Realized Loss Amounts. Thus, the Principal Distribution Amount is larger because the difference between the Class Certificate Balance and the excess of the Stated Principal Balance of the Mortgage Loans is now larger. This omission from Respondents' analysis is critical, because the Principal Distribution Amount (including the Allocable Share) is used to pay the senior certificates, pro rate, until the senior certificates' balances are reduced to zero.

B. Writing Up The Certificate Balance Prior To Distribution Is Supported By The Language Of CWALT 2005-61.

Respondents also argue that, because the distribution of principal in the waterfall is based upon the Principal Distribution Amount, which is calculated immediately prior to the Distribution Date, the order of operations must be pay first, write-up second. (Resp. Mem. of Law at 11.) In so arguing, Respondents contend that, because the Principal Distribution Amount is calculated based upon the certificate principal balance, and because the certificate principal balance is calculated "as of the Distribution Date," the certificate principal balance used must be that balance as of the previous Distribution Date. Respondents' position, however, is belied by the language of the PSA for CWALT 2005-61, the trust in which Respondents and Certificateholder both own certificates.

Pursuant to the PSA, the Certificate Balance is not limited to calculation on a Distribution Date; it can be calculated at *any* date:

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With respect to any Certificate (other than the Class C Certificates) at any date, the maximum dollar amount of principal to which the Holder thereof is then entitled under this Agreement, such amount being equal to the Denomination of that Certificate (A) plus, with respect to the Subordinated Certificates, any increase to the Certificate Balance of such Certificate pursuant to Section 4.02 due to the receipt of Subsequent Recoveries and (B) minus the sum of (i) all distributions of principal previously made with respect to that Certificate and (ii) with respect to the Subordinated Certificates, any Applied Realized Loss Amounts allocated to such Certificate on previous Distribution Dates pursuant to Section 4.02 without duplication.

(CWALT 2005-61 PSA at p. 3 (emphasis added).)

Further, the definition of Certificate Balance makes clear that it is intended to represent "the *maximum* dollar amount of principal to which the Holder thereof is then entitled under this Agreement." (*Id.* (emphasis added).) Thus, to the extent that any Subsequent Recoveries were received in any period that could increase the amount of principal to which the certificateholder is entitled, it must be included in the Certificate Balance and, therefore, the Principal Distribution Amount.

Finally, the plain language of the definition of Certificate Balance supports that all Subsequent Recoveries received as of any date should be included in that balance, subtracting only payments of principal and realized losses previously received or allocated. Certificate Balance is calculated at any date as:

- The Denomination of each Certificate, meaning the Principal Balance of the Certificate at the beginning of the trust;
- Plus any increase to the Certificate Balance due to the receipt of Subsequent Recoveries;
- Minus all distributions of principal *previously* made; and
- Minus Applied Realized Loss Amounts allocated to the Certificate on previous Distribution Dates.

Thus, the Certificate Balance may be calculated "at any date," and not just on a Distribution Date or immediately prior thereto. Moreover, in calculating the Certificate Balance,

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the Trustee must start with the original balance of the certificate and then add *any* Subsequent Recoveries that have been received to date *before* subtracting distributions of principal that were previously made or any Applied Realized Loss Amounts. Therefore, the Certificate Balance used in calculating the Principal Distribution Amount must take into account Subsequent Recoveries from the current period, regardless the date on which the Principal Distribution Amount is calculated, and the order of operations therefore is write up first, pay second.

C. Using Subsequent Recoveries To Pay Unpaid Realized Losses Renders A Provision Of The Distribution Waterfall Meaningless.

Respondents agree that "the key feature" of the distribution waterfall is the distribution of Available Funds to reduce the principal balances of the certificates. (Resp. Mem. of Law at 9.) Respondents go on to argue that a substantial portion of the Allocable Shares should be distributed to compensate their certificates for Unpaid Realized Losses. (*See id.* at 10; Declaration of Jaime D. Sneider, Dkt. 32, Ex. C.).) But when principal distributions are made to compensate for Unpaid Realized Losses in this way, there is no corresponding decrease in the Certificate Balances of the affected certificates. (*See, e.g.*, CWALT 2005-61 PSA § 4.02(a)(4) (indicating when Available Funds are paid in an amount equal to the Unpaid Realized Loss Amount for a class, without reference to Certificate Balances).)

