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

MEMORANDUM OF DW PARTNERS LP AND ELLINGTON MANAGEMENT GROUP, L.L.C. ON THE MERITS OF PETITION FOR JUDICIAL INSTRUCTIONS UNDER ARTICLE 77 AS TO CERTAIN REMAINING DISPUTED TRUSTS

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Respondents DW Partners LP ("DW") and Ellington Management Group, L.L.C. ("Ellington" and together with DW, "Respondents"), by and through their undersigned counsel, respectfully submit this Memorandum on the Merits of the Petition for Judicial Instructions under CPLR Article 77 filed by the Petitioners as to certain remaining disputed trusts.[1] This Memorandum is submitted together with the Affidavits of Houdin Honarvar ("Honarvar Aff.") and Daniel Margolis ("Margolis Aff."), as well as the Affirmation of Amiad Kushner ("Kushner Aff."). This brief addresses, on behalf of DW, those Settlement Trusts identified on Exhibit 1 hereto (the "DW Trusts") and, on behalf of Ellington, those Settlement Trusts identified on Exhibit 2 hereto (the "Ellington Trusts" and, together with the DW Trusts, the "DW and Ellington Trusts").

PRELIMINARY STATEMENT

The role of the Court in this Article 77 proceeding is to interpret certain terms of the JPMorgan Settlement Agreement ("SA"), in light of the terms of the various Governing Documents for the Settlement Trusts, to reflect the mutual intent of the parties to the SA. The unmistakable overarching intent of the SA is to reverse the massive losses incurred by Certificateholders as a result of JPMorgan's role in an unprecedented financial crisis. It is this intent that should guide the Court's decisions on the various distribution issues raised by the Petition, and not any perceived discrepancies in the language of the Governing Agreements, as the Governing Agreements simply never contemplated and do not address the types of Settlement Payments at issue.

With this framework in mind, and upon close review of the relevant provisions of the SA, it is plain that: (a) consistent with the terms of the SA, the Allocable Shares should be applied to

[1] Unless otherwise noted, capitalized terms herein have the same meaning as those terms are defined in the Petition.

reverse or "write-up" the certificate principal balance of *any* certificates in the Settlement Trusts that have experienced "write-downs" or reductions in principal balance due to applied realized losses (the "Exhibit E Issue") (applicable to all of the DW and Ellington Trusts except the BSABS 2006-HE3 Trusts); (b) certificates with a current balance of zero that have not received a "final distribution" should be entitled to be written up as a result of the Settlement Payment, to reverse the very losses the SA was designed to remedy (the "Exhibit G Issue") (applicable to the BSABS 2006-HE3 Trust); (c) the Court should apply the "Write-up First Method" (the "Exhibit D Issue") (applicable to the GPMF 2006-AR1 Trust), reversing prior losses with write-ups before distributing the Settlement Payments, so that the Certificates that suffered losses may receive the compensation that was intended to remedy those losses; and (d) the Petitioners should follow the SA's Write-Up Instruction, to the extent it conflicts with the Governing Agreements (the "Exhibit F Issue") (applicable to the BALTA 2006-3 Trust).[2]

Any other outcome would contravene the terms of the SA, in addition to leading to an absurd and commercially unreasonable result, by allowing Governing Agreement language not designed for this type of payment to alter the agreed-upon remedy. Namely, the Governing Agreements do not contain any provisions covering the receipt of settlement payments, as the drafters of the Settlement Trusts' Governing Agreements did not contemplate that thousands of mortgage loans in each trust would default and engender claims of widespread breaches of representations and warranties, or that financial institutions would enter into bulk settlements as compensation therefor. Since the Governing Agreements are devoid of any clear mechanism to

[2] Charts summarizing the issues being presented as to each of the DW and Ellington Trusts are attached hereto as Exhibits 1 and 2, respectively. Charts containing excerpts of the relevant PSA language for the DW and Ellington Trusts are attached hereto as Exhibits 3 and 4.

address such massive losses or distribute bulk settlement payments redressing same, their terms should not override the SA distribution instructions.

Indeed, while the Governing Agreements generally provide that repurchase of defective loans is the sole remedy for loans that breach representation and warranties, New York courts long ago recognized the limitations of this remedy. As one New York federal judge stated in one of the earliest post-crisis mortgage repurchase cases:

> The [PSAs'] repurchase protocol is a low-powered sanction for bad mortgages that slip through the cracks. It is a narrow remedy ("onesies and twosies") that is appropriate for individualized breaches and designed to facilitate an ongoing information exchange among the parties. This is not what is alleged here. Here, Syncora alleges massive misleading and disruption of any meaningful change by distorting the truth. The futility of applying an individualized remedy to allegedly widespread misrepresentations is evident in the fact that, of the 1,300 loans actually submitted under the repurchase protocol, EMC has remedied only 20.

Syncora Guarantee Inc. v. EMC Mortg. Corp., No. 09 CIV. 3106 PAC, 2011 WL 1135007, at *6 n.4 (S.D.N.Y. Mar. 25, 2011).

The drafters of the SA recognized the limitations of the Governing Agreements and structured the SA to fit within those limitations. Nowhere is this clearer than in the SA's direction to treat each Settlement Trust's Allocable Share "as though such Allocable Share was a 'subsequent recovery' . . . ." Pet., Ex. B (Settlement Agreement, defined above as "SA") § 3.06(a). Most Governing Agreements define Subsequent Recoveries as amounts received "specifically related to a Liquidated Mortgage Loan." *See, e.g.,* Kushner Aff., Ex. A (SAMI 2007-AR4 PSA) Art. I (defining "Subsequent Recoveries"); Kushner Aff., Ex. B (GPMF 06-AR1 PSA) Art. I (same). Yet, the Settlement Payments are not tied to any specific mortgage loans or to liquidated loans only, so certainly they are not "specifically related to a Liquidated Mortgage Loan." Instead, each is a lump-sum payment, intended to be each Settlement Trust's

share of the $4.5 billion Gross Settlement Amount, as determined by the Petitioners' expert pursuant to Section 3.05 of the SA.

