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	Index No. 150973/2016 Assigned to: Scarpulla, J.
Petitioner,	**ANSWER OF CERTAIN INSTITUTIONAL INVESTORS TO THE VERIFIED PETITION**
For Judicial Instructions under CPLR Article 77 On the Distribution of a Settlement Payment.	

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Pursuant to the Court's Order to Show Cause, the investors identified below submit this Answer and supporting evidence in response to the Trustee's second Article 77 Proceeding concerning 530 Countrywide RMBS trusts.[1]

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."[2]

SUMMARY OF ARGUMENT

The Trustee has requested a judicial instruction from this Court as to whether the Trustee should follow the "pay first, write-up second" order of operations called for by the Settlement Agreement[3] in distributing settlement proceeds to each of the 530 Covered Trusts through the payment waterfalls set out in each Trust's Pooling and Servicing Agreement.[4] The Settlement Agreement, including the order of operations provision in Section 3(d) thereof, was approved "in

[1] In answer to the Petition, the undersigned investors deny the allegations in Paragraphs 16-17, 21-22, 25-27, 29-33, 37-40, and 45, and the Prayer for Relief of the Verified Petition ("Petition"), admit the truth of the statements in Paragraphs 20, 23, and 28 of the Petition, lack sufficient information to form a belief as to the truth of the allegations in Paragraphs 13-15 and 43 of the Petition, and take no position on the remaining paragraphs of the Petition.

[2] N.Y.C.P.L.R. 409.

[3] Capitalized terms have the meaning assigned to them in the Trustees' Verified Petition, *In the Matter of the Application of the Bank of New York Mellon*, No. 150973/2016 ["Petition"].

[4] In a handful of trusts, the Governing Agreement is an Indenture of Trust rather than a Pooling and Servicing Agreement. We refer to all such agreements, collectively, as "PSAs" in this Answer.

all respects" in this Court's Final Judgment in the prior, Article 77 Proceeding.[5] The Final Judgment *bars* all certificateholders from raising objections to the Trustee's performance of the terms of the Settlement Agreement. Accordingly, the Court should grant the Trustee's Petition and instruct the Trustee to distribute the Settlement Payment immediately to all 530 Trusts, as the Final Judgment requires, using the "pay first, write-up second" order of operations specified in Section 3(d) of the Settlement Agreement and this Court's Final Judgment.

This proceeding should also be narrowed to only those Trusts as to which certificateholders enter an appearance to express "competing views" concerning how, mechanically, the settlement funds should flow. Pet. at ¶41. The Verified Petition confirms that 355 Trusts do *not* have overcollateralization structures and are not affected by any dispute concerning how overcollateralization should be calculated.[6] The Verified Petition thus states no ground on which the Settlement Payment cannot and should not be distributed immediately to these 355 Trusts. With respect to these 355 Trusts that do not have an overcollateralization feature (the "non-OC Trusts") and for which the PSA does not expressly specify an order of operations, the Trustee should be instructed to pay the settlement payment to those Trusts immediately under the "pay first, write-up second" approach required by the Settlement Agreement and this Court's Final Judgment.

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[5] Modified Judgment Upon Remittitur, *In the Matter of the Application of The Bank of New York Mellon*, Index. No. 651786-2011 [Final Judgment] (Doc. No. 1148) at ¶ 1 (N.Y. Sup. Ct. Apr. 27, 2015). The Trustee's initial Article 77 Petition, which led to the Final Judgment, is referred to herein as the "CW Article 77 Proceeding."

[6] There are 530 Covered Trusts. Though the Trustee's Verified Petition stated that there are 173 OC Trusts, *see* Pet. ¶ 22, Exhibit A to the Verified Petition identified 176 OC Trusts. In the Trustee's March 2, 2016 filing, however, the Trustee further clarified that one of the Trusts it had previously identified as an OC Trust, CWABS 2004-S1, is not actually an OC Trust, and identified only 175 OC Trusts in its March 2 filing.

