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

In the matter of the application of WELLS FARGO BANK, NATIONAL ASSOCIATION, 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, HSBC BANK USA, N.A. and DEUTSCHE BANK NATIONAL TRUST COMPANY (as Trustees, Indenture Trustees, Securities Administrators, Paying Agents, and/or Calculation Agents of Certain Residential Mortgage-Backed Securitization Trusts), Petitioners, For Judicial Instructions under CPLR Article 77 on the Administration and Distribution of a Settlement Payment.	Index No. 657387/2017 Honorable Marcy S. Friedman IAS Part 60 Motion Seq. No. 1

JOINT MERITS SUBMISSION ON BEHALF OF NOVER VENTURES, LLC AND THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., AS TRUSTEE UNDER THE DUKE IX INDENTURE

MCKOOL SMITH P.C.
One Bryant Park, 47th Floor
New York, New York 10036
(212) 849-9400

Counsel for Nover Ventures LLC and Special Litigation Counsel for The Bank of New York Mellon Trust Company, National Association as Trustee under the Duke IX Indenture

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CASES

Nover Ventures, LLC ("Nover") and The Bank of New York Mellon Trust Company, National Association ("BNYMTC"), solely in its capacity as Indenture Trustee under an Indenture, dated as of November 9, 2005 (the "Duke IX Indenture"), by and between Duke Funding IX, Ltd., as issuer, Duke Funding IX Corp., as co-issuer, and BNYMTC, as Indenture Trustee (in such capacity, the "Duke IX Trustee") and acting pursuant to a direction from the Controlling Class under the Duke IX Indenture (the "Duke IX Controlling Class"),[1] are Interested Persons with respect to each of their Settlement Trusts and take the positions as expressed herein.[2] Nover and the Duke IX Trustee (acting at the direction of the Duke IX Controlling Class) submit this Joint Merits Submission and Memorandum of Law pursuant to the December 19, 2017 Order to Show Cause and the August 15, 2018 Stipulation Regarding Merits Briefing Schedule and Trustee Substitutions.

PRELIMINARY STATEMENT

This proceeding was initiated to provide the trustees of 330 RMBS Settlement Trusts ("Petitioners") guidance for distributing the up to $4.5 billion settlement reached with JPMorgan Chase & Co. For each of the Settlement Trusts, the Governing Agreements contain precise language that the Court should follow. Notably, Petitioners and the Institutional Investors (the

[1] BNYMTC is acting in this proceeding solely in its capacity as the Duke IX Trustee, and all of its actions in such capacity in this proceeding are taken at the direction of the Duke IX Controlling Class. For the avoidance of doubt, any and all positions taken in this proceeding are taken solely in its capacity as the Duke IX Trustee at the direction of the Duke IX Controlling Class and none of these positions is, or may be interpreted or perceived as, the position of BNYMTC in its individual capacity or in its capacity as trustee, indenture trustee, securities administrator, paying agent or any other representative capacity on behalf of or for the benefit of any person other than the secured parties under the Duke IX Indenture.

[2] Attached to the Affirmation of Gayle R. Klein as Exhibit A is a list of the Settlement Trusts in which Nover and the Duke IX Trustee, solely in its capacity as Trustee under the Duke IX Indenture, are interested pursuant to the requirements set forth in the Court's August 7, 2018 Decision/Order on the right to appear herein. As reflected in Nover's initial Submission, Dkt. Nos. 165-169, as well as the master chart of parties' positions, reflected at Dkt. No. 231, Nover alleges an interest in and a right to appear relating to multiple Settlement Trusts. The Court limited Nover's right of appearance in its Decision/Order of August 7, 2018, Dkt. No. 471. Nover has appealed that Order. *See* Dkt. Nos. 503-508. Nover, therefore, respectfully objects to a limited appearance and reserves the right to submit additional briefing regarding additional Settlement Trusts should its appeal be successful.

parties that negotiated the terms of the Settlement Agreement) agree that the Settlement Agreement requires the Court to defer to the language of the Governing Agreements when determining how to distribute the Allocable Share for each of the Settlement Trusts. Because the Governing Agreements unambiguously address the distribution methods at issue in this proceeding (the "Petition Issues"), the language of the Governing Agreements should control. The Court should instruct Petitioners to follow the Settlement Agreement without regard to the Governing Agreements. The Court should rely upon to the Settlement Agreement only if the Governing Agreements are silent on a Petition Issue.

Indeed, this is the only fair and reasonable interpretation of the interplay between the Governing Agreements and the Settlement Agreement. When investors purchased the certificates in this action, they relied on the language in those Governing Agreements. Likewise, when Petitioners entered into the Settlement Agreement, they acknowledged the import of the Governing Agreements and expressly provided that the Settlement Agreement would not amend or change any of the terms of the Governing Agreements. To disregard the plain language of the Governing Agreements now would not only frustrate, but would also threaten to undermine the investors' interests in the Settlement Trusts and the very objective of the Settlement Agreement.

