

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

----- X

In the matter of the application of :

U.S. BANK NATIONAL ASSOCIATION, THE BANK OF NEW:
YORK MELLON, THE BANK OF NEW YORK MELLON TRUST:
COMPANY, N.A., WILMINGTON TRUST, NATIONAL:
ASSOCIATION, LAW DEBENTURE TRUST COMPANY OF NEW:
YORK, WELL FARGO BANK, NATIONAL ASSOCIATION, HSBC:
BANK USA, N.A., and DEUTSCHE BANK NATIONAL TRUST:
COMPANY (as Trustees under various Pooling and Servicing:
Agreements and Indenture Trustees under various Indentures),:
AEGON USA Investment Management, LLC (intervenor), Bayerische:
Landesbank (intervenor), BlackRock Financial Management, Inc.:
(intervenor), Cascade Investment, LLC (intervenor), the Federal Home:
Loan Bank of Atlanta (intervenor), the Federal Home Loan Mortgage:
Corporation (Freddie Mac) (intervenor), the Federal National:
Mortgage Association (Fannie Mae) (intervenor), Goldman Sachs:
Asset Management L.P. (intervenor), Voya Investment Management:
LLC (f/k/a ING Investment LLC) (intervenor), Invesco Advisers, Inc.:
(intervenor), Kore Advisors, L.P. (intervenor), Landesbank Baden-:
Wuerttemberg (intervenor), Metropolitan Life Insurance Company:
(intervenor), Pacific Investment Management Company LLC:
(intervenor), Sealink Funding Limited (intervenor), Teachers Insurance:
and Annuity Association of America (intervenor), The Prudential:
Insurance Company of America (intervenor), the TCW Group, Inc.:
(intervenor), Thrivent Financial for Lutherans (intervenor), and:
Western Asset Management Company (intervenor),

Index No. 652382/2014

Part 60

The Honorable Marcy S. Friedman,
J.S.C.

Petitioners,

-against-

AMBAC ASSURANCE CORPORATION, AND THE
SEGREGATED ACCOUNT OF AMBAC ASSURANCE
CORPORATION (intervenor), AND W&L INVESTMENTS, LLC
(intervenor),

Respondents,

for an order, pursuant to CPLR § 7701, seeking judicial instruction,
and approval of a proposed settlement.

----- X

**Petitioners' Supplemental Brief in Opposition to
Objection by W&L Investment**

TABLE OF CONTENTS

I.	Introduction	1
II.	Facts Pertinent to W & L's Objection	3
III.	W & L's Objection is Contrary to the Relevant PSA Terms.....	5
	A. Repurchase Proceeds are Not Defined as Principal Prepayments	7
	B. W & L's Argument Does Not Rest on the PSA Terms at All	8
	Conclusion	9

TABLE OF AUTHORITIES

Cases:

In re Bank of New York Mellon [Countrywide Article 77],
No. 651786/11 2014 WL 1057187 (*N.Y. Sup. Ct. Jan. 31, 2014*), affirmed as
modified by 127 A.D.3d 120 (1st Dep’t 2015) 2

In re The Bank of New York Mellon,
127 A.D.3d 120 (1st Dep’t 2015) 2, 3, 5

Leaman v. Ambrosio,
224 A.D.2d 755 (3d Dep’t 1996) 1

Matter of U.S. Bank N.A. [Citigroup Article 77]
(Sup. Ct. NY Cnty, No. 653902/2014, Dec. 21, 2015, Friedman, J.) 2

*Ret. Bd. of the Policemen's Annuity & Ben. Fund of the City of Chicago v. Bank of
N.Y. Mellon*, 775 F.3d 154, 163 (2d Cir. 2014), cert. denied, No. 15-314,
2016 WL 100377 (U.S. Jan. 11, 2016). 2

Slamow v. Delcol,
174 A.D.2d 725 (2d Dep’t 1991) *aff’d.* 79 N.Y.2d (1992) 5

The Court requested supplemental briefing to address W&L's objection that the distribution provisions of the Settlement Agreement are allegedly inconsistent with the Pooling and Servicing Agreements ("PSAs") that govern two of the Settlement Trusts, Chase 2007-A3 and Chase 2007-S6 ("the W&L Trusts"), because the PSAs allegedly require the settlement payment to be distributed as Repurchase Proceeds, rather than as a Subsequent Recovery. For the reasons stated below, W&L's objection should be overruled.