At the same time, the unambiguous language of the PSAs provides that the entire amount of Subsequent Recoveries received is applied to increase the Class Certificate Balances, without exception. For example, Section 4.02(j) of CWALT 2005-61 PSA provides, in part:

Application of Subsequent Recoveries. On each Distribution Date, the Trustee shall allocate the amount of the Subsequent Recoveries for Loan Group 1, if any, to increase the Class Certificate Balance of the Group 1 Certificates to which Applied Realized Loss Amounts have been previously allocated, sequentially, to the Class 1-A-1, Class 2-A-1, Class 1-A-3, Class 1-M-1, Class 1-M-2, Class 1-M-3, Class 1-M-4, Class 1-M-5 and Class 1-M-6 Certificates, in that order, in each case by not more than the amount of the Unpaid Realized Loss Amount of such Class.

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(CWALT 2005-61 PSA at p. 71 (emphasis added); see also CWALT 2006-OA3 PSA § 4.02(i) ("On each Distribution Date, the Trustee shall allocate the amount of the Subsequent Recoveries, if any, to increase the Class Certificate Balance of the Classes of Certificates to which Applied Realized Loss Amounts have been previously allocated..." (emphasis added)).) Under these circumstances, it cannot be that Subsequent Recoveries are used to pay Unpaid Realized Losses because, in that event, they are not used to increase Certificate Balances as required by the PSAs.

Such an interpretation of the PSAs renders a provision of the distribution waterfall meaningless and, therefore, is untenable under New York law. See, e.g., Nostrom v. A.W. Chesterton Co., 15 N.Y.3d 502, 508 (N.Y. 2010) (holding that a construction that renders one part of a contract meaningless should be avoided); Columbus Park Corp. v. Department of Housing Preservation & Dev., 80 N.Y.2d 19, 30-31 (N.Y. 1992) (stating that a construction which makes a contract provision meaningless is contrary to basic principles of contract interpretation). Instead, the Certificate Balances must first be increased (written-up), which then increases the Principal Distribution Amount. This prevents leakage to the more junior certificateholders, as intended by the overcollateralized trust structure.

Respondents' contention that only a portion of amounts received as Subsequent Recoveries need increase the Certificate Balances is contrary to the plain and unambiguous terms of the PSAs and would render the section of the distribution waterfall regarding the write-up of Subsequent Recoveries meaningless. Respondents' argument, therefore, fails as a matter of law.

II. Respondents' Proposed Interpretation Of The PSAs Leads To Absurd, Commercially Unreasonable Results That Are Contrary To The Reasonable **Expectations Of Investors.**

As described above, Respondents' proposed payment methodology is unsupported by the unambiguous language of the PSAs. Additionally, the Court should reject Respondents' proposed interpretation of the PSAs because a "contract should not be interpreted to produce an NYSCEF DOC. NO. 243 RECEIVED NYSCEF: 05/05/2017

absurd result, one that is commercially unreasonable, or one that is contrary to the intent of the parties." *Cole v. Macklowe*, 99 A.D.3d 595, 596 (1st Dept. 2012). Respondents' position can lead to an absurd result in a multitude of ways. Below are but three examples.

First, Respondents advocate for a different result than the other 516 Covered Trusts because their fourteen trusts are structured in a "fundamentally different way," are "designed to afford only limited protection of principal after which distributions are made to certificates in order of seniority for any unpaid realized losses," and would ensure that certificateholders below the Super Senior Certificates "would recover some of their realized losses in the event of a sufficiently large Subsequent Recovery." (Resp. Mem. of Law at 15-17.) Respondents have presented zero evidence to support their theory and, in fact, it is untrue.

Apart from some slight definitional differences, these fourteen trusts are overcollateralized trusts that operate similarly to the other OC Trusts. Indeed, the Trustee (*see* Verified Petition ¶ 32, Dkt. 1),⁴ the Institutional Investors (*see* Answer of Certain Institutional Investors to the Verified Petition at 3, Dkt. 34),⁵ Federal Home Loan Mortgage Corporation (*see* Answer of Federal Home Loan Mortgage Corp. to the Verified petition at 2, Dkt. 40),⁶ and economic theorists⁷ agree: overcollateralized trusts are designed to insulate senior

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⁴ "An [overcollateralized trust] is designed to create credit enhancement, or protection, for more senior Certificateholders through a concept called overcollateralization."