Accordingly, the Petition Issues can and should be resolved by reference to the unambiguous terms of the respective Governing Agreements. In particular, regarding those Settlement Trusts with Governing Agreements that specify which certificates are eligible to be written up (the Exhibit E Settlement Trusts), the Court should direct Petitioners to write up only the eligible, subordinate certificates. (*See* Section I, *infra*.). For those Settlement Trusts with Governing Agreements that contain the so-called "Retired Class Provision" (the Exhibit G Settlement Trusts), the Court should direct the Petitioners to follow the write-up provisions in the

Governing Agreements and write up the zero balance certificates. (*See* Section II, *infra*.) For those Settlement Trusts where there is a perceived ambiguity as to whether a Settlement Trust's Allocable Share write-up should occur before or after distribution of the Allocable Shares to the certificateholders (the Exhibit D Settlement Trusts), the Court should direct the Petitioners to write up certificates before distributing the Allocable Share to the certificateholders. (*See* Section III, *infra*.) For those Settlement Trusts where the Governing Agreements require that certificates be written up in a manner inconsistent with that prescribed by the Settlement Agreement (*i.e.*, in reverse order of previously allocated losses) (the Exhibit F Settlement Trusts), the Court should direct the Petitioners to follow the Governing Agreements. (*See* Section IV, *infra*.) And, finally, for those Settlement Trusts where the Petitioners perceive an ambiguity as to whether subsequent recoveries should be treated as interest or principal (the Exhibit H Settlement Trusts), given that there is no dispute among any of the Interested Persons, the Court should direct the Petitioners to treat subsequent recoveries as principal. (*See* Section V, *infra.*)

STATEMENT OF FACTS

On December 15, 2017, Petitioners initiated this Article 77 proceeding for judicial instructions concerning the administration and distribution of a Settlement Payment of up to $4.5 billion by JP Morgan Chase & Co. to 330 trusts. (Petition at ¶¶ 1, 9 (Dkt. No. 1).) Based on a formula set forth in the Settlement Agreement, a portion of the Settlement Payment was transferred to each of the 330 Settlement Trusts (each an "Allocable Share"). (Settlement Agreement at § 3.05 (Dkt. No. 3).) The Settlement Agreement requires the Allocable Share for each Settlement Trust to thereafter be distributed to the holders of the certificates, notes, or other securities issued by such Settlement Trust. (*Id.* at § 3.06)

"Each certificate generally has, or is assigned a certificate principal balance equal to the total distribution of 'principal amount' such certificate is entitled to receive."[3] (Petition at ¶ 3.) The Governing Agreements for each of the Settlement Trusts set forth, in detail, how cash flows, losses, and cash collections are to be received, allocated, and processed, including when the collections are received subsequent to the allocation of losses ("Subsequent Recoveries"). By their Petition, Petitioners seek judicial guidance as to how the Allocable Shares should be distributed to the certificateholders given the perceived contradicting language of the Governing Agreements and the Settlement Agreement. *See generally,* Petition.

There can be no contradiction between the Governing Agreements and the Settlement Agreement because, under the express terms of the Settlement Agreement, where the Governing Agreements unambiguously dictate how the funds should be dispersed, the terms of the Governing Agreements control. (*See* Settlement Agreement at §§ 3.06(d), 7.05, 7.13.) Only if the Governing Agreements are silent on one of the Petition Issues should the Court instruct Petitioners to follow the terms of the Settlement Agreement. Three provisions in the Settlement Agreement necessitate this interpretation.

First, the Settlement Agreement provides that each Settlement Trust's Allocable Share shall be distributed to each Trust in accordance with the distribution provisions of the respective Settlement Trust's Governing Agreement. (Settlement Agreement at § 3.06(a) ("Each Trust's Allocable Share shall be deposited into the related Trust's collection or distribution account pursuant to the terms of the Governing Agreements, for further distribution to Investors in accordance with the distribution provisions of the Governing Agreements") (emphasis added).) Second, the Settlement Agreement provides that it does not amend any term of any Governing

[3] Capitalized terms used but not defined herein have the same meanings as ascribed in the Settlement Agreement or in the Governing Agreements.

Agreement. (Settlement Agreement at § 7.05 ("The Parties agree that this Settlement Agreement reflects a compromise of disputed claims and is not intended to, and shall not be argued or deemed to constitute, an amendment of any term of any Governing Agreement.") (emphasis added).) And third, consistent with the two foregoing provisions, Section 7.13 of the Settlement Agreement provides that while the Settlement Agreement supersedes all prior agreements and understandings between the parties that negotiated the settlement, it is still subject to the provisions of Section 7.05 and therefore is not "an amendment of any term of any Governing Agreement[s]".

Here, each of the Governing Agreements, which each are hundreds of pages in its own right, address in ample detail each of the five Petition Issues. The Court should instruct Petitioners consistent with the Governing Agreements, even if it conflicts with the Settlement Agreement.

ARGUMENT

Under New York law, "written agreements are construed in accordance with the [contracting] parties' intent and the best evidence of what parties to a written agreement intend is what they say in their writing. As such, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms." *Schron v. Troutman Sanders LLP*, 20 N.Y.3d 430, 436 (2013) (internal quotation marks and citations omitted). The Settlement Agreement reflects this principal by unambiguously deferring to the terms of the Governing Agreements and explicitly disclaiming any intent to alter any clear provision of the Governing Agreements. (*See* Settlement Agreement at §§ 7.05, 7.13.)