Regarding the remaining 175 OC Trusts, the Trustee's Petition suggests that following the Settlement Agreement and this Court's Final Judgment may produce a "temporary, and illusory, overcollateralization," Pet. at ¶¶ 25 & 26, in certain of those trusts, leading to what the Trustee calls "leakage," whereby settlement proceeds will be siphoned from the senior certificateholders to the more junior ones. This concern is unwarranted: Nothing in the PSAs (or the Settlement Agreement) requires or permits the Trustee to recognize "temporary or illusory" overcollateralization midway through a distribution; instead, the plain terms of the PSAs require the Trustee to calculate overcollateralization either *after* a distribution is made in full or by reference to the *prior* month's ratio. This is not only required by the PSAs, it is consistent with the purpose of their overcollateralization provisions: overcollateralization exists for the sole purpose of protecting the senior certificateholders against the risk of loss. Those provisions therefore cannot be interpreted in a manner that perversely *increases* the senior certificates' risk of loss by *decreasing* the amount by which they are overcollateralized, as would occur if the Settlement Payment were paid to junior holders based upon a transitory overcollateralization. With respect to the 175 OC Trusts, therefore, the Trustee should be instructed to follow the plain text of both the Settlement Agreement and the Final Judgment by "paying first, and writing up second." In doing so, the Trustee should also be instructed to assess overcollateralization only as of the end or beginning of the distribution (depending on the PSA at issue), and not in the middle of the distribution, as such mid-course adjustments have no basis in the PSAs.[7]

[7] In the alternative, were this Court to choose from one of the three options identified in the Trustee's Prayer for Relief, see Pet. at 16, then the Court should select the option identified as "(i)(a)" in the Petition because that option achieves the same economic result as advocated herein and most accords with the structure and purpose of the Settlement Agreement and PSAs.

I. THE TRUSTEE SHOULD BE REQUIRED TO FOLLOW THE ORDER OF OPERATIONS FOR THE COVERED TRUSTS SPECIFIED IN THE SETTLEMENT AGREEMENT AND THIS COURT'S FINAL JUDGMENT.

The Settlement Agreement provides that the Trustee shall employ a "pay first, write-up second" order of operations in distributing the settlement proceeds,[8] which is consistent with the Trustee's "longstanding practice in distributing Subsequent Recoveries in the Covered Trusts."[9] Before consummating the Settlement, the Trustee filed the CW Article 77 proceeding "to give Certificateholders an opportunity to be heard in opposition or in support of the Settlement, and to seek an order, among other things, (i) approving the Settlement, and (ii) declaring that the Settlement is binding on all Trust Beneficiaries and their successors and assigns."[10] In that proceeding, no objection was raised as to the use of the "pay first, write-up second" order of operations, nor did any certificateholder assert that following this procedure would be inconsistent with or violate the terms of any PSA for the Covered Trusts.[11] On April 27, 2015, this Court entered the Final Judgment and approved the Settlement "in all respects."[12]

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[8] *See* Settlement Agreement, CW Article 77 (Doc. No. 3) at ¶ 3(d)(ii) (emphasis added) (providing that the write-up of certificate balances in the Covered Trusts shall occur "*after the distribution* of the Allocable Share to Investors …."); *see also* Pet. at ¶ 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 ….").

[9] *See* Petition, Second Article 77, at ¶ 20.

[10] *See* Countrywide Article 77 Verified Petition, CW Article 77 at Doc. No. 1, ¶ 16; *see also* Settlement Agreement, attached as Ex. B thereto.

[11] *See* Affidavit of Robert Madden at ¶2.

[12] *See* Countrywide Article 77 Modified Judgment Upon Remittitur (Doc. No. 1148) at ¶ 1.

A. The Final Judgment Is *Res Judicata* And Bars Claims That Could Have Been Asserted In The Prior Article 77 Proceeding, Including Those Contesting The Order Of Operations In The Settlement Agreement.

The Final Judgment resolves the first instruction requested by the Trustee concerning whether it should follow the order of operations in the Settlement Agreement. Under the doctrine of *res judicata*, the Final Judgment bars certificateholders from asserting any claim that was or could have been litigated in the CW Article 77 proceeding pertaining to the Settlement Agreement, including any claim that the Trustee's use of the "pay first, write-up second" order of operations would violate its duties under the PSAs for the Covered Trusts where no order of operations is otherwise specified. As the Court of Appeals has explained:

> Under the doctrine of res judicata, 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. *The rule applies not only to claims actually litigated but also to claims that could have been raised in the prior litigation.* The rationale underlying this principle is that a party who has been given a full and fair opportunity to litigate a claim should not be allowed to do so again. Additionally, under New York's transactional analysis approach to res judicata, 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.[13]

These principles "apply with equal force" to trust administration proceedings, such as the prior Article 77 proceeding, and are "conclusive and binding" against "all persons over whom the [court] obtained jurisdiction."[14]

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[13] *In re Hunter*, 4 N.Y.3d 260, 269 (2005) (emphasis added, citations and internal quotation marks omitted).