The SA recognizes that the defined term "subsequent recovery" under the Governing Agreements is incongruous with the nature of the Settlement Payments, and that, while not perfect, it is likely the best mechanism existing under the Governing Agreements for this type of payment. This is why the SA directs the Payments to be treated "as though" they were subsequent recoveries and provides for an alternative treatment if a particular Governing Agreement does not include such a term (distribution of the Allocable Share "as though it was unscheduled principal," which also fails to match neatly with the nature of the Settlement Payments). *See* SA § 3.06(a).

Regardless, any objections to the SA's treatment of the Settlement Payment, or to the SA's distribution and write-up instructions as conflicting with the Governing Agreements, are barred by the doctrine of *res judicata*, as such objections could have and should have been raised in the prior Article 77 proceeding approving the SA. In fact, this Court ultimately rejected objections along these lines in that proceeding and, in a Final Order and Judgment approving the SA, held that any objections that had not been raised were deemed waived.

As such, while Respondents will demonstrate herein that the Governing Agreements are largely harmonious with the plain language of the SA, to the extent any Governing Agreement appears to conflict with the same, the SA must control, as the Governing Agreements' distribution provisions simply were not intended to—and do not—apply to the Settlement Payments.

STANDARD OF REVIEW

A CPLR Article 77 proceeding is governed by CPLR Article 4, which requires the court to make a summary determination upon the pleadings, papers, and admissions, to the extent no triable issues of fact are raised. CPLR 409(b); *In re U.S. Bank National Association*, 51 Misc.3d 273, 276 (N.Y. Sup. 2015). Respondents submit that no triable issues of fact have been raised, so the Court should decide the merits of the Petition upon the pleadings, papers and admissions.

ARGUMENT

I. CONSISTENT WITH THE PLAIN TERMS OF THE SA, SUBSEQUENT RECOVERIES SHOULD BE APPLIED TO WRITE UP THE BALANCE OF ANY CERTIFICATES WITH LOSSES (EXHIBIT E).

Contrary to the suggestion by certain Interested Parties that the "Exhibit E" Settlement Trusts limit subsequent recovery write-ups to subordinate classes, the unambiguous terms of the SA provide that Subsequent Recoveries resulting from the Settlement Funds are to be applied to write up the balance of *any* certificates that suffered losses. As is set forth in subsection I.A., *infra*, the identified language of the Governing Agreements is not to the contrary, as has been confirmed by the course of performance of the parties to the DW and Ellington Trusts. As is set forth in subsection II.A., *infra*, to the extent there is any apparent conflict between the SA and the Governing Agreements, Interested Parties are barred, by the doctrine of *res judicata*, from arguing that the Governing Agreements take any precedence over the terms of the SA. In any event, the SA should control, as the identified provisions actually do not address bulk settlement payments to the trusts, would create an absurd result, and/or are the product of scrivener's error.

A. The SA Mandates That All Classes of Certificates That Suffered Losses Are Eligible for Write-Ups.

Consistent with its overarching purpose, the plain language of the SA dictates that all classes of certificates that suffered losses are eligible for recompense through the application and distribution of the Settlement Payments. Consistent with principles of subordination, the SA provides that ***all*** classes of certificates must be written up in the reverse order in which they experienced losses.

1. The Clear Language of the SA Permits All Classes of Certificates to Be Written Up.

Section 3.06(b) of the SA sets out a specific method for allocating the Settlement Payments to write up certificates in the applicable Settlement Trusts. Specifically, this subsection provides that the Petitioners shall apply each Allocable Share "***in the reverse order of previously allocated losses***, to increase the balance ***of each class of securities*** (other than any class of REMIC residual interests) to which such losses have been previously allocated." SA § 3.06(b) (emphasis added). There is no suggestion in the SA that write-ups are to be applied only to subordinate certificates, or that senior certificates should be excluded from write-ups. The only classes excluded from receiving write-ups under the SA are the REMIC residual interests. *Id.* All other classes, including Class A certificates, which are generally considered the "senior" certificates under the Governing Agreements, are to be written up by the amount of the Settlement Payment "by not more than the amount of such losses previously allocated to that class of securities . . . ." *Id.* The clear intent of SA is that any certificate that has experienced a write-down is eligible to be written up. This allocation methodology follows the basic principle of "subordination" common amongst nearly all residential mortgage-backed securities

("RMBS") trusts, namely, that junior certificates should absorb losses before senior certificates.[3] The SA's directive to write up bonds in the reverse order of previously allocated losses preserves that senior-subordinate structure by instructing Petitioners to write up senior certificates, which were last in line to absorb losses and write-downs, before writing up subordinate certificates.

This structure was no accident. As Petitioners' witnesses have testified in prior proceedings, the goal of the SA was that "the distribution of [settlement] proceeds goes to senior Certificateholders first regardless of what caused their losses." Kushner Aff., Ex. D (*In the Matter of the Application of U.S. Bank, N.A.*, No. 652382/2014 ("*In re U.S. Bank, N.A.")*, Doc. No. 588 ("January 26, 2016 Transcript") (N.Y. Sup. Feb. 25, 2016)) at 358:14-17 (testimony of Loretta Lundberg). That testimony reflects the common-sense understanding in the RMBS industry that senior certificates should be compensated ahead of more junior, or subordinate, certificates. In the prior Article 77 proceeding approving the SA, this Court recognized that those parties who purchased subordinated certificates "assumed the risk that [they] would suffer the first losses were the Trusts to fail" and that "their right to receive distributions with respect to the mortgage loans would be subordinated to the rights of the holders of more senior certificates." *See In re U.S. Bank*, Doc No. 593 (Decision) (N.Y. Sup. Aug. 12, 2016). Thus, the Court should instruct the Petitioners to follow the SA write-up instruction, as it reflects the intent of the parties to the SA and of the Governing Agreements to preserve the senior-subordinate structure.