Each of the Petition Issues may either be resolved by the express, clear and unambiguous terms of the Governing Agreements or, where the Governing Agreements are silent as to the

issue, the Court may properly interpret the Governing Agreements. *See, e.g.*, *In re Trusteeship Created by Amer. Home Mortg. Inv. Tr. 2005-2*, No. 14 CIV 2494 (AKH), 2014 WL 3858506, at *12 (S.D.N.Y. July 24, 2014) (*citing Moser v. Darrow*, 341 U.S. 267, 274 (1951)) ("Trust instruction proceedings are a well-established procedure by which trustees (and other affected parties) can seek judicial guidance from the court about how to resolve immediate and difficult issues of interpretation of governing documents.").

I. Petitioners Should Not Write Up Senior Bonds Where Doing So Is In Conflict with The Governing Agreements (Exhibit E).

For those Trusts identified on Exhibit E of the Petition, the Court must instruct Petitioners to follow the Governing Agreements' express terms and not write up senior bonds. The Governing Agreements for each Settlement Trust listed on Exhibit E specifically provides that only a subset of the Certificates may be written-up. (*See* Petition at ¶ 45.) Under New York law, a written agreement that is "complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms." *Greenfield v. Philles Records*, 98 N.Y.2d 562, 569 (2002). Moreover, a court must interpret the contract in accordance with its plain meaning unless it would produce a result that is absurd, commercially unreasonable or contrary to the reasonable expectations of the parties. *See In re Lipper Holdings, LLC*, 1 A.D.3d 170, 171 (1st Dept. 2003) (quotations and citations omitted). For the Exhibit E Settlement Trusts, the precise language of the Governing Agreements is dispositive.

The Governing Agreements of the Exhibit E Settlement Trusts specifically set forth terms and conditions under which only subordinate certificates will be written-up. Provisions governing the application of realized losses to certificates and the allocation of Subsequent Recoveries against those losses are trust-specific—and can be group and/or certificate dependent even within a trust. Potential investors, for example, were made aware from the Governing

Agreement and the prospectus supplement when a trust was structured that subordinate certificates would receive preferential treatment to the senior bonds for certain groups with respect to subsequent recoveries—a fact that investors relied upon when purchasing such tranches of certificates.

Moreover, that there is differential treatment regarding the application of realized losses and the allocation of subsequent recoveries among different groups in the same trust dispositively demonstrates that such treatment was intentional. For example, the BALTA 2006-2 Trust[4] provides different distribution methodologies for its two groups of certificates, Group I and Group II. While Group I and Group II both have senior and subordinated classes, those groups allocate losses and subsequent recoveries in different ways.

Specifically, for the BALTA 2006-2 Group I certificates, the Governing Agreement provides that the Subsequent Recoveries are to be applied first "to the Group I Senior Certificates to the extent of any Applied Realized Loss Amounts before being applied to the Group I Subordinate Certificates." (BALTA 2006-2 A&R PSA at § 6.03(b)). Conversely, for the BALTA 2006-2 Group II certificates, "Subsequent Recoveries will be applied to increase the Certificate Principal Balance of the Class of Group II Subordinate Certificates with the highest payment priority to which Realized Losses have been allocated . . . . The amount of any remaining Subsequent Recoveries will be applied to sequentially increase the Certificate Principal Balance of the Group II Subordinate Certificates." (BALTA 2006-2 A&R PSA at § 6.04(h).) The different treatment of Subsequent Recoveries within the BALTA 2006-2 Governing Agreement highlights that the drafters of the Governing Agreements intentionally treated the write-up of subsequent recoveries differently. And the BALTA 2006-2 Trust is not an anomaly. Differing treatment of write-ups among groups or classes also occurs in, for

[4] *See* BALTA 2006-2 A&R PSA, Klein Aff. at Exh. B.

example, BALTA 2006-3 and BALTA 2006-4. (*See* BALTA 2006-3 A&R PSA, Klein Aff. Exh. C; BALTA 2006-4 A&R PSA, Klein Aff. Exh. D.)[5] Some trusts, like GPMF 2005-AR5, have multiple groups, but the language relating to write-ups is the same across those two groups. For those trusts, there is likewise no reason to depart from the precise language of the Governing Agreements and write-up ineligible certificates. The language of each Governing Agreements should be enforced.

When a Governing Agreement expresses that only certain classes of certificates should be written up, the Court should give meaning and effect to the omission of other classes and instruct Petitioners to follow the language of the Governing Agreements and write up only those classes of certificates expressly provided for therein. To do otherwise would "violate[] a fundamental principle of contract interpretation by failing to give effect to a defined term. . . ." *Mionis v. Bank Julius Baer & Co.*, 301 A.D.2d 104, 109 (1st Dep't 2002); *see also Vintage, LLC v. Laws Const. Corp.*, 13 N.Y.3d 847, 849 (2009) (where the provisions under consideration "have a definite and precise meaning, unattended by danger of misconception . . . [and] there is no reasonable basis for a difference of opinion" there is no ambiguity); *Loch Sheldrake Assoc. v Evans*, 306 N.Y. 297, 305 (1954).

Failure of the Court to give effect to the transaction parties' use of the particular defined term in the Subsequent Recovery write-up provision would undermine the parties' specific inclusion of the defined term because it would result in the application of Subsequent Recoveries against realized losses for more classes of certificates than were expressly defined. *See Two Guys from Harrison-N.Y., Inc. v. S.F.R. Realty Assoc.*, 63 N.Y.2d 396, 403 (1984) ("In

[5] Given that Petitioners already have provided the Court with an electronic version of all Governing Agreements such that all Governing Agreements are already part of the record, Nover and the Duke IX Trustee (acting at the direction of the Duke IX Controlling Class) are providing a copy of only those Governing Agreements referenced herein.

construing a contract, one of a court's goals is to avoid an interpretation that would leave contractual clauses meaningless.") (internal citations omitted).