[14] *Id*. at 261 ("In this case, we are required to decide whether the doctrine of *res judicata* applies to judicial proceedings settling an estate and a trust accounting .... These principles apply with equal force to judicially settled accounting decrees. As a general rule, an accounting decree is conclusive and binding with respect to all issues raised and as against all persons over whom [the court] obtained jurisdiction. ... [It is] self-evident that every decree whether upon an accounting or otherwise is binding upon all persons of whom jurisdiction was obtained. In accord with *res*

In the CW Article 77 proceeding, the Trustee filed a Verified Petition in which it announced to all certificateholders that it had entered into a settlement agreement that (among other things) required it to distribute the settlement proceeds through the trust payment waterfalls using a "pay first, write-up second" order of operations, and asked for judicial approval of its actions in doing so.[15] The Settlement Agreement was not only attached to the Trustee's Petition, it was posted on the Trustee's website for any certificateholder to review, if it wished.[16] Any certificateholder that objected to this order of operations, or believed that carrying it out would violate the Trustees' duties under the PSAs, had both the opportunity *and the obligation* to raise this claim in the CW Article 77 proceeding. Under the terms of the Order to Show Cause issued in the CW Article 77 proceeding, a massive and worldwide notice program was implemented to notify certificateholders of the relief the Trustee was seeking.[17] Under the terms of that Order, certificateholders were also notified that, "any Potentially Interested Person who fails to object in the manner described above shall be deemed to have *waived the right to object* (including any right of appeal) and shall *forever be barred from raising such objection in this or any other action or proceeding*, unless the Court orders otherwise." (Emphasis added.)

Certificateholders plainly understood that Order to require them to appear and object if they contended that any part of the Settlement Agreement violated any term of the PSAs. Though

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judicata, an accounting decree is therefore conclusive as to issues that were decided as well as those that could have been raised in the accounting.") (citations and internal quotation marks omitted).

[15] NYSCEF Doc. 1 (CW Article 77 Verified Petition) and Ex. B to Verified Petition (Executed Copy of Settlement Agreement).

[16] *See* Countrywide RMBS Settlement Website, http://www.cwrmbssettlement.com/docsny.php. (last visited March 1, 2016).

[17] Order to Show Cause, CW Article 77 (N.Y. Sup. Ct. June 29, 2011) NYSCEF Doc. 13.

several did object, no certificateholder lodged any objection to the order of operations in the Settlement Agreement, nor did any certificateholder object that the order of operations violated any provision of any PSA.[18] The Final Judgment—entered after a nine week trial and an appeal to the First Department—approved the Settlement Agreement "in all respects." Accordingly, any claim by a certificateholder in this or any other proceeding concerning the Trustee's implementation of the order of operations in the Settlement Agreement is barred by the Final Judgment under the doctrine of *res judicata*.[19]

B. Claims That The Order Of Operations In The Settlement Agreement Violate Any PSA At Issue Are Also Barred By Prior Article 77 Court's Order To Show Cause And By The Doctrines Of Waiver And Estoppel.

Any claim that the Trustee's implementation of this order of operations for a trust at issue in this proceeding violates a PSA is also waived and barred under the terms of the Show Cause Order in the CW Article 77 Proceeding. The purpose of a trustee instruction proceeding, such as this one, is to protect a trustee from a later suit regarding future conduct.[20] Here, the Trustee provided fulsome notice to all certificateholders that—if approved—the Settlement Agreement

[18] *See* Affidavit of Robert Madden at ¶2. In any event, any objections were overruled in the Final Judgment.

[19] There is only one Trust as to which any party has identified an order of operations that is specified in the PSA. *Cf.* Trustee's Submission Under The Order of February 29, at 1 (Dkt. 27). For the remaining Trusts, including all the OC Trusts, no order of operations is specified in the PSA. For all Trusts for which no order of operations is specified in the PSA (*i.e.*, every Trust except for CWALT 2005-66), the Settlement Agreement and Final Judgment bars a certificateholder from challenging the order of operations required under Subparagraphs 3(d)(1) and (ii) of the Settlement Agreement (*i.e.*, pay first, write-up second).