I. Introduction

W&L's sole objection is that The Bank of New York Mellon Trust Company abused its discretion as a trustee when it entered into a settlement agreement that characterizes the settlement proceeds as a "Subsequent Recovery" for payment under the waterfall in the W&L PSAs.¹ W&L's objection suggests that characterizing the settlement proceeds as "Repurchase Proceeds" would result in a different distribution to different investors (including W&L) than will occur if the funds are characterized as a "Subsequent Recovery."

W&L is wrong. Under the PSAs for both trusts, Repurchase Proceeds are required to be deposited into the same account, and distributed at the same time to the same investors (in their bargained for order of priorities), as Subsequent Recoveries. W&L, as the current holder of deeply subordinated, Class B certificates (which were long ago written off and have no principal balance owed), would receive no part of the settlement proceeds regardless of how those funds

¹ W&L alleges it holds interests only in the W&L Trusts, for which The Bank of New York Mellon Trust Company is the Trustee. It does not challenge the reasonableness of the settlement *amount* for the W&L Trusts or any terms of the Settlement Agreement for those trusts other than the distribution provision. W&L also does not challenge the decisions of the other trustees to accept the settlement for their trusts, nor would it have standing to do so. *See Ret. Bd. of the Policemen's Annuity & Ben. Fund of the City of Chicago v. Bank of N.Y. Mellon*, 775 F.3d 154, 163 (2d Cir. 2014), cert. denied, No. 15-314, 2016 WL 100377 (U.S. Jan. 11, 2016).

were characterized, because the funds would inevitably be paid to certificateholders who bargained for a more senior position in the contractual payment waterfall.

Unable to dispute that it will recover nothing if the settlement proceeds are distributed through the payment waterfall as required by the PSAs (whether as a Subsequent Recovery or Repurchase Proceeds), W&L's supplemental brief offers a new, equally flawed, argument. Now, W&L claims that, because the PSAs provide that repurchase is the "sole remedy" the Trustees may pursue against the Originator of mortgage loans for breaches of representations and warranties, this somehow means that the Trustee *cannot* settle the Trusts' repurchase claims *unless* it identifies each claim of breach, returns each defective loan to the Originator, and receives repurchase proceeds in return. W&L Brief at 3.²

W&L's argument wrongly conflates the remedies the Trustee can enforce against the Originator with the Trustees' power to resolve claims it owns and is directly contrary to Justice Kapnick's decision in *Countrywide I* (and this Court's decision in the Citigroup Article 77) that "[i]nherent in the Trustee's power to commence litigation is the power to settle litigation."³ Nothing in the PSAs or the law requires a Trustee to identify every single breaching loan before it can settle a repurchase claim; to the contrary, as the First Department held, a Trustee's exercise of settlement discretion to resolve repurchase and servicing claims must be upheld *unless* the Trustee acts unreasonably and in bad faith. *In re The Bank of New York Mellon*, 127 A.D.3d 120,

² "Payment for breaches of representations and warranties other than as set forth in Section 3.01 [the repurchase protocol] is inconsistent with the Governing Agreements."

³ *In re The Bank of New York Mellon [Countrywide Article 77]*, No. 651786/11 2014 WL 1057187, at *9 (N.Y. Sup. Ct. Jan. 31, 2014), *affirmed as modified by*, 127 A.D.3d 120 (1st Dep't 2015). *Accord Matter of U.S. Bank N.A. [Citigroup Article 77]*, 653902/2014 at *12 (NY Sup. Ct. Dec. 21, 2015) (RMBS PSAs "effectively grant the Trustee the power and authority to commence litigation and, with it, the discretionary power to settle litigation.") (citations and quotations omitted).

125 (1st Dep’t 2015) (“It is not the task of the court to decide whether we agree with the trustee's judgment; rather, our task is limited to ensuring that the trustee has not acted in bad faith such that his conduct constituted an abuse of discretion.”).⁴

W&L also does not allege (nor could it) that the Trustee’s acceptance of a settlement of repurchase claims, and distributing the settlement proceeds as provided in the PSAs would be unreasonable or in bad faith. Instead, it simply wants a different Settlement Agreement: W&L urges the court to rewrite the Settlement Agreement to require the Trustee to turn back the clock, identify the certificates that suffered the losses on defective loans (as opposed to suffering losses for other reasons)—an impossible task that W&L offers no plan to accomplish—and then pay the settlement proceeds to W&L (on the unexplained and plainly wrong theory that its certificates suffered all of the losses on defective loans). W&L points to no provision of the PSAs, and no principle of law, that would permit the Court to do so.