The prospectus supplements—documents that investors rely on (and are told to rely on) when making investment decisions—similarly support the conclusion that, in such circumstances, Subsequent Recoveries should only be applied to subordinate certificates and not the senior certificates. For example, the section of the prospectus supplement for BALTA 2006-2 that describes exactly how to write-up certificates based on the receipt of subsequent recoveries provides:

> [T]he Certificate Principal Balance of each class of Subordinate Certificates that has been reduced by the allocation of a Realized Loss to such Certificate will be increased, in order of seniority, by the amount of such Subsequent Recovery, but not in excess of the amount of any Realized Losses previously allocated to such class of Certificates and not previously offset by Subsequent Recoveries.

(BALTA 2006-2 Prospectus Supplement at p. 60, Klein Aff. Exh. E.) There is no similar language in the prospectus supplement for senior certificates. Moreover, in the same prospectus supplement, Certificate Principal Balance is defined as: "With respect to any Certificate, . . . as of any distribution date will equal such Certificate's initial principal amount on the Closing Date plus, in the case of a Subordinate Certificate, any Subsequent Recoveries added to the Certificate Principal Balance of such Certificate, ..." (*Id.* at 97.) The prospectus supplements supports that only subordinate certificates should be written-up for Exhibit E Settlement Trusts.

Some Interested Persons argue that the Settlement Agreement and the Governing Agreements conflict. That is not true. The Settlement Agreement simply provides that write-ups should be applied "in the reverse order of previously allocated losses, to increase the balance of each class of securities." (Settlement Agreement at § 3.06(b).) The Governing Agreements discuss the order of operations, but they also define exactly which classes are eligible for write-ups. The Settlement Agreement, conversely, *does not* define precisely which certificate classes

are eligible to be written-up, nor does it specify that senior certificates must always be written-up. Moreover, even if the Settlement Agreement were ambiguous on those points, by its express terms, the Settlement Agreement is not intended to and does not amend or supersede the Governing Agreements. (*See* Settlement Agreement §§ 7.05, 7.13.)

The Court should instruct Petitioners to apply the plain and unambiguous terms of the Governing Agreements and use the Allocable Shares to write-up only subordinate certificates for Exhibit E Settlement Trusts because that is the result the Governing Agreements require.

II. Petitioners Should Write-Up Zero Balance Certificates (Exhibit G).

For those Trusts identified on Exhibit G of the Petition, the Court should instruct Petitioners to write up zero balance bonds, regardless the so-called "Retired Class Provision". As Petitioners note, just because certain certificate balances in these trusts were reduced to zero does not mean that they are precluded from being written up later. (Petition at ¶¶ 54, 58.) Indeed, the Governing Agreements establish that irrespective of the presence of a Retired Class Provision, certificate principal balances may be written up once they have been reduced to zero. (*See, e.g.*, BALTA 2006-2 A&R PSA.)

At the outset, the term "Retired Class Provision" is a complete misnomer. When considered in context, the so-called Retired Class Provision is simply a statement at the end of the (oftentimes lengthy) distribution waterfall to make clear that once investors have been fully paid in the amount of their certificates they are not entitled to further distributions. Such an interpretation makes sense, whereas any other interpretation does not. The Court, therefore, should avoid interpreting this provision as precluding payment to zero-balance certificates because it would lead to an absurd and commercially unreasonable result. *See In re Lipper Holdings, LLC*, 1 A.D.3d at 171 (a court should not interpret a contract in a manner that would produce a result that is absurd, commercially unreasonable or contrary to the reasonable

expectations of the parties). As Petitioners note, if the classes of certificates with zero balances are not written up, the meaning and intent of the Settlement Agreement would not be applied because the Allocable Share would be redirected to loan groups that either already have been compensated for the same claims or that are not subject to the Settlement Agreement. (Petition at ¶ 60.) Such an interpretation makes no sense.

Moreover, multiple relevant sections of the Governing Agreements support the write-up of zero balance certificates. The definition of "Certificate Principal Balance" in Exhibit E Settlement Trust Governing Agreements contemplates that certificates with a zero balance should be written-up. For example, the definition of "Certificate Principal Balance" for the BSABS 2005-AC7 trust provides that the balance for ***any*** Certificate should be increased by any subsequent recoveries received pursuant to the section regarding the allocation of realized losses:

> Certificate Principal Balance: As to **any** Certificate (other than any Class R Certificate) and as of any Distribution Date, the Initial Certificate Principal Balance of such Certificate plus any Subsequent Recoveries added to the Certificate Principal Balance of such Certificate pursuant to Section 6.05 less . . . .

(BSABS 2005-AC7 PSA, §1.01 at p. 13, Klein Aff. Exh. F) (emphasis added). The prospectus supplement further provides that that subsequent recoveries should be applied to the Certificate Principal Balance of all certificates, not just the ones that have not yet been reduced to zero. (BSABS 2005-AC7 Prospectus Supplement at 97, Klein Aff. Exh. G.) Thus, the Court must instruct the Petitioners to write-up certificates with zero balances.