⁵ The Institutional Investors state that the "sole purpose" of overcollateralization is "protecting the senior certificateholders against the risk of loss".

⁶ "The purpose of overcollateralization is to provide a cushion of protection in the form of extra assets. . . . Only if the trust is at or above OC Target on the relevant distribution date are collections not required to be distributed sequentially and in order of propriety to the senior classes." (footnote omitted)

⁷ See, e.g., Securitization of Financial Assets § 8.02[B], at 8-10 (Jason H.P. Kravitt ed., 3d ed. 2012); Brian P. Lancaster, Glenn M. Schultz, & Frank J. Fabozzi, Structured Products and Related Credit Derivatives: A Comprehensive Guide for Investors 183 (2008) (the

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certificateholders from losses, and operate to afford payment to the most-senior classes before the less-senior classes. Respondents have identified no real differences and cited no authority that would indicate that these trusts were designed to compensate certificateholders per some other intended result from a different, one-off overcollateralization structure than the other OC Trusts.

Second, by Respondents' admission, the only method by which their proposed "leakage" downstream to the Senior Support Certificates is the unusual, coincidental collision of a "sufficiently large Subsequent Recovery" and the timing of when the funds are received by the fourteen trusts. (Resp. Mem. of Law at 17, 20-22.) No one who participated in the creation of these trusts foresaw a massive one-time event of Subsequent Recoveries such as is proposed here. Indeed, as the Trustee notes, Subsequent Recoveries were thought of as funds received by a trust unexpectedly in connection with a single mortgage loan that previously had been written off. (See Trustee Mem. of Law, Dkt. 10, at 4.) See also CWALT 2005-61 PSA at p. 31 (defining Subsequent Recoveries as, "with respect to a Liquidated Mortgage Loan in that Loan Group . . ., unexpected amounts received by the Master Servicer . . . specifically related to such Liquidated Mortgage Loan"). Subsequent Recoveries are typically limited to funds such as property tax rebates received after foreclosure and adjustments to payment on private mortgage insurance claims. (Id.) As such, historical Subsequent Recoveries for the Covered Trusts have been modest and often offset in the same losses incurred by the trust. (Id.) Therefore, the "sufficiently large" Subsequent Recoveries described by Respondents is a one-time anomaly.

Additionally, Respondents admit that the level of their recovery would be highly variable depending on when the settlement proceeds were distributed. (See Resp. Mem. of Law at 20overcollateralization test is "structured to protect the senior classes in the event of default or poor management").

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22.) Respondents argue that as each month passes and the Super Senior Certificates realize

losses, Respondents' recovery will decrease. Under Respondents' theory of distribution, had the

Settlement Payment been allocated (or a "record date" set) as of the date the Settlement

Agreement was executed, or even as of the date of the filing of the original Article 77 proceeding

seeking approval of same, Respondents' portion of the distribution would be radically different.

Indeed, the Allocable Shares are consideration for the trusts' release of claims against the

mortgage loan sellers for breaches of their representations and warranties. If those breaches had

been remedied timely—i.e. if the sellers had repurchased defective mortgage loans promptly

after loans defaulted or breaches were otherwise discovered—those Subsequent Recoveries

would have been paid to the trusts years ago, and the certificates held by Respondents would not

under any contract interpretation be situated to receive a disproportionate windfall. Thus, while

Respondents seemingly agree that no certificateholder should benefit merely from the timing of

the distribution of the Allocable Shares (see Resp. Mem. of Law at 21), that is precisely what

they seek to do. Such a result that could occur only under a one-time circumstance that the

drafters of the Governing Agreements could not have foreseen is absurd, commercially

unreasonable, and contrary to the expectations of the certificateholders with respect to both the

PSAs and the Settlement.