[20] *See City Bank Farmers' Trust Co. v. Smith*, 263 N.Y. 292, 295-96 (1934). (The purpose of a trustee instruction proceedings is "to protect trustees in the class of cases where the advice of competent lawyers is not sufficient protection, because of the doubtful meaning of the trust instrument, or because of uncertainty as to the proper application of the law to the facts of the case."); *BlackRock Fin. Mgmt. v. Segregated Account of Ambac Assur. Corp.*, 673 F.3d 169, 174 (2nd Cir. 2012) (Article 77 "proceedings are used by trustees to obtain instruction as to whether a future course of conduct is proper ….").

would obligate the Trustee to distribute the proceeds via a "pay first, write-up second" order of operations. The Court's Show Cause Order, which was disseminated to all certificateholders via the extensive, worldwide notice program, notified certificateholders that any claim that the Settlement Agreement violated the Trustee's duties under a Pooling and Servicing Agreement (PSA) would be waived and barred if not asserted. Accordingly, any certificateholder who claimed that the "pay first, write-up second" order of operations in the Settlement Agreement violated a PSA was obliged to appear and make that argument known to the court in the first Article 77 Proceeding. Having failed to do so there, certificateholders waived any such claim here as a matter of law[21] and under the terms of the Show Cause Order.

Any such claim is also barred by the doctrine of estoppel. Estoppel is established by proof of "the word or deed of one party upon which another rightfully relies and so relying changes his position to his injury."[22] As set out in the Trustee's Verified Petition, in the first Article 77 Proceeding, the Trustee specifically sought and obtained an instruction that agreeing to and performing the Settlement Agreement was consistent with its duties under the PSAs. Had any objecting certificateholder notified the Trustee, pursuant to the Show Cause Order, of a claim that the order of operations allegedly violated a PSA, the Trustee and the Article 77 Court could have addressed that issue *before* the Settlement Agreement became final and binding on the Trustee and the Trusts. No such objection was made. The judgment is now final and the Trustee must perform the Settlement Agreement in accordance with its terms, by following the

[21] *Nassau Trust Co. v. Montrose Concrete Prods. Co.*, 56 N.Y.2d 175, 184 (N.Y. 1982) (valid waiver "requires no more than the voluntary and intentional abandonment of a known right which, but for the waiver, would have been enforceable); *Hadden v. Consolidated Edison Co.*, 45 N.Y.2d 466, 469 (1978) (waiver established "by such conduct or failure to act as to evince an intent not to claim the purported advantage).

[22] *Nassau Trust*, 56 N.Y.2d at 184.

order of operations set out in Section 3(d) thereof. In these circumstances, certificateholders are estopped from asserting at this late date that the order of operations violates any PSA.

Accordingly, the Court should: (i) instruct the Trustee to perform Section 3(d) of the Settlement Agreement, and (ii) enter a judgment barring and estopping any certificateholder from challenging the Trustee's application of 3(d) described above.

II. THE PSAS FOR THE OC TRUSTS DO NOT PERMIT OR CREATE "TEMPORARY AND ILLUSORY OVERCOLLATERALIZATION."

The second instruction requested in the Verified Petition concerns the 175 OC Trusts. For the reasons stated below, the Court should instruct the Trustee that—where an overcollateralization calculation impacts distribution of the Settlement Payment—the PSAs do not permit the Trustee to recalculate overcollateralization midway through the distribution by giving effect to a partial distribution; instead, as specified by the PSAs, the Trustee should make the overcollateralization calculation either (i) *after* first paying the settlement payment and then writing up the certificate balance once the distribution is complete or (ii) *before* the distribution takes place, by reference to the required overcollateralization calculation for the prior month. This is the approach mandated by the PSAs and, contrary to the Petition, it does not cause "leakage" of the settlement payment to junior tranches. Applying these provisions in accordance with their terms is also consistent with the purpose of the PSAs overcollateralization provisions, which exist solely to protect senior certificates against the risk of loss. *See* Pet. at ¶23 ("An OC Trust is designed to create credit enhancement, or protection, for more senior Certificateholders…").