[3] *See*, *e.g.* Kushner Aff., Ex. C (BSMF 2006-AR1 ProSupp) at S-46 ("Subordination provides the holders of Offered Certificates in a Loan Group having a higher payment priority with protection against Realized Losses on the related mortgage loans. In general, this loss protection is accomplished by allocating any Realized Losses in a Loan Group in excess of available Excess Spread and any current overcollateralization (if any) for such loan group among the related Subordinate Certificates, beginning with the Subordinate Certificates with the lowest payment priority until the Current Principal Amount of that subordinate class has been reduced to zero.").

2. The Governing Agreements' Write-Up Provisions Do Not Apply by Their Terms

At least one Interested Party[4] has suggested that Petitioners should not follow the SA, because certain language in the Governing Agreements for the DW and Ellington Trusts purportedly prohibits senior certificates from receiving write-ups. However, such Governing Agreement language does not apply to the Settlement Payments. In this regard, DW and Ellington adopt and incorporate by reference Point III.A.2 of the merits brief of Tilden Park Capital Management LP ("Tilden Park").

3. In any Event, the Governing Agreements Do Not Prohibit Write-Ups of Senior Certificates

Even if the Court were to find that the Governing Agreements' write-up provisions apply to the Settlement Payments, such provisions do not prohibit write-ups to senior certificates. Certain Governing Agreements for the DW and Ellington Trusts that first appear to limit write ups from Subsequent Recoveries to Subordinate Certificates later contain a carve-out that reveals that no such limitation exists. For example, after discussing the application of Subsequent Recoveries to increase the Certificate Principal Balance of Subordinate Certificates, Section 6.03(a) of the BALTA 2006-3 Governing Agreement provides that:

> ***Notwithstanding the forgoing, any Subsequent Recoveries will be allocated to the Group I Senior Certificates to the extent of any Applied Realized Loss Amounts before being applied to the Group I Subordinate Certificates.*** Holders of such Group I Certificates will not be entitled to any payments 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 Group I Certificate of such Class*** in accordance with its respective Fractional Undivided Interest.

[4] Respondents are informed and believe that only Nover Ventures, LLC is arguing that Settlement Trusts featuring the Exhibit E issue prohibit applying the Settlement Payments to write up senior certificates.

Kushner Aff. Ex. E (BALTA 2006-3 PSA) § 6.03(a) (emphasis added). Provisions like this make it abundantly clear that any write ups resulting from Subsequent Recoveries ***must*** be applied to Senior Certificates before Subordinate Certificates. Further, such directive contains no condition that the Subsequent Recoveries must reduce Realized Loss, but instead states that bonds will be increased "to the extent of any Applied Realized Loss Amounts," reinforcing that the SA's instruction to "increase the balance ***of each class of securities***…to which such losses have been previously allocated" is consistent with the letter and intent of the Governing Agreements.

For other of the DW and Ellington Settlement Trusts, the Governing Agreements contain no explicit prohibition on writing up senior certificates. For example, Section 6.02(b) of the SAMI 2007-AR4 PSAs states that:

> If, after taking into account such Subsequent Recoveries, ***the amount of a Realized Loss is reduced***, the amount of such remaining Subsequent Recoveries will be applied to increase the Current Principal Amount of the Class of Subordinate Certificates with the highest payment priority to which Applied Realized Loss Amounts have been allocated . . . .

See, e.g., Kushner Aff. Ex. F (SAMI 2007-AR4 PSA) § 6.02(b) (emphasis added); *see also*, Kushner Aff. Ex. G (BSMF 2006-AR1 PSA) § 6.02(b) (same); Kushner Aff. Ex. H (GPMF 2006-AR1 PSA) § 6.02(b) (substantially similar). The most likely explanation for the asymmetric language in these Trusts, which call for write-downs to senior certificates but do not discuss write-ups for senior certificates, is that such write-up instructions were an inadvertent hold-over from another RMBS Trust that did not permit write-downs to senior certificates.[5]

[5] As the Petitioners have noted, there are certain Settlement Trusts in which only subordinate classes receive subsequent recovery write-ups under the applicable Governing Agreements, but unlike the Settlement Trusts discussed in this section, Class A certificates are not allocated realized losses, as they are only allocated to subordinate classes of certificates. Pet. ¶ 48 n. 21 (citing examples). These Trusts are commonly referred to as "implied write-down" deals. For these, it makes sense that the write-up instructions in the Governing Agreements

Tellingly, many of the Prospectus Supplements (each, a "ProSupp") for the DW and Ellington Trusts featuring this language explicitly contemplate write-ups for all classes of certificates.[6] For example, the SAMI 2006-AR5 ProSupp states that, "***the Certificate Principal Balance of each class of 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." Kushner Aff. Ex. I (SAMI 2006-AR5 ProSupp) at S-66 (emphasis added); *see also* Kushner Aff. Ex. J (SAMI 2007-AR4 ProSupp) at 74 ("to the extent the Servicer receives Subsequent Recoveries with respect to any mortgage loan, the amount of the Realized Loss with respect to that mortgage loan will be reduced to the extent such recoveries are applied to reduce the Current Principal Amount of ***any class of Certificates***…") (emphasis added). Other ProSupps that do discuss subordinate write-ups, such as GPMF 2006-AR1, do not explicitly preclude write-ups to senior classes, and in fact suggest that only write downs to the Subordinate Certificates were contemplated. *See, e.g.,* Kushner Aff., Ex. K. (GPMF 2006-AR1 ProSupp) at S-37, S-38 ("Subordination provides the holders of Offered Certificates having a higher payment priority with protection against Realized Losses on the mortgage loans. In general, this loss protection is accomplished by allocating any Realized Losses among the Subordinate Certificates…the Current Principal Amount of each class of Subordinate Certificates that has been reduced by the allocation of a Realized Loss to such Certificate will be increased,

limit write-ups to subordinate classes because these are the only such classes that are allocated realized losses. *Id.* Given that the Governing Agreements were often pulled together in a matter of weeks, borrowing substantial amounts of language from prior deals, it is likely that these write-up instructions were borrowed from an implied write-down deal without updating the language appropriately.

