

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

In the matter of the application of

Wells Fargo Bank, National Association, *et al.*,

Petitioners,

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

Index No. 657387/2017

IAS Part 60

Hon. Marcy S. Friedman

**MEMORANDUM OF LAW OF U.S. BANK NA, IN ITS CAPACITY AS TRUSTEE FOR THE NIM TRUSTS LISTED ON EXHIBIT A, AND POET AND PROPHET, ON THE ORDER OF THE DISTRIBUTION OF THE SETTLEMENT PAYMENT**

Respondents U.S. Bank National Association (“U.S. Bank”), solely in its capacity as Indenture Trustee for the NIM Trusts listed on Exhibit A (the “NIM Trusts”), and solely at the direction of Respondents Poetic Holdings VI LLC, Poetic Holdings VII LLC (together, “Poetic”) and Prophet Mortgage Opportunities Fund LP (“Prophet”), and together with Poetic and Prophet as certificateholders in the Settlement Trusts listed on Exhibit B, jointly submit this memorandum of law and the accompanying affirmation of Donald W. Hawthorne (“Hawthorne Aff.”) to address the questions raised in the Petition regarding the order of distribution of the settlement payment (the “Order of Payment Issue”). Specifically, the Petition asks the Court for instructions on whether to “administer and distribute the applicable Allocable Shares using the Pay First Method, the Write-Up First Method, or a different method authorized by this Court.” Pet. Request For Relief 5(a).<sup>1</sup> For the reasons given below, it is Respondents’ position, with

<sup>1</sup> All capitalized terms in this Memorandum have the meaning given to them in the Petition, unless otherwise specified.

respect to the Settlement Trusts listed on Exhibit B (the “Poetic / Prophet Trusts”), that the Trustees should apply the Write-Up First Method.<sup>2</sup>

### ARGUMENT

Each Trust’s Allocable Share of the Settlement Payment is “a ‘subsequent recovery’ relating to principal proceeds available for distribution” on the distribution date “immediately following” its deposit into the Trust’s collection or distribution account.” Settlement Agreement 3.06(a); Pet. 8. The Allocable Share is to be distributed “in accordance with the distribution provisions of the [PSAs].” Settlement Agreement 3.06(a).

Each of the PSAs for the Exhibit B Trusts contains a section titled “Distributions,” at Section 5.04 (for the BSABS Trusts) or 6.04 (for some SACO Trusts), which governs the distribution of interest and principal. That section requires that “on each Distribution Date, an amount equal to the Interest Funds and Principal Funds for each Loan Group for such Distribution Date shall be withdrawn by the Trustee from the Distribution Account and distributed in the following order of priority...” Section 5.04(a). The first step of the waterfall, Section 5.04(a)(1), addresses the use of the Interest Funds to be used to cover various payments

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<sup>2</sup> Pursuant to the Court’s Order dated September 14, 2018 and at the direction of Respondents Poetic and Prophet (each in their capacities as holders of notes issued by the NIM Trusts), U.S. Bank, solely in its capacity as Indenture Trustee under the NIM Trusts referenced on Exhibit A hereto (which hold a direct interest in the Settlement Trusts referenced on Exhibit B hereto), has substituted into this proceeding in place of Respondents Poetic and Prophet. This memorandum of law addresses only the Order of Payment Issue and it reflects the position of Poetic and Prophet as set forth in their initial Answer dated January 29, 2018. U.S. Bank, in its capacity as Indenture Trustee under certain other NIM Trusts, has also substituted into this proceeding on behalf of Respondents HBK Master Fund LP (“HBK”). At the direction of HBK, U.S. Bank will submit another memorandum of law with respect to the Order of Payment Issue (the “HBK Memorandum of Law”). Additionally, U.S. Bank, in its capacity as Indenture Trustee for all the NIM Trusts participating in this proceeding, at the direction of HBK, Poetic and Prophet, together with Poetic and Prophet, is also submitting a joint brief addressing issues raised in the Petition regarding the Retired Class Provision. The HBK Memorandum of Law, may in some respects, advance positions contrary to those asserted herein; however, as contemplated by the Court’s substitution order, U.S. Bank has taken appropriate measures to address any potential or actual conflicts of interest. Furthermore, U.S. Bank’s capacity in its role as NIM Trustee hereunder is a separate and distinct capacity from that of U.S. Bank in its role as Petitioner and Trustee of the Settlement Trusts.

relating to interest and the treatment of excess spread. The waterfall then moves to Section 5.02(a)(2), which provides that “Principal Funds ... shall be distributed in the following manner and order of priority...” In the following subsections, the Trustee is directed to distribute the Principal Distribution Amount (consisting of Principal Funds and certain defined elements of excess spread) to each class of certificates, “until the Certificate Principal Balance thereof is reduced to zero,” and then move on to the next. *See* Hawthorne Aff. Ex. 1 (BSABS 2005-HE3 “Distributions” Section).