A. The Three Types of Overcollateralization Structures in the OC Trusts

The Trustee's submission provided citations to the central distribution sections in the PSAs for the 175 OC Trusts, but the operation of those sections turns on the definition of

specialized terms included in each provision. Exhibits A-1, A-2, and A-3 to the Affidavit of David M. Sheeren, filed herewith, are spreadsheets setting out the text of the relevant overcollateralization definitions for each of the 175 OC Trusts. As is demonstrated in the Exhibits, there are three key "types" of overcollateralization definitions and procedures, but *none of them* includes any language that requires or allows a "mid-distribution" adjustment to the overcollateralization calculation. Instead, the PSAs uniformly require overcollateralization to be calculated either immediately *before* or immediately *after* a given distribution is made – not *during* a distribution. Accordingly, no "temporary, and illusory overcollateralization … during the distribution process," Pet. at ¶26, can occur as result of the "pay first, write-up second" sequence, because the plain terms of each of the PSAs for the OC Trusts do not allow for the creation of overcollateralization "during" a distribution.

1. **In 161 Of The OC Trusts, Overcollateralization Is Specifically Calculated *After* Giving Effect To The Distribution To Be Made On That Date.**

First, in 161 of the 175 OC Trusts,[23] overcollateralization is defined as the amount by which (x) the sum of the aggregate mortgage loan balances exceeds (y) the sum of the aggregate Certificate Principal Balances of the Certificates *after* giving effect to the distributions *to be made* on such distribution date.[24] Thus, in the vast majority of the OC Trusts, overcollateralization is measured only *after* (i) the entire Subsequent Recovery is paid and

[23] *See* Ex. A-1 to the Sheeren Affidavit.

[24] *See, e.g.*, CWALT 2005-J4 (Defining "Overcollateralized Amount" as: "For any Distribution Date, the amount, if any, by which (x) the aggregate Stated Principal Balance of the Mortgage Loans (after giving effect to Principal Prepayments, the principal portion of any Liquidation Proceeds and any Subsequent Recoveries received in the related Prepayment Period) as of the Due Date in the month of that Distribution Date exceeds (y) the aggregate Class Certificate Balance of the Offered Certificates as of such Distribution Date (after giving effect to distributions of the Principal Remittance Amount for each Loan Group to be made on such Distribution Date).") (emphasis added).

distributed on the distribution date, at which point (ii) the Certificate Principal Balances are then "written up" in the amount of such Subsequent Recovery.[25] To put the point directly, overcollateralization is determined for these 161 trusts *after* the money has physically been distributed to the certificateholders entitled to receive it, at which point the certificate balances in each of the trusts are written up to balance the structure. There cannot be any "midstream" or "temporary and illusory overcollateralization that exceeds the OC Target," Pet. ¶26, in these 161 Trusts.

2. In Two Trusts, Overcollateralization Is Measured As Of The Month *Prior* To The Distribution And Is Not Affected By The Amount Of The Current Month's Distribution.

Second, in two of the 175 Trusts,[26] the PSA defines overcollateralization as the amount by which (x) the sum of the aggregate mortgage balances exceeds (y) the sum of the aggregate Certificate Principal Balances of the Certificates *before* giving effect to the distributions to be made on such distribution date.[27] In these Trusts, overcollateralization is measured just *prior* to

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[25] *Compare* Settlement Agreement, CW Article 77, at Section 3(d)(ii), *with*, *e.g.*, CWALT 2005-J4 PSA at § 4.02(g) ("Application of Subsequent Recoveries") ("First, if Subsequent Recoveries have been received with respect to a Liquidated Mortgage Loan, the amount of such Subsequent Recoveries will be applied pro rata based on the Unpaid Realized Loss Amounts for each Class, to increase the Class Certificate Balance of the Class-l-A-4 and Class l-A-6 Certificates in an amount up to the amount of Unpaid Realized Losses on each such Class of Certificates. Second, if Subsequent Recoveries have been received with respect to a Liquidated Mortgage Loan the amount of such Subsequent Recoveries will be applied sequentially, in the order of payment priority, to increase the Class Certificate Balance of each Class of Subordinated Certificates to which Realized Losses have been allocated, but in each case by not more than the amount of Unpaid Realized Losses on that Class of Certificates. Holders of such Certificates will not be entitled to any payment in respect of Current Interest on the amount of such increases for any Interest Accrual Period preceding the Distribution Date on which such increase occurs. Any such increases shall be applied pro rata to the Certificate Balance of each Certificate of such Class.").

[26] *See* Exhibit A-2 to the Sheeren Affidavit.