[6] PSAs and ProSupps must be read together, as they are part of a single transaction. *See Nau v. Vulcan Rail & Construction Co.*, 286 N.Y. 188, 197 (1941) (holding that instruments executed at substantially the same time and related to the same subject matter are contemporaneous writings that must be read together as one); *Fundamental Long Term Care Holdings, LLC v. Cammeby's Funding LLC*, 20 N.Y.3d 438, 445 (2013) (same)

in order of seniority, by the amount of such Subsequent Recovery…"). All such evidence supports interpreting these provisions as not barring senior certificate write-ups.

4. The Governing Agreement Parties' Past Performance Demonstrates Their Understanding that Senior Certificates May Be Written Up.

Historically, the Petitioners have applied Subsequent Recoveries to write up the certificate principal balance of *all* certificates, not just subordinate certificates, confirming this interpretation of the write-up provisions of the Governing Agreements as consistent with the instructions contained in the SA. As the United States Supreme Court has held, "[g]enerally speaking, the practical interpretation of a contract by the parties to it for any considerable period of time before it comes to be the subject of controversy is deemed of great, if not controlling, influence." *Old Colony Trust Co. v. City of Omaha*, 230 U.S. 100 (1913). New York Courts have also adopted and followed this principle of contract interpretation. *See*, *e.g.*, *Federal Ins. Co. v. Americas Ins. Co.*, 258 A.D.2d 39, 44 (1st Dep't 1999) ("Furthermore, the parties' course of performance under the contract is considered to be the 'most persuasive evidence of the agreed intention of the parties.'" (quoting, *Webster's Red Seal Publs. v. Gilberton World–Wide Publs.*, 67 A.D.2d 339 (1st Dep't 1999))). Indeed, "[t]he parties to an agreement know best what they meant, and their action under it is often the strongest evidence of their meaning." Restatement [Second] of Contracts § 202, comment g.

A review of the remittance reports for the relevant DW and Ellington Trusts confirms that the trust parties' interpretation of the Governing Agreements' write-up provisions was that Subsequent Recoveries should be applied to write up *all* certificates that had suffered losses, whether senior or subordinate. For example, even as recently as August 2018, well after this Exhibit E issue had been identified by Petitioners, the Remittance Report for the SAMI 2006-AR5 Trust reflects that the Trust received a Subsequent Recovery for Group 1 loans that was

applied (as a credit under Current Realized Loss) to write up the 1-A-2 certificates for this trust, one of the senior classes. *See*, Margolis Aff. ¶ 3 & Ex. A (SAMI 2006-AR5 August 2018 Remittance Report), pp. 1, 25, 64.[7] In July 2018, the GPMF 2005-AR4 Trust received a Subsequent Recovery, which was applied to write up the IV-A-2 certificates, one of the senior classes. *See*, Margolis Aff. ¶ 4 & Ex. B (GPMF 2005-AR4 July 2018 Remittance Report), p. 1. In May 2018, the BALTA 2006-3 Trust received a Subsequent Recovery, which was applied to write up the I-A-1 certificates—again, a senior class. *See*, Margolis Aff. ¶ 5 & Ex. C (BALTA 2006-3 May 2018 Remittance Report), p. 1. Likewise, in May 2018, Subsequent Recoveries were applied to write up the principal balance of I-A-1, II-A-1, and II-A-2 certificates in the BSARM 2005-3 Trust, which are all senior classes, while in December 2017, Subsequent Recoveries were applied to write up the principal balance of I-A-2 and II-A-2 certificates in the BSMF 2006-AR5 Trust, which are both senior classes. *See*, Margolis Aff. ¶ 6 & Ex. D (BSARM 2005-3 Trust May 2018 Remittance Report), p. 1; *id.* ¶ 7 & Ex. E (BSMF 2006-AR5 Trust December 2017 Remittance Report), p. 1. Such past performance is the strongest possible evidence that the parties never intended that senior bonds be precluded from receiving write ups due to Subsequent Recoveries.

B. To the Extent the SA and Governing Agreements Conflict, the SA Should Control as to Settlement Payment Write-Ups.

While Respondents maintain that the Governing Agreements are harmonious with the SA with respect to the application of write-ups, to the extent any Party argues that the Governing Agreements conflict with the SA, such a challenge is barred by *res judicata*. Further, any

[7] Further detail on this example is provided for illustration. The relevant loan took a loss of $154,648 in May 2013. This loss was later recovered in August 2018, resulting in realized gains on the group level of $154,347.73 after deducting losses from four other loans. The resulting Subsequent Recovery was applied to, *inter alia*, the Class 1A2 (senior) Certificates. *See* Margolis Aff. ¶ 3; Ex A (SAMI 2006-AR5 August 2018 Remittance Report), pp. 1, 25, 64.

apparent conflict is illusory, and the SA should control, as the Governing Agreements were not designed to, and do not, address the distribution of these bulk Settlement Payments. As such, restricting write-ups to subordinate certificates in the application of the Settlement Payment would be contrary to the terms of the SA and would create an absurd, commercially unreasonable result, undermining the overarching intent of both the SA (redressing losses caused by defective loans) and the Governing Agreements (ensuring subordination and absorption of losses first by the subordinate classes).