The Petition asks the Court for instructions on whether the Trustees should apply one of “two different approaches to perform these operations:”

- 1) “The Petitioners could first distribute the Settlement Payment based on certificate principal balances that do not account for the Settlement Payment Write-Up and thereafter apply the Settlement Payment Write-Up to the pertinent certificate principal balances (the “Pay First Method” Method);” or
- 2) “First apply the Settlement Payment Write-Up to the pertinent certificate principal balances and thereafter distribute the Settlement Payment based on the newly written up certificate principal balances (the “Write-Up First Method”).”

Pet. 22.

Application of the Pay First Method, as opposed to the Write-Up First Method, has the potential to create a number of problems relating to both overcollateralization and undercollateralization. *See, e.g.*, Pet. 24-34. Fortunately, as to the Poetic / Prophet Trusts, the text of the PSAs is clear: the Trustees must necessarily apply the Write-Up First Method.<sup>3</sup>

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<sup>3</sup> The provisions of the PSAs govern the distribution of the Settlement Payment, as is set out in the J.P. Morgan Settlement Agreement itself, *see id.* at 3.06, and 7.02 (providing that nothing in it is “intended to, and shall not be argued or deemed to constitute, an amendment of any term of any [PSA].”)

Under the Poetic / Prophet Trusts' PSAs, the entire Distributions section is premised on the calculation of Certificate Principal Balance, which must be ascertained before such distributions can be made. That is because, on any particular Distribution Date, distributions are made sequentially to each Class of Certificates, starting with the most senior, until the Certificate Principal Balance for that class is "reduced to zero." Of course, it would be impossible for the Trustee to know when the Certificate Principal Balance has been reduced to zero by distributions if it were not calculated before the distributions were made.

Moreover, the calculation of Certificate Principal Balance on any given Distribution Date must include a write-up for Subsequent Recoveries that the Trust has received, which the Trustee shall distribute on that date. That is because Certificate Principal Balance is defined as comprising four elements:

- (1) Initial Certificate Principal Balance; plus
- (2) "any Subsequent Recoveries added to the Certificate Principal Balance of such Certificate pursuant to Section 5.04(b); minus
- (3) "all amounts distributed with respect to such Certificate in reduction of the Certificate Principal Balance thereof on previous Distribution Dates; and minus
- (4) "any Applied Realized Loss Amounts allocated to such Certificate on previous Distribution Dates."

*See* Hawthorne Aff. Ex. 2 (BSABS 2005-HE3 definition of "Certificate Principal Balance.")

The first of these components is simply the original Principal Balance as of the closing of the Trust. The third and fourth components – reductions for amounts already paid out as principal, and for realized loss amounts – are expressly applicable only to the extent that such amounts were distributed or allocated on previous Distribution Dates. The second item – an

increase for Subsequent Recoveries – is not defined in that way. It reflects the PSAs’ Parties intent that, on any given Distribution Date, while *reductions* for amounts paid out and realized losses are subtracted from Certificate Principal Balance only to the extent they occurred on previous Distribution Dates, write-ups for Subsequent Recoveries received for distribution are to be included in the calculation of Certificate Principal Balance before they are distributed on that date. In other words, write-ups occur before distribution, write-downs afterwards.

That this difference in treatment of write-ups for subsequent recoveries and write-downs for amounts previously distributed or allocated for realized losses is intentional is further underscored by language that appears elsewhere in the PSAs, in Section 5.05, which relates to write-downs for realized losses. *See* Hawthorne Aff. Ex. 3 (BSABS 2005-HE3 Section 5.05). In the majority of the Poetic / Prophet Trusts at issue, Section 5.05 expressly provides that “all Realized Losses to be allocated to the Certificate Principal Balances of all Classes on any Distribution Date shall be so allocated *after* the actual distributions to be made on such date as provided above.” *Id.* at Section 5.05(a). No such statement is found in the immediately preceding section relating to the writing *up* of Certificate Principal Balances in connection with Subsequent Recoveries. The clear implication is that the writing up of Certificate Principal Balances before distribution was assumed, and it was necessary to specify a different order of operations with respect to the application of Realized Losses.

### **Conclusion**

For the foregoing reasons, Respondents respectfully request that the Court instruct the Trustees to apply the Write-Up First Method with respect to the Poetic / Prophet Trusts.

Dated: September 14, 2018

Respectfully submitted,

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**EXHIBIT A**

<b>NIM Trusts</b>	<b>Settlement Trusts</b>
BSNIM 2005-HE3N	BSABS 2005-HE3
BSNIM 2005-HE6N	BSABS 2005-HE6
BSSP 2005-29N	SACO 2005-WM3
BSSP 2005-32N	SACO 2005-9
BSSP 2006-3	SACO 2005-10

**EXHIBIT B**

<b>Settlement Trust</b>
<u>BSABS 2005-HE3</u>
<u>SACO 2005-4</u>
<u>SACO 2005-7</u>
<u>SACO 2005-WM1</u>