Third, Respondents' proposed method of distribution is absurd because paying funds to

mezzanine and junior certificateholders without first taking into account an attendant write-up of

Certificate Balances would result in disproportionate payments to junior certificateholders even

lower in the intended order of priority than the Senior Support Certificates. Under Respondents'

reading of the PSAs and Settlement Agreement, any amounts "in excess of the Principal

Distribution Amount flow to subordinate classes of securities for unpaid realized losses." (Id. at

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19.) But in some of the fourteen trusts at issue, Unpaid Realized Losses are not allocated to reduce the Certificate Balance of any class of Senior Certificates (including Senior Support Certificates).⁸ Rather, Unpaid Realized Losses are recognized only by the Subordinated Certificates:

Unpaid Realized Loss Amount: For any Class of Subordinated Certificates, (x) the portion of the aggregate Applied Realized Loss Amount previously allocated to that Class remaining unpaid from prior Distribution Dates minus (y) any increase in the Class Certificate Balance of that Class due to the receipt of Subsequent Recoveries to the Class Certificate Balance of that Class pursuant to Section 4.02(g).

(CWALT 2005-61 PSA at p. 35 (emphasis added).) But Subsequent Recoveries in those trusts get allocated to increase Certificate Balances for both Subordinated Certificates and Senior Certificates that have suffered previous losses, starting with the most senior:

Application of Subsequent Recoveries. On each Distribution Date, the Trustee shall allocate the amount of the Subsequent Recoveries for Loan Group 1, if any, to increase the Class Certificate Balance of the Group 1 Certificates to which Applied Realized Loss Amounts have been previously allocated, sequentially, to the Class 1-A-1, Class 2-A-1, Class 1-A-3, Class 1-M-1, Class 1-M-2, Class 1-M-3, Class 1-M-4, Class 1-M-5 and Class 1-M-6 Certificates, in that order, in each case by not more than the amount of the Unpaid Realized Loss Amount of such Class. . . .

(See, e.g., CWALT 2005-61 § 4.02(j).) Therefore, Respondents' theory could result in a windfall to the Subordinated Certificates because the lion's share of Subsequent Recoveries over the Principal Distribution Amount would skip Senior Certificateholders—including both Super Senior and Senior Support Certificateholders—and flow straight to Subordinated Certificates. Such a result makes no economic sense, is commercially unreasonable and is unfair under any contract interpretation. This lopsided result can be avoided simply by following the plain

 8 These trusts are CWALT 2005-61, CWALT 2005-69, CWALT 2005-72 and CWALT 2005-76.

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language of the Governing Documents of these fourteen trusts and performing a write-up of the Certificate Balances before distributing Subsequent Recoveries.

III. Alternatively, The Court Should Find The PSAs Are Ambiguous And Afford Limited Discovery And Set A Trial On The Merits.

Finally, if the Court does not agree with Certificateholder that the PSAs unambiguously require write-up first and payment second, Certificateholder requests in the alternative that the Court find them ambiguous and afford Certificateholder the opportunity to conduct limited discovery of the drafters of the PSAs and present evidence regarding the appropriate interpretation.

A contract is ambiguous if it is reasonably susceptible to more than one interpretation. See Natt v. White Sands Condo., 95 A.D.3d 848, 849 (2d Dept. 2012) ("Contract language is ambiguous when it is reasonable susceptible of more than one interpretation and there is nothing to indicate which meaning is intended, or where there is contradictory or necessarily inconsistent language in different portions of the instrument." (quotations and citations omitted)). The existence of ambiguity is determined by examining the "entire contract and consider[ing] the relation of the parties and the circumstances under which it was executed," with the wording viewed "in the light of the obligation as a whole and the intention of the parties as manifested thereby." Kass v. Kass, 91 N.Y.2d 554, 566 (N.Y. 1998) (quoting Atwater & Co. v. Panama R.R. Co., 246 N.Y. 519, 524 (N.Y. 1927)). Certificateholder believes that the PSAs are unambiguous as to the order of operation and the distribution of Subsequent Recoveries through the applicable principal distribution waterfalls. However, if the Court disagrees, then Certificateholder requests it find the PSAs ambiguous and allow Certificateholder the opportunity to prove by parol evidence that the PSAs require an order of operation of write-up first and pay second.

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CONCLUSION

For the foregoing reasons, Certificateholder respectfully requests the Court to instruct the

Trustee to distribute the Allocable Shares for the Subject Trusts in a manner that is consistent

with the terms, meaning, and intent of the PSAs, either by adopting the order of operations

described therein or by applying a one-time adjustment to any overcollateralized Covered Trusts

to prevent leakage. Certificateholder also requests all other relief, at law or in equity, to which it

may be justly entitled.

DATED: March 14, 2016

New York, New York

Respectfully submitted,

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