1. Res Judicata Bars Any Argument that the Plain Terms of the SA Conflict with the Governing Agreements and Should Not Be Followed.

Any argument that the SA conflicts with the Governing Agreements is barred by the doctrine of *res judicata*, given that this Court approved the SA and deemed any such challenges waived in a prior Article 77 proceeding brought by the same Petitioners and covering the same trusts. *See generally In re U.S. Bank, N.A.*, Doc. No. 593 (Decision) (N.Y. Sup. August 12, 2016). The prior Article 77 proceeding was the proper forum to raise any arguments of conflict or inconsistency between the SA and Governing Agreements, and Interested Parties are now barred from making such an argument in this proceeding. In this regard, DW and Ellington adopt and incorporate by reference Point I of the merits brief of Tilden Park.

2. The Governing Agreements Do Not Address Bulk Settlement Payments.

A review of any of the Governing Agreements at issue makes clear that the drafters did not contemplate that claims for breaches of representations and warranties with respect to thousands of loans would be settled at once, resulting in bulk settlement payments. To wit, the Governing Agreements make no mention of settlement payments to the Trust or provide instruction on how such payments should be applied or distributed.

Recognizing this limitation, the drafters of the SA directed Petitioners to treat each Settlement Trust's Allocable Share "as though such Allocable Share was a subsequent recovery…" SA § 3.06(a). Most Governing Agreements define a Subsequent Recovery as amounts received "specifically related to a Liquidated Mortgage Loan." *See, e.g.,* Kushner Aff., Ex. A (SAMI 2007-AR4 PSA) Art. I (defining "Subsequent Recoveries"); Kushner Aff., Ex. B (GPMF 06-AR1 PSA) Art. I (same). Yet, the Settlement Payments are not tied to any specific mortgage loans, let alone "specifically related to a Liquidated Mortgage Loan." Instead, each is a lump-sum payment, intended to compensate each Settlement Trust out of the Gross Settlement Amount pro rata based on Trust losses. *See* SA § 3.05. Thus, the SA directs the Payments to be treated "as though" they were subsequent recoveries and provides for an alternative treatment if a particular Governing Agreement does not include such a term (distribution of the Allocable Share "as though it was unscheduled principal," which also fails to match neatly with the nature of the Settlement Payments). *See* SA § 3.06(a). Where, as here, any apparent conflict with the language of the Governing Agreements is the result of gaps in the framework of the Governing Agreements rather than direct conflict, the SA should control, as it was specifically designed to address these unique payments. Indeed, the SA itself recognizes this, providing not only that the SA "shall not be argued or deemed to constitute, an amendment of any term of any Governing Agreement" but also that "compliance with the Settlement Agreement and its Exhibits shall be deemed compliance with the Governing Agreements." SA § 7.05. There is thus no conflict created by Petitioners carrying out the SA write-up instruction, and any argument to the contrary is prohibited by the SA's own terms.

3. Any Order Restricting the Write Up of Senior Certificates Would Lead to an Absurd and Commercially Unreasonable Result.

Should the Court nevertheless determine that the Governing Agreements specifically address this situation and mandate write-ups to subordinate certificates only, the Court should direct the Petitioners to ignore such language so as to carry out the intent of the parties to the SA and prevent an absurd and commercially unreasonable result. "[A] contract should not be interpreted to produce a result that is absurd, commercially unreasonable, or contrary to the reasonable expectations of the parties." *New York Univ. v. Pfizer Inc.*, 151 A.D.3d 42, 52 (1st Dep't 2017) (quoting *Matter of Lipper Holdings v. Trident Holdings*, 1 A.D.3d 170, 171 (1st Dep't 2003)); *see also Wallace v. 600 Partners Co.*, 86 N.Y.2d 543, 547 (1995) (even "[i]n the absence of a claim for reformation, courts may, as a matter of interpretation, carry out the intention of a contract by transposing, rejecting, or supplying words to make the meaning of the contract more clear.").

Given that the parties to the SA expressly contemplated that senior Certificateholders would have the highest priority in receiving Settlement Payment write-ups to reverse their losses, it would be absurd to allow write-ups to benefit the subordinated bonds at the senior bonds' expense. Further, given that subordination is an essential form of credit enhancement for senior bonds such as DW's and Ellington's holdings in these trusts, it would be commercially unreasonable for senior, Class A certificates to be denied a write-up while Class B certificates gain a windfall. (*See* discussion in Section I.A.1, *supra*, pertaining to subordination, which is incorporated herein by reference.) In fact, even the Petitioners have expressed concern that restricting write-ups would create an untenable result—one that they would not be able to carry out. U.S. Bank has stated that, "it needs an appropriate mechanism by which to apply the entire amount of the applicable settlement payment write-up" and that write-up restrictions could create

a situation in which the only certificates that are purportedly eligible for write-up "do not have sufficient losses to absorb the entire settlement payment write-up." Kushner Aff. Ex. L (September 10, 2018 email from U.S. Bank Counsel). U.S. Bank thus took the position that "any [final] order must have an appropriate mechanism to ensure that the entire amount of the settlement payment write-up will be applied." *Id.* Any order limiting write-ups to subordinate bonds could create just such an unworkable and commercially unreasonable result, denying Petitioners an appropriate mechanism to carry out the SA. In order to avoid such a result, the Court should direct Petitioners to interpret the Governing Agreements so as to ignore any provision purporting to limit write-ups to subordinate certificates. *New York Univ.*, 151 A.D.3d at 52; *Wallace*, 86 N.Y.2d at 547.