The section regarding the allocation of subsequent recoveries further confirms that subsequent recoveries are applied to increase the Certificate Principal Balance, regardless whether it is zero. For example, Section 6.05(c) of the BALTA 2005-AC7 Governing Agreement provides that subsequent recoveries are applied against the Certificate Principal

Balance of the Class of Subordinate Certificates with the highest payment priority, regardless of the outstanding balance:

> In addition, in the event that the Master Servicer receives any Subsequent Recoveries from the Company or the related Servicer, the Master Servicer shall deposit such funds into the Master Servicer Collection Account pursuant to Section 5.06. 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 Subordinate Certificates with the highest payment priority to which Realized Losses have been allocated**, but not by more than the amount of Realized Losses previously allocated to that Class of Subordinate Certificates pursuant to this Section 6.05 and not previously reimbursed to such Class of Subordinate Certificates with Net Monthly Excess Cashflow pursuant to clause third of Section 6.04(a) . . . .

(Emphasis added).) Given that realized losses necessarily may result in a Certificate Principal Balance being reduced to zero, had the parties intended that zero-balance certificates not be written-up, they would have expressly provided in the Subsequent Recovery write-up provisions.

Petitioners note that there is nothing on the face of the Retired Class Provisions or in the applicable Governing Agreements that preclude zero balance classes from being written up. (Petition at ¶ 56.) Petitioners in fact recognize that if the Certificate Principal Balances of these classes are written-up, then the classes no longer have a zero balance and can receive a portion of the trust's Allocable Share or, at the least, future principal and interest distributions. (*Id.* at ¶ 57.)

Had the drafters intended that the Retired Class Provision preclude the subsequent write-up of certificates, the Governing Agreements would have so provided. As is made clear in the prior section relating to Exhibit E, when the drafters of Governing Agreements intended that only certain certificates should be written-up, they include clear and specific language relating thereto. Here, because there is no such limitation, the inescapable conclusion is that the parties did not intend to preclude write-up of zero balance certificates. *Quadrant Structured Prods. Co., Ltd. v. Vertin*, 23 N.Y.3d 549, 560 (2014) (under New York law, where the parties to a contract

omit specific terms, "the inescapable conclusion is that the parties intended the omission"); *A-Pix, Inc. v. SGE Entm't Corp*., 222 A.D.2d 387, 389 (1st Dep't 1995) ("If the parties had intended to exclude royalties or net revenues received from direct distribution of videos by SGE, they would have used the express language of exclusion as they did in that subdivision (b) which immediately follows (a) in issue herein."); *Sally v. Sally*, 225 A.D.2d 816, 819 (3rd Dep't 1996) ("Had the parties intended to limit plaintiff's obligation to provide health insurance to a specific number of years, they would have done so, as they did for the hospitalization insurance obligation.").

The fact that that certain certificates may have a zero balance does not mean that those certificates are somehow "retired" or have received a "final distribution", as some Interested Persons have argued. "Retirement" is a particularized situation that occurs *only* when certain conditions are met, which are described in the section of the Governing Agreements entitled "Final Distribution on the Certificates." There is no evidence that establishes that the prerequisites of a final distribution have occurred. Zero-balance bonds, therefore, may be written-up because they have not received a final distribution.

Under the terms of the Governing Agreements, no final distribution may be made until after both: (a) notice to certificateholders that a final distribution in retirement is scheduled to be made; and (b) the surrender of the related certificates at the office of the securities administrator. (BSABS 2005-AC7 PSA, at § 11.02.) For the trusts in this proceeding, there has been no notice of final distribution, no surrender of certificates, and no formal final distribution in retirement on the Settlement Trusts. To the contrary, certificates in trusts such as BSABS 2005-AC7 (and others) still have an assigned CUSIP number and are still actively traded. Accordingly, the

certificates have not reached a final distribution and, therefore, are still subject to write-up from Subsequent Recoveries and further distributions.

III. Write-Up First Is The Only Appropriate Method (Exhibit D).

The Settlement Agreement does not specify whether a Settlement Trust's Allocable Share Write-Up should occur either after distribution of such Allocable Shares to: (a) certificateholders (the "Pay First Method"); or (b) the Petitioners but ***before*** distribution to certificateholders (the "Write-Up First Method"). The only plausible interpretation of the Settlement Agreement is, however, that the Write-Up First Method should be used. Indeed, the Write-Up First Method is consistent with the plain language of the Governing Agreements and the trusts' structures and is the ***only*** method that produces consistent results across all scenarios.

Applying the Pay First Method would create inconsistent results and multiple layers of uncertainty. The Pay First Method also may lead to absurd, commercially unreasonable distributions, which are contrary to the reasonable expectations of investors and drafters of the Settlement Agreement—and the original parties to the Governing Agreements. The absurdity of the Pay First Method is highlighted by the fact that leakage to subordinate certificateholders is dependent on both the unusually large amount of subsequent recoveries ***and*** the timing of when those funds are received. Such wild swings in recovery are not contemplated by the Settlement Agreement or the Governing Agreements.