II. Facts Pertinent to W&L’s Objection

W&L “purchased certificates in the 5 most subordinated tranches issued by” Chase 2007-A3 and Chase 2007-S6. RX 328, Lewis Rep’t. at ¶ 2.⁵ Each of the Certificates W&L owns “has been written down to zero as a result of realized losses on the underlying mortgage loans and the allocation of the associated realized losses...” *Id.* W&L objects to the treatment of the Settlement Payment as a “Subsequent Recovery,” arguing that instead “[t]he Settlement Payment should be distributed to all of those Investors who suffered a loss as a result of the actions of Chase.”

NYSCEF 148, W&L Obj. Ltr. at 2. It also asserts that “[t]he purpose of the settlement agreement

⁴ W&L’s citation to *Nomura* is misplaced. The case does not address the power of a Trustee to *settle* repurchase claims that it owns.

⁵ Petitioners have a pending objection to the admission of this document and cite it here only to establish W&L does not dispute that it owns certificates that have been written down to zero.

is to compensate certificateholders for losses from breaches of representations and warranties, not from losses suffered *by the trust or something else* for all of the other reasons why this trust might suffer such losses but specifically to compensate for losses from breaches of representations and warranties.” Jan. 20, 2016 Tr. at 30:21-31:2 (Opening Statement of W&L Counsel) (emphasis added).⁶

W&L’s Pretrial Brief demands that all of the settlement proceeds for the W&L Trusts be distributed to W&L. *See* NYSCEF 576, Objectors’ Trial Brief at 18.⁷ W&L suggests the Court should also direct the Trustee to use additional means (W&L is silent as to what means) to roll back the clock to: a) identify which of the realized losses in the trust were caused by breaches of representations and warranties, as opposed to other factors, b) determine when those “repurchase” losses occurred, and c) identify which investors in Trust Certificates bore those “repurchase” losses when they were realized. W&L again cites no provision of the PSA that would authorize the Trustee to pay the Settlement Payment to certificates that have been written off—because no such provision exists.

Finally, though W&L invokes the losses suffered by Class B Certificateholders to support its objection, W&L’s expert testified that the *senior* certificateholders have suffered the vast bulk of losses incurred on the Trusts’ Mortgage Loans. *See* Depo. Tr. Matthew Lewis at 97:19-99:14

⁶ In fact, the purpose of the Settlement Agreement is to resolve claims belonging to the RMBS Trusts that “arise under or are based upon the Governing Agreements and that relate to the origination, sale, delivery and/or servicing of Mortgage Loans to or in the Settlement Trusts,” Ex. 2 and 3 at Section 3.02, not to “compensate individual investors” for losses they might have suffered. Though the proceeds of the Settlement Payment will flow to Certificateholders under the terms of the PSAs, the claims released in the Settlement Agreement belong to the RMBS Trusts, not to individual investors. *Id.* at 3.01 and 3.02 (defining “Released Claims”).

⁷ Though W&L invokes losses suffered by Class B Certificateholders at earlier dates, it does not claim that W&L itself suffered such losses. W&L’s failure to offer proof that it suffered losses, when such evidence is within its control, is striking.

(Senior Certificates in Chase 2007-S6 suffered 64% of realized losses and will suffer losses in the future) and 140:16-142:7 (Senior Certificates in Chase 2007-A3 suffered 62% of realized losses).

III. W&L's Objection is Contrary to the Relevant PSA Terms

Under New York law, the Court cannot rewrite the PSAs,⁸ nor can it substitute its judgment for that of the Trustee and re-write the Settlement Agreement. *In re The Bank of New York Mellon (Countrywide II)*, 127 A.D.3d at 125. The plain terms of the PSAs refute W&L's claim that The Bank of New York Mellon abused its discretion when it agreed to the distribution formula in the Settlement Agreement.

Each of the PSAs contains identical terms specifying how particular types of cash flow are classified and how payments to certificateholders are calculated. Section 1.01 of the PSAs defines the operative terms as follows:

- "Available Distribution Amount" is an amount equal to the amount on deposit in the "Collection Account."
- "Subsequent Recovery" is defined as "[t]he amount, if any, recovered by the Servicer with respect to a Liquidated Mortgage Loan with respect to which a Realized Loss has been incurred..."
- "Repurchase Proceeds" is defined as "all proceeds of any Mortgage Loan or property acquired in respect thereof" that has been repurchased pursuant to the repurchase provisions of the PSAs.
- "Outstanding Certificate Principal Balance" means, with respect to any certificate, "the Original Certificate Principal balance of such Class ...*minus* the sum of (i) any distributions of principal made on such Class ... prior to such Distribution Date and (ii) any Realized Losses allocated to such Class prior to such Distribution Date."