Alternatively, the Court may deem any such contrary language in the Governing Agreements to be scrivener's error, and may correct such error in its final order. A court may correct scrivener's error when the agreement does not accurately express the parties' intentions, as manifested by their prior agreements, course of performance, or practical interpretation of the contract. *See, e.g.*, *Warberg Opportunistic Trading Fund L.P. v. GeoResources, Inc.*, 151 A.D.3d 465 (1st Dep't 2017). As set forth above, to the extent that provisions such as Section 6.02 of the SAMI 2007-AR4 PSA are interpreted as limiting write-ups to reverse Realized Losses for only "Subordinate Certificates," such language is contrary to the clear intent of the SA and the Governing Agreements, as well as the parties' course of performance. There is ample support in the Governing Agreements for the finding of a scrivener's error in this regard. For example, in the SAMI 2007-AR4 PSA, the definition of "Current Principal Amount"—which does ***not*** limit write-ups—refers to a write-up "pursuant to Section 6.02(h)," Kushner Aff. Ex. M (SAMI 2007-AR4 PSA) Art. I (defining "Current Principal Balance"), but no such "Section

6.02(***h***)" exists.[8] Rather, the PSA provision that purportedly limits write-ups is located at Section 6.02(***b***), further implying that such provision was included in error.

Further evidence of this scrivener's error appears in the ProSupps. As noted in Section I.A.1, *supra*, many of the ProSupps expressly contemplate write-ups to senior bonds. Reading the ProSupps together with the PSAs, as one must (*see, e.g.*, *Wells Fargo Bank, N.A. v. ESM Fund I, LP,* 785 F.Supp.2d 188, 195 (S.D.N.Y. 2011), *aff'd sub nom. Wells Fargo Bank, N.A. v. Fin. Sec. Assur. Inc*., 504 F.App'x 38 (2d Cir. 2012); *In re Trusteeship Created by Am. Home Mortg. Inv. Trust 2005-2*, No. 14 Civ. 2494, 2014 WL 3858506, at *20-21 (S.D.N.Y. July 24, 2014)), given the ProSupps' unambiguous language entitling all parties to write ups from the Settlement Payment, any errant PSA language should be corrected or ignored. *Warberg*, 151 A.D.3d at 470-71; *Wallace*, 86 N.Y.2d at 547. Thus, if the Court indeed finds a conflict between the Governing Agreements and the SA on this issue, it should avoid an unworkable and erroneous result by directing Petitioners to follow the write-up instructions in the SA.

II. CERTIFICATES WITH A ZERO PRINCIPAL BALANCE SHOULD BE WRITTEN-UP TO PERMIT THEIR RECEIPT OF SETTLEMENT FUNDS.

The plain language of the SA allows a certificate with a Current Principal Amount of zero to be written up as a result of the Settlement Payment.[9] The SA provides that "distribution"—the payment of cash to bondholders—and writing up, or increasing the principal balance of those bonds, are two separate events. Per the SA, certificates should be written up, "[a]fter the distribution of the Allocable Share to a ***Settlement Trust***" and not after distribution to

[8] *See also*, Kushner Aff. Ex. N (BSMF 2006-AR1 PSA) Art. I (defining "Current Principal Amount") (wherein Section 6.02(h) is referenced in the definition of "Current Principal Amount" but no such subsection exists); Kushner Aff. Ex. O (BSMF 2006-AR3 PSA) Art. I (same); Kushner Aff. Ex. P (BSMF 2006-AR5 PSA) Art. I (same); Kushner Aff. Ex. Q (GPMF 2006-AR3 PSA) Art. I (same).

[9] This argument is being asserted as to DW only, as to the BSABS 2006-HE3 Trust.

the individual classes of certificates. SA § 3.06(b) (emphasis added). Further, the writing up process "***shall not affect the distribution*** of the Settlement Payment provided for in Subsection 3.06(a)" (*id.* (emphasis added)), again confirming that writing-up is distinct from distribution, and that the write-up process will not affect the process by which the Allocable Shares are paid out through the Settlement Trusts' distribution waterfalls. This distinction is important, as the Governing Agreement language identified by Petitioners on Exhibit G as potentially restricting write-ups of certificates with a certificate principal balance or certificate principal amount of zero (each, a "Zero Balance Class") actually restricts only "distributions" to Zero Balance Classes during the time their balances remain at zero. As a careful review of the Governing Agreements makes plain, Zero Balance Classes are still entitled to have their balances increased, thereby reviving their right to distributions.

Only one of the Governing Agreements for the Ellington and DW Trusts, the BSABS 2006-HE3 PSA (the "BSABS PSA"), was identified on Exhibit G as purporting to make Zero Balance Classes ineligible for write-ups. Section 6.04(a) of the BSABS PSA provides that;

> notwithstanding the foregoing, on any Distribution Date after the Distribution Date on which the Certificate Principal Balance of a Class of Class A Certificates or Class M Certificates has been reduced to zero, that Class of Certificates will be retired and will no longer be entitled to distributions…

Kushner Aff. Ex. R (BSABS 2006-HE3 PSA) § 6.04(a).

Notably, as the Petitioners have observed,[10] provisions such as the one quoted above say nothing about write-ups, and specify only that a "retired" bond "will no longer be entitled to ***distributions***," meaning the specific process by which money is paid out to Certificateholders.

[10] Petitioners noted that nothing in these provisions, or anywhere else in the Governing Agreements, says that such certificates may not be written up on account of Subsequent Recoveries. Pet. ¶ 57. Moreover, "[i]f the certificate principal balances of such classes are written up, they would then no longer have balances of zero," and consequently they would be entitled to resume receiving distributions.

Id. In fact, the provision for writing up certificates in the BSABS PSA is found in a separate subsection of the PSA than the distribution subsection, and notes that such write-up occurs "***in addition to***," and thus separate from, "distributions." *Id*. § 6.04(b). As with the Settlement Agreement, the BSABS 2006-HE3 PSA maintains the distinction between "writing up" certificates and "distributing" to Certificateholders, with the former separate from and unaffected by the latter, confirming that a restriction on distributions to Zero Balance Classes does not carry with it any restriction on write-ups.