A. Write-Up First Is Consistent With A Proper Interpretation Of The Governing Agreements.

Each Governing Agreement contains a specific waterfall provision that dictates the principal amounts and interest amounts distributable to classes of certificates and the order of priority in which such amounts are distributed among such classes. (Petition at ¶ 3.) The Settlement Agreement provides that the Allocable Shares shall be distributed to investors "in

accordance with the distribution provisions of the Governing Agreements . . . ." (Settlement Agreement § 3.06(a).) The clear and unambiguous terms of the Governing Agreements indicate the distribution must be made pursuant to the Write-Up First Method. Given that the Settlement Agreement does not purport to alter the Governing Agreements (Settlement Agreement at § 7.05), the Petitioners should follow the "order of operations" expressed in the related Governing Agreements: namely, the Write-Up First Method.[6]

Generally, the order of operations to write up certificate principal balances before distributing subsequent recoveries is expressed in the definition of "Certificate Principal Balance," among other contractual provisions. The Certificate Principal Balance is the lynchpin of the Governing Agreements. Certificateholders are entitled to receive payments of principal until their respective class Certificate Balance is reduced to zero. In essence, the Certificate Principal Balance is the amount to which certificateholders are entitled to be paid from the trust.

The definition of "Certificate Principal Balance" in each Governing Agreement requires the Trustee to determine such balances pursuant to a precisely defined set of calculations. Embedded in these calculations is an order of operations for treatment of Subsequent Recoveries. The Governing Agreements, like the Settlement Agreement contemplates, requires the write-up of Certificate Principal Balances in the amount of subsequent Recoveries before making any distributions.

For example, "Certificate Principal Balance" is defined in the BSABS 2005-AC7 Pooling and Servicing Agreement as:

> Certificate Principal Balance: As to any Certificate (other than any Class R Certificate) and **as of any Distribution Date, the Initial Certificate Principal Balance** of such Certificate **plus any Subsequent Recoveries added to the Certificate Principal Balance** of such Certificate pursuant to Section 6.05 less

[6] The Settlement Agreement, therefore, requires the Court to instruct Petitioners to follow the methodology set forth by the Governing Agreements.

> the sum of (i) **all amounts distributed** with respect to such Certificate in reduction of the Certificate Principal Balance thereof **on previous Distribution Dates** pursuant to Section 6.04 and (ii) any Applied Realized Loss Amounts allocated to such Certificate on previous Distribution Dates.

(BSABS 2005-AC7 PSA, § 1.01 at p. 13.)

Therefore, by its terms, "Certificate Principal Balance" is measured "as of any Distribution Date" and is calculated as follows:

- First, the Trustee uses the Initial Certificate Principal Balance of each Certificate, meaning the Principal Balance of the Certificate as of the beginning of the Trust;
- Second, the Trustee adds the amount of any Subsequent Recoveries received since the last distribution date;
- Third, the Trustee subtracts the cumulative amount of all principal distributed with respect to the certificate on "***previous*** Distribution Dates," again meaning all loss amounts for all Distribution Dates before the one on which the calculation is made; and
- Finally, the Trustee subtracts the cumulative amount of any Applied Realized Loss Amounts allocated to such certificate "on ***previous*** Distribution Dates," again meaning all loss amounts accounted for on all Distribution Dates before the one on which the calculation is made.

Thus, the Certificate Principal Balance accounts for all principal payments distributed and Realized Losses allocated on ***past*** Distribution Dates, and specifically requires that the Trustee incorporate Subsequent Recoveries received since the last distribution date to the Certificate *on the **present** Distribution Date*. Because no distributions of principal can be made under the waterfall provisions without reference to "the" Certificate Principal Balance of a certificate, and because that Balance incorporates a write-up for Subsequent Recoveries to be made ***on the present Distribution Date***, it follows that the write-up must occur ***before*** performing the distributions.

Not only does the plain language of the Certificate Principal Balance make clear that it includes Subsequent Recoveries, it also makes sense. Subsequent Recoveries are defined as

collections of funds relating to particular Mortgage Loans that resulted in a Realized Loss. (BSABS 2005-AC7 PSA, § 1.01 at p. 46.) When a Subsequent Recovery is applied to a Realized Loss, the Realized Loss is reduced by the amount of the Subsequent Recovery. Therefore, the only way to ascribe meaning to the use of the term "Applied Realized Loss Amounts" instead of "Realized Loss" in the Certificate Principal Balance definition is that Subsequent Recoveries are used to write up Certificate Principal Balances to take into account anticipated losses before distributions are made, and the distribution of those funds then operate to reverse a Realized Loss on a particular Distribution Date.

The Governing Agreements' provisions regarding allocation of Subsequent Recoveries further harmonizes with a write-up first order of operations. For example, with respect to Subsequent Recoveries, the BSABS 2005-AC7 PSA provides:

> In addition, in the event that the Master Servicer receives any Subsequent Recoveries from the Company or the related Servicer, the Master Servicer shall deposit such funds into the Master Servicer Collection Account pursuant to Section 5.06. 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 Subordinate Certificates with the highest payment priority to which Realized Losses have been allocated, but not by more than the amount of Realized Losses previously allocated to that Class of Subordinate Certificates pursuant to this Section 6.05 and not previously reimbursed to such Class of Subordinate Certificates with Net Monthly Excess Cashflow pursuant to clause *third* of Section 6.04(a); provided, however, to the extent that no reductions to a Certificate Principal Balance of any Class of Subordinate Certificates currently exists as the result of a prior allocation of a Realized Loss, such Subsequent Recoveries will be applied as Excess Spread. The amount of any remaining Subsequent Recoveries will be applied to sequentially increase the Certificate Principal Balance of the Subordinate Certificates, beginning with the Class of Subordinate Certificates with the next highest payment priority, up to the amount of such Realized Losses previously allocated to such Class of Subordinate Certificates pursuant to this Section 6.05 and not previously reimbursed to such Class of Subordinate Certificates with Net Monthly Excess Cashflow pursuant to clause *third* of Section 6.04(a). **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 to the Certificate Principal Balance of each Subordinate Certificate of such Class in accordance with its respective Percentage Interest**. . . .