The PSAs require cash to be distributed on a current basis on each monthly Distribution Date:

⁸ *Slamow v. Delcol*, 174 A.D.2d 725, 727 (2d Dep't 1991) *aff'd* 79 N.Y.2d (1992) ("A court may not rewrite into a contract conditions the parties did not insert by adding or excising terms under the guise of construction...").

- Section 5.08 states that “the Servicer shall segregate and hold all funds collected and received pursuant to a Mortgage Loan separate and apart from any of its own funds and general assets and shall establish and maintain one or more collection accounts for the benefit of the Certificateholders (collectively, the “Collection Account.”) (emphasis added); and,
- Section 5.08 also states that both Subsequent Recoveries and Repurchase Proceeds must be deposited in the Collection Account: “The Servicer shall deposit or cause to be deposited in the Collection Account on a daily basis ...and retain therein (iii) Any Subsequent Recovery... [and] (vi) All Repurchase Proceeds...”.

Section 6.01(I) and (II) describe the payment waterfall that must be used to distribute cash from the Collection Account in each month. Each month, the funds in the Collection Account are aggregated into the Available Distribution Amount, which is then distributed in accordance with the payment waterfall in Section 6.01. Section 6.01(I) of the waterfall does not apply, because each of the W&L Trusts has reached its Credit Support Depletion Date.⁹ The governing waterfall is therefore the one found in Section 6.01(II). It states that “[o]n or after the Credit Support Depletion Date,” the entirety of the Available Distribution Amount must be paid to the Class A Certificates until they are paid in full. Since the Settlement Payments are not large enough to retire the Class A Certificates in full, no part of the Available Distribution Amount is permitted to flow to the Class B Certificates under the PSAs.¹⁰

W&L cites no provision of the PSAs that would authorize, much less require, the Servicer or the Trustee to go back in time to treat cash “as though” it had been received at an

⁹The Credit Support Depletion Date occurs when the subordinate Class B and Class M Certificates have been written down to zero as a result of the accrual of realized losses on Mortgage Loans. *See* PSA Section 1.01 (“Credit Support Depletion Date”). W&L does not dispute that the two W&L Trusts have reached their Credit Support Depletion Dates.

¹⁰ The result would not differ even had the Credit Support Depletion Date not been reached: under the PSA waterfall, every element of the cash distribution formula requires that a given certificate have a *positive* Outstanding Unpaid Principal Balance before it can receive funds. Since the W & L Certificates have been written down to zero, they would still be entitled to no portion of the Settlement Payment.

earlier date. Instead, the definition of Available Distribution Amount requires that all funds received since the prior month's Distribution Date first must be deposited in the Collection Account, as described in Section 5.08, and then must be distributed at the next Distribution Date, pursuant to Section 6.01. BNYMellon therefore did not act *unreasonably* or in *bad faith* by agreeing to a Settlement distribution formula that mirrors the way both Repurchase Proceeds and Subsequent Recoveries would be treated under the terms of the PSAs.

A. Repurchase Proceeds are Not Defined as Principal Prepayments.

W&L's counsel, and its expert witness, Matthew Lewis, each claim that Repurchase Proceeds are considered principal prepayments under these PSAs. "The repurchase proceeds, unlike subsequent recoveries, have to be paid as pre-payments. The loan comes out, the repurchase price goes in." Jan. 20, 2016 Tr. at 34:22-24 (Argument of W&L Counsel); *see also* Depo. Tr. Matthew Lewis at 171:5-18 (testifying that his "understanding" is that payments for repurchase of breaching mortgages "are treated as prepayments.").¹¹ W&L's brief adds to this theory by citing language from the Prospectus Supplements indicating that Repurchase Proceeds will have "the effect of prepayments." Supp. Br. at 5 *citing* RX 303 at S-28; RX-304 at S-16. Though the receipt of Repurchase Proceeds can result in a prepayment of principal on certificates, W&L cites no provision of the PSAs that authorizes or requires the Trustee or the Paying Agent to go back and ensure Repurchase Proceeds are paid to the particular

¹¹ Mr. Lewis testified "he was not offering a legal opinion on the meaning of the pooling and servicing agreements...[or] an opinion based on [his] industry experience that the treatment of the settlement payments and subsequent recoveries is wrong." Depo. Tr. at 14:23-15:18. Such testimony would not have been credible, in any event, because Mr. Lewis never read the PSAs that govern these Trusts. *Id.* at 134:2-6.