[27] *See, e.g.*, CWALT 2006-OA10 (Defining "Overcollateralized Amount" as: "An amount equal to the excess of the aggregate Stated Principal Balance of the Mortgage Loans as of the

the distribution; it does not and cannot change *during* the distribution. Accordingly, as with the 161 OC Trusts above, there cannot be any "temporary and illusory overcollateralization that exceeds the OC Target." Pet. ¶26.

3. There Are 12 Overcollateralization "Target" Trusts, Which Likewise Do Not Create Leakage When The PSAs Are Applied According To Their Terms.

Finally, in 12 of the 175 OC Trusts,[28] the PSAs define overcollateralization *target amounts*, not overcollateralization itself.[29] In these 12 Trusts, the overcollateralization target amount for a given distribution is defined as the overcollateralization target amount in effect for the *prior* distribution period – that is, the previous month. Therefore, the only provision in the PSAs relating to overcollateralization is defined as a fixed, dollar amount in effect for the prior month: it is not affected *at all* by the distribution of the Settlement Payment and certainly does not and cannot change *during* a distribution.

In light of the plain language of the PSAs, the Trustee cannot consider any "temporary or illusory overcollateralization" that allegedly arises *during* a distribution, because the PSAs do not permit the Trustee to "recalculate" overcollateralization midway through a distribution, "in between step one (payment) and step two (write up)." Pet. at ¶26. The Trustee should therefore be instructed to distribute the Settlement Payment to the OC Trusts immediately, in accordance

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Due Date in the month of that Distribution Date (after giving effect to Principal Prepayments received in the related Prepayment Period) over the aggregate Class Certificate Balance of the Senior Certificates (other than the Notional Amount Certificates) and the subordinated Certificates immediately prior to such Distribution Date.") (emphasis added).

[28] *See* Exhibit A-3 to the Sheeren Affidavit.

[29] *See, e.g.*, CWALT 2005-69 (Defining "Overcollateralization Target Amount" as: "[I]f a Trigger Event is in effect on any Distribution Date, the Overcollateralization Target Amount will be the Overcollateralization Target Amount as in effect for the prior Distribution Date.") (emphasis added).

with the Settlement Agreement and Final Judgment, and to disregard any claimed "overcollateralization" that arises "in between step one (payment) and step two (write up)," Pet. at ¶26, of the distribution. In addition, even if a dispute is demonstrated as to one category of OC Trusts, the Trustee should be instructed to distribute the Settlement Payment to the uncontested OC Trusts immediately, again because both the PSAs and the Final Judgment are clear on these points.

B. Distribution Of The Settlement Payment To Junior Holders In The OC Trusts Is Also Inconsistent With The Purpose Of The Overcollateralization Provisions.

The PSAs should be interpreted consistent with the intent of the parties. *See, e.g.*, *Novak & Co., Inc. v. New York Convention Center Development Corp.*, 202 A.D.2d 205, 608 N.Y.S.2d 219 (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, 483 N.Y.S.2d 103 (2d Dep't 1984)). The purpose of overcollateralization is to protect and 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 it, 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.***

Pet. at ¶23 (emphasis added).

In plain terms, overcollateralization is an asset cushion meant to provide stable and predictable protection to the senior certificates against the risk of loss. The junior certificates, in contrast, bear the risk of loss and are compensated for that greater risk with a higher coupon rate than the rate paid to the safer, less risky, senior certificates. Pet. 7 ¶23. Where the prescribed overcollateralization cushion is absent, trust distributions are made in order of seniority, with senior certificates being paid principal first. The junior certificates receive principal payments only when senior Certificateholders are fully protected (because they are fully over-collateralized) or when the senior certificates have been paid in full. This structure is set out plainly in the PSAs and is one to which all certificateholders bound themselves when they purchased their certificates.

Recognizing "illusory" or "temporary" overcollateralization midway through a distribution eviscerates the purpose of overcollateralization. As the Trustee's Petition confirms, "the OC Target [in the OC Trusts] 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."[30] Unsurprisingly, the Trustee cites no PSA language that suggests overcollateralization is meant to be an "artificial" concept, nor does it point to any language requiring the Trustee to give effect to *illusory* or *temporary* overcollateralization "between steps" in a distribution. We have examined the PSAs for all 175 OC Trusts have found no such language. *See, e.g.*, Sheeren Aff., Exs. A-1, A-2, A-3.

