

DISPUTES AFFECTING THE BSABS-AQ1 TRUST

Two issues presented in the Petition will have a significant impact on Certificateholders in the BSABS-AQ1 Trust: (i) whether section 3.06(b) of the Settlement Agreement should be interpreted and enforced to supersede clear conflicting provisions in the PSA governing the BSABS-AQ1 Trust (the “AQ1 PSA”) and (ii) whether the Trustee should apply the “Pay First” or “Write-Up First” Method. On both points, the GMO Funds agree with the positions of the Institutional Investors and oppose the positions of the Tilden Park entities (“Tilden Park”).

JOINDER AND ARGUMENT

I. BSABS AQ1 Class A Certificate Principal Balances Should Be Written Up Sequentially

A. Terms of the AQ1 PSA Clearly Require Sequential Write-Up

The AQ1 PSA distributes principal amounts to Class A Certificates sequentially (*i.e.*, first to Class A-1, second to Class A-2, and third to Class A-3) and allocates realized losses *pro rata* among those classes of Class A Certificates.³ The AQ1 PSA also specifically contemplates how Subsequent Recoveries, such as the Allocable Share, should be applied to write up certificate principal balances. It provides:

If, after taking into account such Subsequent Recoveries, the amount of a Realized Loss is reduced, the amount of such Subsequent Recoveries will be applied to increase the Certificate Principal Balance of the Class of Certificates *with the highest payment priority to which Realized Losses have been allocated [(i.e. sequentially)]*.⁴

³ AQ1 PSA §§ 5.04(a)(2)(A)(i), 5.05(a).

⁴ AQ1 PSA § 5.04(b) (emphasis added).

These AQ1 PSA provisions reflect the bargained-for relative economic rights of the Class A Certificateholders.⁵ In the preliminary answers to the Petition, no party disputed this straightforward meaning of the AQ1 PSA.

B. The Settlement Agreement Preserves the Clear Contractual Bargain Struck in the AQ1 PSA

Section 7.05 of the Settlement Agreement provides that “the Settlement Agreement shall not be argued or deemed to constitute, an amendment of any term of any Governing Agreement.” Parties understood that the Settlement Agreement would have to be implemented in conjunction with hundreds of complex Accepting Trusts containing widely different terms. This provision ensured that the new global agreement would preserve the established contractual economic rights of different Certificateholders under each of those trusts. There is no principled reason why the Settlement Agreement should redistribute write-ups across a single trust from one group of Certificateholders to another.

C. The Settlement Agreement Write-Up Instruction Applies Only to Fill Gaps in the Absence of a Conflicting Provision in the AQ1 PSA

Tilden Park argues that section 7.05 of the Settlement Agreement gets nullified by section 3.06(b) of the Settlement Agreement, which provides that the Trustee should “apply . . . the amount of the Allocable Share for that [BSABS-AQ1 Trust] in the reverse order of previously allocated losses, to increase the balance of each class of securities . . . to which such losses have been previously allocated” (the “Settlement Agreement Write-Up Instruction”). But these two provisions need not conflict.⁶ For the Accepting Trusts subject to the Settlement Agreement that

⁵ The Petition recognized that the AQ1 PSA suggests that subsequent recovery write-ups should be applied in the same sequential manner as the AQ1 PSA provides for distributions of principal, and not based on the *pro rata* allocation of losses. Petition ¶ 50.

⁶ Courts have long recognized the elementary rule of contract construction that clauses of a contract should be read together contextually in order to give each of them meaning. *See, e.g., HSBC Bank USA v. Nat'l Equity Corp.*, 279 A.D.2d 251, 253, (N.Y. App. Div. 2001).

are either silent on this point or not inconsistent with section 3.06(b), the Settlement Agreement Write-Up Instruction can fill that gap or clarify provisions in existing Governing Agreements. For Accepting Trusts with clearly contrary provisions, such as the BSABS-AQ1 Trust, section 7.05 assures that the Settlement Agreement does not rewrite those existing provisions.