Instead, the write up provisions in the BSABS PSA demonstrate that Zero Balance Classes are eligible to be written up when subsequent recoveries are received. Section 6.04(b) provides that Subsequent Recoveries, "shall be applied to increase the Certificate Principal Balance of the Class of Certificates to which the highest payment of priority to which Realized Losses have been allocated," without including any Zero Balance Class restriction. *See id*.

Though certain Interested Parties may suggest that the term "retired" necessarily implies that future write-ups are restricted, a review of the BSABS PSA provisions associated with retirement reveals that only those Zero Balance Classes that have been paid in full become retired, not those whose balances were reduced to zero as a result of the application of Realized Losses. First, the process for retirement of a Class of Certificate is set forth in a section entitled "Final Distribution on the Certificates," which provides that retirement occurs if, "the Securities Administrator determines that a Class of Certificates shall be retired ***after final distribution on such Class***." BSABS PSA § 11.02(ii) (emphasis added). Such provision further requires the Securities Administrator to "notify the Certificateholders within five (5) Business Days after such Determination Date that ***the final distribution in retirement of such Class of Certificates*** is

scheduled to be made on the immediately following Distribution Date." *Id.* (emphasis added).[11] Further, Section 11.02 requires that retired Certificates be "cancell[ed]" upon final distribution—a process that involves the "presentation and surrender" of Certificates at the Trustee's corporate trust office prior to the final distribution. *Id.* § 11.02 (describing "surrender ... for payment of the final distribution and cancellation"). Similarly, if a Certificateholder opts to transfer or exchange its Certificates, or if Certificates are lost or mutilated, those Certificates must be "surrendered" and "shall be cancelled." *Id*. §§ 5.03, 7.02(b).

These provisions surrounding retirement make clear that such a drastic measure only occurs if certificates are lost, destroyed, or fully paid off and not, as here, when their Certificate Principal Balance has been temporarily reduced to zero as a result of the application of Realized Losses—Losses that may be reversed under the write-up provisions of the BSABS PSA. Indeed, the terms of the BSABS PSA that address distributions to Zero Balance Classes say nothing about cancelling or surrendering those certificates.[12] This explains why neither the Securities Administrator nor the Trustee of the BSABS 2006-HE3 Trust has indicated that it has taken any steps to cancel or make final distributions on the Trust's Zero Balance Classes, or provided any notice of same. *See* Honarvar Aff. ¶ 3. As such, DW's Certificates in the BSABS 2006-HE3 Trust were never presented or surrendered to the Trustee for cancellation, and no final distribution was made. *Id.* ¶ 4.

[11] These provisions plainly require that, for a Class of Certificates to be retired, the Securities Administrator must provide notice to the affected Certificateholders in advance of the final distribution to such Class. No such notice was provided to DW in the BSABS 2006-HE3 Trust, indicating that the Securities Administrator did not believe that such Certificates should be retired. *See* Honarvar Aff. ¶ 3.

[12] Notably, the ProSupp for the BSABS 2006-HE3—which must be read together with the PSA—is not to the contrary. Nothing in the ProSupp provides for the cancellation of Zero Balance Classes or restricts write-ups of Zero Balance Classes, and in fact the ProSupp is consistent with the PSA in providing for retirement "only upon presentation and surrender of the security at the office of the related trustee." *See* Kushner Aff. Ex. S (BSABS 2006-HE3 ProSupp) at 126.

Instead, by definition, the Zero Balance Certificates that DW holds in the BSABS 2006-HE3 trust are "outstanding" under the BSABS PSA. The BSABS PSA provides that "all Certificates" are deemed "Outstanding" "except [for] (a) Certificates theretofore canceled" or "delivered . . . for cancellation" and "Certificates in exchange for which or in lieu or which other Certificates have been executed and delivered." Kushner Aff. Ex. T (BSABS 2006-HE3 PSA) Art. I (defining "Outstanding"). Similarly, Section 6.04(c) of the BSABS PSA provides that, "[s]ubject to Section 11.02 hereof respecting the final distribution, on each Distribution Date the Securities Administrator shall make distributions to each Certificateholder of record on the preceding Record Date…" Because DW's Certificates in the BSABS 2006-HE3 Trust have not been cancelled and are thus still "outstanding" under the plain terms of the PSA, they are therefore entitled to the same write-ups as any other outstanding certificate. Respondents respectfully ask the Court to instruct Petitioners to follow the plain text of the SA and write up Classes in the BSABS PSA's order of priority, regardless of whether they are Zero Balance Classes.

III. THE WRITE-UP FIRST METHOD SHOULD BE USED FOR GPMF 2006-AR1, AS IT IS CONSISTENT WITH THE SA AND THE PSA.

The terms of the SA and the PSA for the GPMF 2006-AR1 Settlement Trust unambiguously call for the application of the Write-Up First Method with respect to this trust.[13] The SA directs that the distribution to Certificateholders shall be "***in accordance with the distribution provisions of the Governing Agreements*** . . . as though such Allocable Share was a 'subsequent recovery' relating to principal proceeds available for distribution on the immediately

[13] This argument is asserted on behalf of Ellington only, which owns Class A certificates in the GPMF 06-AR1 Settlement Trust.

following distribution date." SA § 3.06(a) (emphasis added).[14] The GPMF 2006-AR1 PSA, in turn, requires the use of the Write-Up First Method:

> . . . in the event that the Servicer receives any Subsequent Recoveries, the Servicer shall deposit such funds into the Custodial Account pursuant to Section 4.01(a)(ii). 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 Current Principal Amount of the Class of Subordinate Certificates with the highest payment priority to which Applied Realized Loss Amounts have been allocated***, but not by more than the amount of Applied Realized Loss Amounts previously allocated to that Class of Subordinate Certificates. . . .