There is simply no support in any PSA for a claim that the Trustee could or should give effect to "temporary" "midstream" or "illusory" overcollateralization, when that result is at odds with what the Trust's *actual* assets and liabilities will be once the distribution is concluded (or

[30] Pet. 1 at ¶26 (emphasis added).

commenced) and the required write-up has occurred. To the contrary, doing so would violate the text and intent of the overcollateralization provisions because it would cause the seniors to become *less* overcollateralized than they were before the distribution was made. Accordingly, the Court should instruct the Trustee to distribute the Settlement Payment in the OC Trusts in accordance with the order of operations specified in the PSAs, and without regard to any claimed "temporary or illusory overcollateralization," as the PSAs do not permit a recalculation of overcollateralization or overcollateralization targets midway through a distribution.

III. AS THERE IS NO TRIABLE ISSUE OF FACT IN THE PETITION REGARDING HOW THE SETTLEMENT SHOULD BE DISTRIBUTED TO THE 355 NON-OC TRUSTS, THE TRUSTEE SHOULD BE INSTRUCTED TO DISTRIBUTE THE SETTLEMENT PAYMENT TO ALL NON-OC TRUSTS IMMEDIATELY.

The "concern" that prompted the Trustee to file this second, Article 77 Petition arose solely in the context of certain OC Trusts. Pet. at ¶¶25-26, and ¶41. The Petition cites no facts demonstrating any impediment—or even any dispute—concerning how the Settlement Payment should be distributed in the non-OC Trusts. Under N.Y.C.P.L.R. 409, therefore, the Petition presents no triable issue of fact regarding how the Settlement Payment should be distributed to the 355 non-OC Trusts.[31] The Court should therefore instruct the Trustee to distribute the Settlement Payment to those trusts immediately.[32]

IV. STATEMENT OF INVESTORS REGARDING ESCROWED SETTLEMENT PAYMENT

The undersigned investors do not dispute the investments into which the Court authorized the Trustee to place the escrowed Settlement Payment. They do believe, however, that the

[31] The Non-OC Trusts are identified by Trust name on Exhibit "A" to the Petition.

[32] The Trustee's alternative form of relief (*i.e.*, an order directing it to *ignore* the Settlement by reversing the order of operations to "write-up first, pay second" as to all trusts, Pet. at Prayer for Relief (c) at pg. 16) does not present a triable issue of fact, either. The order of operations specified in the Settlement Agreement was approved in the Final Judgment and is *res judicata*.

Trustee should not charge any Trustee fee on the escrowed proceeds, because the Settlement Payment could and should have been distributed in accordance with the Settlement Agreement and Final Judgment when it was received. Accordingly, since this proceeding has been filed for the protection of the Trustee, the Trustee should not be permitted to charge any fee, of any kind, on the escrowed proceeds.

CONCLUSION

For the reasons set forth above, the investors identified below respectfully request that the Court direct the Trustee to distribute the settlement payment immediately as to all 530 Covered Trusts under the "pay first, write-up second" formulation set forth in the Settlement Agreement and Final Judgment, and without permitting "leakage" on account of any mid-distribution "illusory" overcollateralization. To the extent there is a dispute for this Court to resolve as to the distribution of the settlement proceeds to the 175 OC Trusts, the Trustee should be instructed to distribute the Settlement Payment to the 355 non-OC Trusts immediately, as the Petition discloses no triable issue of fact concerning whether the Trustee should—as it is required to do—perform the Settlement Agreement in accordance with its terms and with the Final Judgment.

If there is a dispute as to how the Settlement Payment is to be distributed to a particular sub-category of OC Trusts (either with respect to those sub-categories set forth in Sections II.A.1–3 above or otherwise), this proceeding should be limited solely to such sub-category of OC Trusts where a certificateholder appears and lodges an objection. As to all other categories of the OC Trusts, there is again no triable issue of fact raised by the Petition, and the Trustee should

accordingly be instructed to distribute the settlement proceeds immediately to all categories of Trusts for which no objection has been raised in this proceeding.[33]

Dated: New York, New York
March 4, 2016

WARNER PARTNERS, P.C.

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[33] In the alternative, were this Court to choose from one of the three options identified in the Trustee's Prayer for Relief, see Pet. at 16, then the Court should select the option identified as "(i)(a)" in the Petition because that option achieves the same economic result as advocated herein and most accords with the structure and purpose of the Settlement Agreement and PSAs.

Investment Management LLC; and Western Asset Management Company

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