(BSABS 2005-AC7 PSA § 6.05(c) (emphasis added).)

Section 6.05(c)'s clause regarding current interest confirms that the only appropriate interpretation is the Write-Up First Method. Section 6.05(c) provides that certificates to which Subsequent Recoveries have been allocated are not entitled to current interest on the amount of increases for any Accrual Period preceding the Distribution Date on which the increase occurs. If the distributions were to happen before the write-up of the Certificate Principal Balance then this provision is unnecessary. Specifically, if the Trustee were to distribute the funds before writing up the Certificates, there would not be any current interest to allocate with respect to the increase of Certificate Principal Balance from Subsequent Recoveries. Therefore, because the Governing Agreements specify that when a Subsequent Recovery write-up occurs, and because current interest from the preceding distribution is explicitly excluded, Section 5.04(b) must mean that the write-up occurs before payment is made.

B. The Write-Up First Method Is Also Prescribed By The Settlement Agreement.

The Settlement Agreement prescribes that the Write-Up First Method must be employed. Section 3.06 contains detailed instructions regarding how the Settlement Payment should be distributed to the Trusts, as well as how the Allocable Shares should be distributed to investors. Specifically, Section 3.06(a) states, in relevant part:

> Each Trust's Allocable Share shall be deposited into the related Trust's collection or distribution account pursuant to the terms of the Governing Agreements, for further distribution to Investors in accordance with the distribution provisions of the Governing Agreements . . . .

Section 3.06(a) clearly contemplates two separate payments: the first being the distribution of the Allocable Share to a Settlement Trust and the second being a subsequent distribution to

investors. Section 3.06(a) is clear that the Allocable Shares are to be distributed to investors "in accordance with the distribution provisions of the Governing Agreements." (*Id.*) Therefore, the Settlement Agreement contemplates that there are multiple steps involved in the distribution of the funds, and that distribution to the Trust is a distinct step from distribution to investors.

Section 3.06(b), thereafter, delineates that there is a step in between distribution to a trust itself and the investors. Section 3.06(b) provides, in relevant part:

> **After the distribution of the Allocable Share to a Settlement Trust** pursuant to Subsection 3.06(a), the Accepting Trustee for such Settlement Trust will apply . . . the amount of the Allocable Share for that Settlement 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, but in each case by not more than the amount of such losses previously allocated to that class of securities pursuant to the Governing Agreements. . . .

(Emphasis added.)

Given that Section 3.06 specifically contemplates two payments—one to each Trust and then one to Investors—if the write-up of losses were to be applied after payment to investors, Section 3.06(b) would state that the write-up occurs "after the distribution of the Allocable Share to Investors." It does not. Section 6.03(b) states that a write-up is to be applied "[a]fter the distribution of the Allocable Share to a Settlement Trust." Accordingly, Section 3.06(b) evidences that Petitioners should use the Write-Up First Method.[7] The Court should therefore instruct Petitioners to do so.

Moreover, the Pay-First approach is contrary to Settlement Agreement Section 3.06(b) because it affects the distribution of the Settlement Payment by causing inconsistent and absurd

[7] Justice Scarpulla previously determined that the Pay First Method was applicable in *In the Matter of the Application of the Bank of New York Mellon, in its Capacity as Trustee or Indenture Trustee*, Index No. 150973/2016, NYSCEF Doc. No. 193. However, that decision and order related to a different settlement agreement with different language and different trusts. Moreover, that decision was appealed by multiple parties and the final judgment in the matter was the result of a settlement. *See, e.g.*, Index No. 150973/2016, NYSCEF Doc. Nos. 196, 197, 272. Accordingly, that decision is distinguishable and, in any event, is not binding precedent.

results. Indeed, other provisions in Section 3.06 evidence that the Write-Up First Method is the only appropriate method. The last sentence of Section 3.06(b) provides:

> For the avoidance of doubt, this Subsection 3.06(b) [describing the write-up] is **intended only to increase the balances of the related classes of securities**, as provided for herein, and **shall not affect the distribution of the Settlement Payment** provided for in Subsection 3.06(a).

(Emphasis added.) Thus, because the Settlement Agreement provides that the write-up methodology used must not affect how the Settlement Payment is distributed, the Write-Up First Method must apply because it is the only distribution method that results in a consistent distribution, regardless the scenario. Conversely, the Pay First Method leads to inconsistent (and, in some cases, absurd) results. The Pay-First Method, therefore, violates Section 3.06(b) of the Settlement Agreement.