Kushner Aff. Ex. H (GPMF 2006-AR1 PSA) at § 6.02(b) (emphasis added).) Thus, when the Master Servicer receives Subsequent Recoveries, it deposits them into a "Custodial Account," and *they are not immediately distributed*. *Id*. A calculation is then applied to determine whether such Subsequent Recoveries would reduce the amount of Realized Losses to the Certificates. *Id.* ("If, after taking into account such Subsequent Recoveries, the amount of a Realized Loss is reduced…") If yes, the Certificates with the highest payment priority to which Applied Realized Loss Amounts have been allocated—here, the Class A-1A and A-2A bonds, pro rata (*see id*. § 6.02(a); Art. I (defining "Applied Realized Loss Amount"))—are "written-up" and their Current Principal Amounts ("CPAs") are

[14] To the extent the SA suggests any order of operations, it is consistent with the PSA:

> ***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*** (other than any class of REMIC residual interests) ***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.

SA § 3.06(b) (emphasis added). The Settlement Agreement specifies that write ups are to be applied immediately following the distribution of the Allocable Share *to a Settlement Trust*, not after the distribution of such Allocable Share to Certificateholders.

increased to reverse Realized Losses. The PSA's definition of "Current Principal Amount" further supports this reading, as it includes any write-ups made as of that Distribution Date:

> Current Principal Amount: With respect to any Class A, Class M or Class B Certificate ***as of any Distribution Date***, the initial principal amount of such Certificate . . . ***plus, in the case of the Subordinate Certificates, any Subsequent Recoveries added to the Current Principal Amount of such Certificate pursuant to Section 6.02([b])***, and reduced by (i) all amounts distributed on previous Distribution Dates on such Certificate with respect to principal and (ii) any Applied Realized Loss Amounts allocated to such Certificate ***on previous Distribution Dates***. . . .

Id. § 1.01 (emphasis added).[15]

Distributions are then made to Certificateholders based on the CPA as of a particular Distribution Date, and thus can be made only after the calculation of CPA, including any increase in CPA pursuant to the application of Subsequent Recoveries as of that Distribution Date. To wit, the "Distribution Amount" for a particular certificate is based on "the aggregate Current Principal Amount of the Class A Certificates ***immediately prior to such Distribution Date***" (*see, e.g.*, *id.* at Art. I at 5, Definition of "Class A Principal Distribution Amount"), and the Distribution Amount is then distributed to Certificateholders on such Distribution Date. Because a Class's CPA on any Distribution Date is calculated *prior* to distributions, and those distributions depend on the CPA "as of" such Distribution Date, the write-ups to account for new Subsequent Recoveries necessarily must occur *before* distributions of CPA are made. Taken together, the only reasonable interpretation of these provisions is the Write-Up First Method. *See Brad H. v. City of New York*, 17 N.Y.3d 180, 185 (2011) ("A written agreement that is clear,

[15] The "Subsequent Recoveries" in the definition of CPA are clearly *new* subsequent recoveries. When the drafters of the GPMF Trust PSA intended to refer to amounts allocated previously, they did so explicitly (*i.e.*, referring to distributions made, and Applied Realized Loss Amounts applied "on previous Distribution Dates"). Here again, the definition distinguishes these *new* Subsequent Recoveries that increase the CPB from the distributions and Realized Losses accumulated from "previous distribution dates."

complete and subject to only one reasonable interpretation must be enforced according to the plain meaning of the language chosen by the contracting parties.").

In sum, the clear terms of the PSA mandates that the GPMF Trust certificates be written up prior to the distribution of the Allocable Shares to Certificateholders.

IV. PETITIONERS SHOULD FOLLOW THE SETTLEMENT WRITE-UP INSTRUCTIONS WITH RESPECT TO BALTA 2006-3

Considering the unique challenges surrounding distribution of this bulk settlement payment to hundreds of Settlement Trusts, the parties to the SA explicitly decided that any write-ups to the principal balance of certificates in the Settlement Trusts should occur in the reverse order of previously allocated losses.[16] SA § 3.06(b). As discussed in Section I.A.1, *supra*, the purpose of doing so is to first reverse any losses allocated to the most senior certificates in the Settlement Trusts in accordance with the senior-subordinate structure.

Arguably, Section 6.03(a) of the BALTA 2006-3 Trust conflicts with the SA's write-up provision and intent. Section 6.03(a) provides that any write-ups "shall be applied to the Certificate Principal Balance of each Group I Certificate of such Class ***in accordance with its respective Fractional Undivided Interest***" (i.e., in a pro rata fashion). Kushner Aff., Ex. E (BALTA 2006-3 PSA) § 6.03(a) (emphasis added). However, for the reasons stated in Section I.A.2, *supra*, this write-up provision does not apply to bulk settlement payments, and thus the SA's instruction to write-up Certificates in the reverse order of previously allocated losses should control, as it will effectuate the SA's intent of reversing losses in the order of seniority.

PRAYER FOR RELIEF

DW and Ellington respectfully request that the Court enter judgment as follows:

[16] This argument is being made as to Ellington only and applies to the Certificates Ellington holds in the BALTA 2006-3 Trust.

a) Instruct Petitioners that Subsequent Recoveries constituting the Allocable Share for each Settlement Trust shall be applied to write up the certificate principal balances of all certificates in accordance with the SA;

b) Further instruct Petitioners that the Settlement Payment should be applied to increase the certificate balance of all certificates according to the DW and Ellington Governing Documents' order of payment priority, without regard to whether any certificate has a certificate principal balance or certificate principal amount of zero;

c) Follow the "Write-Up First Method" as to the Allocable Share for the GPMF 2006-AR1 Settlement Trust;

d) Follow the SA write-up instructions as to the BALTA 2006-3 Trust; and

e) Granting such other, further, and different relief as may be just and proper.

Dated: September 14, 2018
New York, New York

Respectfully submitted,

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