In contrast, Tilden Park's proposed interpretation violates the canon of contract construction disfavoring an interpretation "that has the effect of rendering at least one clause superfluous or meaningless." *See, e.g., LaSalle Bank Nat'l Ass'n v. Nomura Asset Capital Corp.*, 424 F.3d 195, 206 (2d Cir. 2005). If any provision of the Settlement Agreement that conflicts with a clear provision of a Governing Agreement amends the Governing Agreement provision, then section 7.05 becomes a nullity that serves no purpose.⁷

II. The Settlement Agreement Requires the Pay First Method Without Temporary Overcollateralization

As explained in greater detail in Section II of the Institutional Investors' Brief, Sections 3.06(a) and 3.06(b) of the Settlement Agreement require the Trustee to first make distributions from the Settlement Payment and only afterwards write up certificate principal balances. The AQ1 PSA and other Governing Agreements do not clearly specify an order of operations for distributions and write-ups, so the Settlement Agreement filled that gap using language virtually identical to language in other prior global RMBS settlement agreements that applied the "pay first method."⁸ Section III.B. of the Institutional Investors' Brief illustrates the absurd consequences of Tilden Park's contrary interpretation where trusts that have suffered monumental losses, and will not be anywhere close to overcollateralized before or after the Settlement Payment is made,

⁷ Other sections of the Settlement Agreement provide clear indication that they intend to supersede conflicting provisions of Governing Agreements or section 7.05 of the Settlement Agreement, but section 3.04(b) of the Settlement Agreement includes no such indication.

⁸ *See* Institutional Investors' Brief Section II.D-F.

would somehow become “temporarily” overcollateralized during the Settlement Payment distribution, even though the balances of the underlying mortgages never exceed the balances of the outstanding certificates.

III. The Court Should Interpret the Settlement Agreement in a Manner Consistent with the Expectations of the Parties

The Institutional Investors group includes 18 out of the 21 Certificateholders that were signatories to the Settlement Agreement. These institutional asset managers were the primary economic stakeholders who negotiated the Settlement Agreement.⁹ They intervened as co-petitioners in the previous proceeding before this Court under CPLR Article 77, and, as this Court is aware, participated actively and extensively in that proceeding to address objections and obtain approval of the Settlement Agreement.¹⁰ The Institutional Investors are among the most sophisticated RMBS investors and were represented throughout this process by experienced counsel at Gibbs & Bruns LLP. As primary architects of, parties to, and advocates for the Settlement Agreement from inception through approval, the Institutional Investors would have understood how that agreement operated and was intended to interact with provisions of Governing Agreements of the Affected Trusts.

Tilden Park believes that the Institutional Investors simply got it wrong. They do not explain whether this is because the Institutional Investors all along failed to understand the

⁹ Brief of Petitioner-Trustees in Support of the Settlement at 1, In the matter 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, Wells Fargo Bank, National Association, HSBC Bank USA, N.A., and Deutsche Bank National Trust Company, No. 652382/2014 (N.Y. Aug. 3, 2014).

¹⁰ Petition to Intervene as Co-Petitioners to Support Settlement at 3, In the matter 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, Wells Fargo Bank, National Association, HSBC Bank USA, N.A., and Deutsche Bank National Trust Company, No. 652382/2014 (N.Y. Aug. 5, 2014). (representing that they and their clients, in aggregate, represented investments of billions of dollars and over 32% of the securities issued by the Accepting Trusts).

provisions of the Settlement Agreement that they negotiated extensively and shepherded through approval or because the Institutional Investors are now choosing to try to retroactively re-construct the Settlement Agreement after the fact. Neither seems likely.

CONCLUSION

As set forth herein and in Sections II and V of the Institutional Investors' Brief, (i) the Settlement Agreement does not amend or supersede the AQ1 PSA's clear controlling instruction to conduct write-ups of Class A Certificates sequentially and (ii) the Trustee should apply the Pay First Method. Accordingly, the GMO Funds respectfully request that the Court issue an order directing the Trustee to distribute the Allocable Share and write up the certificate principle balances of the BSABS-AQ1 Trust certificates in accordance with the foregoing.

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