By way of example, the Pay First Method could result in the distribution of a large portion of the Settlement Payment to a certificate insurer (*see* Petition at ¶ 33), when the Settlement Payment was intended to be distributed entirely to Investors. (Settlement Agreement at §3.06(a))(stating that each Trust's Allocable Share shall be deposited into Trust accounts "for further distribution to Investors").) And in some instances it is entirely unclear how to distribute the Settlement Payment under the Pay First Method. (Petition at ¶¶ 38-40.) These problems do not arise under the Write-Up First Method. (Petition at ¶ 29; 40.)[8]

The application of the Pay First Method causes "leakage" of the Settlement Payment to junior certificateholders only in certain trusts that have an overcollateralized structure. (*See, e.g.*, Petition at ¶¶ 24, 29-34.). That "leakage" occurs only because of a fiction; under the Pay First

[8] Petitioners note other problems evident with the Pay First Method that are not present with the Write-Up First Method, including the fact that the Pay First Method could cause the certificate principal balances to be artificially inflates such that they do not reflect the actual future cashflows available from the underlying mortgage loans. (Petition at ¶ 34.)

Method certain trusts merely "appear to be temporarily overcollateralized." (*See* Petition at ¶ 28.) But the OC Trusts receiving the Settlement Payment are not, in fact, overcollateralized. Rather, the appearance of overcollateralization is temporary, fleeting, and caused solely by the size and timing of the Settlement Payment.

Additionally, junior classes' level of recovery due to "leakage" is highly variable under the Pay First Method depending on when the settlement proceeds are distributed. The illusory, temporary overcollateralization of certain trusts occurs under the Pay First Method because of the unusual, coincidental collision of a sufficiently large subsequent recovery and the timing of when those funds are received. The Settlement Payment is a one-time anomaly and the timing of its distribution under the Pay First Method (but not under the Write-Up Method) dictates who will recover.

For example, had the Settlement Payment been allocated 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, the "leakage" to junior classes of holders under the Pay First Method would be different. In fact, 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 junior certificates would not under any contract interpretation be situated to receive any portion of the Settlement Payment, much less a disproportionate windfall. Conversely, with the exception of the circumstance in which the passage of time results in more senior certificateholders being paid in full, the dollar

amount of the Allocable Shares to certificateholders in a trust is not time dependent under the Write-Up First Method.

Allowing leakage to junior classes, the amount of which is entirely dependent upon timing of the distribution, is contrary to the specific term of the Settlement Agreement that provides the write up shall not effect distribution of the Settlement Payment. Moreover, such "leakage" from 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.

IV. The Court Should Follow The Subsequent Recovery Write-Up Orders Specified In The Governing Agreements (Exhibit F).

The Settlement Agreement purports to require Petitioners to write-up certificates by the amount of the Allocable Share for that trust in the reverse order of previously allocated losses. (Settlement Agreement at § 3.06(b).) As Petitioners note, this instruction is not consistent with all Governing Agreements. (Petition at ¶¶ 49-52.) Again, the Settlement Agreement is not intended to supersede or amend any Governing Agreement. (Settlement Agreement ¶¶ 7.05, 7.13.) The Court should apply the plain and unambiguous terms of the Governing Agreements and use the allocation methods expressly provided for in the Governing Agreements.

Moreover, there are several trusts for which the allocation method is silent. In those cases, the Settlement Agreement should control. Accordingly, for those Trusts containing the Exhibit F issue, Nover and the Duke IX Trustee (acting at the direction of the Duke IX Controlling Class) respectfully request that the Court apply the Governing Agreements' allocation method where in conflict with the Settlement Agreement, and to apply the Settlement Agreement's allocation method where the Governing Agreements are silent.

V. The Settlement Payment Should Be Treated As Principal Although Certain Governing Agreements Specify Subsequent Recoveries Should Be Treated As Interest (Exhibit H).

Finally, Petitioners note that, for a very small number of Settlement Trusts, the applicable Governing Agreements contain provisions that appear to suggest that subsequent recoveries are included in interest collections as opposed to principal collections. (Petition at ¶¶ 63-65.) The Settlement Agreement makes clear that the Allocable Shares are to be treated as payments of principal (*see* Settlement Agreement § 3.06(a)) and all Interested Persons who have appeared in this proceeding agree that the Allocable Shares should be treated as payments of principal. Given there is no dispute on this issue, the Court should instruct Petitioners that the Settlement Payment should be distributed as principal for all Settlement Trusts identified on Exhibit H.

CONCLUSION

For the foregoing reasons, as well as those to be presented in additional briefing and at oral argument before the Court, Nover and the Duke IX Trustee (acting at the direction of the Duke IX Controlling Class) respectfully request that the Court instruct Petitioners to distribute the Allocable Shares for the Settlement Trusts in a manner that is consistent with the terms, meaning, and intent of the Governing Agreements by following the language of those Agreements, including without limitation, by using the Write-Up First Method (Exhibit D), not writing up senior certificates because to do so would be contrary to the Governing Agreements (Exhibit E), following the Governing Agreements where it differs from the Settlement Agreement (Exhibit F), writing up zero balance certificates (Exhibit G), and treating subsequent recoveries as principal (Exhibit H). Nover and the Duke IX Trustee (acting at the direction of the Duke IX Controlling Class) also request all other relief, at law or in equity, to which they may be justly entitled.

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Respectfully submitted,

MCKOOL SMITH, P.C.

By: /s/ Gayle R. Klein
Gayle R. Klein
Robert W. Scheef
David I. Schiefelbein

One Bryant Park, 47th Floor
New York, New York 10036
gklein@mckoolsmith.com
rscheef@mckoolsmith.com
(t) (212) 402-9400
(f) (212) 402-9444

Attorneys for Nover Ventures, LLC and as attorneys for The Bank of New York Mellon Trust Company, National Association as Indenture Trustee under the Duke IX Indenture