certificateholders whose certificates bore a loss on a specific, ineligible mortgage loan.¹² W&L Supp. Br. at 8. To the contrary, the PSAs are clear that both Repurchase Proceeds and Subsequent Recoveries must be deposited in the Collection Account, Section 5.08(vi) (Subsequent Recovery) and (iii) (Repurchase Proceeds), where they are distributed monthly as part of the Available Distribution Amount. *See* Section 6.01(I) or 6.01(II). In addition, the defined term Principal Prepayments in these PSAs expressly excludes *both* Subsequent Recoveries and Repurchase Proceeds.¹³ In these PSAs, *both* Subsequent Recoveries and Repurchase Proceeds are required to be deposited in the Collection Account and distributed as part of the Available Distribution Amount. When that happens, the subordinated Class B Certificates W&L now owns would not receive any portion of the Settlement Payment, even if it were defined as Repurchase Proceeds, rather than as a Subsequent Recovery.

B. W&L’s Argument Does Not Rest on the PSA Terms at All.

W&L’s Supplemental Brief concedes the Settlement Payment would *not* flow differently if it were treated as “Repurchase Proceeds,” rather than as a “Subsequent Recovery,” so W&L has retreated to the following argument: *If* Repurchase Proceeds had been received before the certificates W&L now owns were written off, the persons who held those certificates then *might*

¹² In fact, the Prospectus Supplements W&L cites state plainly that when Repurchase Proceeds are received (which could occur years *after* a Certificate was written down as a result of a loss), those proceeds are paid out “in the month *following* the month of such repurchase,” whenever the repurchase occurs, in accordance with the contractual waterfall. RX 303 at S-81 (emphasis added); RX 304 at S-57.

¹³Section 1.01 defines Principal Prepayments as “Any payment or other recovery of principal on a Mortgage Loan . . . provided, however, that the term Principal Prepayment does not include Insurance Proceeds, Liquidation Proceeds, Subsequent Recoveries, condemnation awards *or other cash proceeds from a source other than the applicable Mortgagor.*” (Emphasis added). The Mortgagor is the borrower. Repurchase Proceeds are *not* received from the applicable Mortgagor: they are received, if at all, from the mortgage Seller. *See* 3.01 (last paragraph) and 2.02 (same).

have received payment of some portion of the Repurchase Proceeds from the Available Distribution Amount. From this, W&L argues that it should receive the entire Settlement Payment for itself. But nothing in the PSAs would ever have required that *all* Repurchase Proceeds be paid to the Class B Certificates, as W&L's Objection argues; to the contrary, as demonstrated above, Repurchase Proceeds are simply deposited in the Collection Account and distributed as part of the Available Distribution Amount pursuant to the Sections 5.08 and 6.01, above, where they are first used to pay interest and retire principal on more senior certificates in the waterfall.

W&L's speculation that earlier distributions of Repurchase Proceeds might have resulted in fewer or slower write-offs of the certificates likewise does not state any ground on which the Court could grant the extraordinary relief W&L seeks: payment of the entire Settlement Amount to W&L. Again, no provision of the PSAs authorizes such a result.

Conclusion

W&L's objection should be overruled. The Settlement Payment is not large enough to cause the Class A Certificates to be paid in full, so regardless of how the Settlement Payment is classified, its receipt in the Collection Account would never result in a distribution to the Class B Certificates W&L now owns. Both Repurchase Proceeds and Subsequent Recoveries are included in the Available Distribution Amount, and they flow to the Class A Certificates under the terms of the governing waterfall. BNYMellon therefore did not act unreasonably or in bad faith in agreeing to the terms of the Settlement Agreement.

Dated: January 25, 2016
New York, New York

WARNER PARTNERS, P.C.

By: s/ Kenneth E. Warner
Kenneth E. Warner
950 Third Avenue, 32nd Floor
New York, New York 10022
(212) 593-8000

GIBBS & BRUNS LLP

Kathy D. Patrick
1100 Louisiana Avenue, Suite 5300
Houston, TX 77002
(713) 650-8805

*Attorneys for Intervenor-Petitioners, the
Institutional Investors*

MAYER BROWN LLP

By: Matthew D. Ingber

Matthew D. Ingber
1221 Avenue of the Americas
New York, NY 10020
(212) 506-2500

*Attorneys for Petitioners
The Bank of New York Mellon and
The Bank of New York Mellon
Trust Company, N.A.*