

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

IAS Part 60

Hon. Marcy S. Friedman

**ANSWER OF
 RESPONDENT
 D. E. SHAW REFRACTION
 PORTFOLIOS, L.L.C.
 TO THE PETITION**

Respondent D. E. Shaw Refraction Portfolios, L.L.C. (“DESRP”), as and
 for its Answer to the Petition in this proceeding, hereby states as follows:

I. Overview of DESRP’s Position

DESRP holds ownership interests in four Settlement Trusts¹ affected by
 the issues raised by Petitioners in this proceeding. They are identified below along with
 the class DESRP owns and the Exhibits to the Petition on which they appear:

SACO 2005-9 (M1) (Exhibits D and G);
 GPMF 2005-AR2 (A2) (Exhibits D and E);
 SAMI 2006-AR7 (A2A) (Exhibits D and F); and
 SAMI 2007-AR1 (1A2) (Exhibits D and F).

¹ Capitalized terms not otherwise defined in this Answer are used with the same
 meanings as defined in the Petition.

With respect to SACO 2005-9, it is DESRP's position that the Write-Up First Method should be used in applying the Settlement Payment. This resolves the issue reflected on Exhibit D. DESRP believes the "Retired Class Provision" issue (reflected on Exhibit G) will be moot if the Write-Up First Method is used for SACO 2005-9; but in the event that this issue is not moot, it is DESRP's position that the Retired Class Provision should not be given effect. *See* Point II below.

With respect to GPMF 2005-AR2, it is DESRP's position that the Write-Up First Method should be used in applying the Settlement Payment for this Settlement Trust as well. With respect to the issue of whether the Subsequent Recovery write-up instructions should apply to the senior classes of this Settlement Trust (reflected on Exhibit E), it is DESCO's position that the Subsequent Recovery write-up instructions should apply to the senior classes. *See* Point III below.

With respect to the two SAMI Settlement Trusts, it is DESRP's position that the Write-Up First Method should be used in applying the Settlement Payment for these Settlement Trusts as well. In addition, with respect to the issue reflected on Exhibit F, it is DESRP's position that Subsequent Recovery write-ups should occur in reverse order from the allocation of realized losses. *See* Point IV below.

II. The Write-Up First Method Should Be Used for SACO 2005-9

A. The PSA Requires the Write-Up First Method

The Write-Up First Method should be used for SACO 2005-9 for several reasons. First, and most important, the text of the applicable Pooling and Servicing Agreement ("PSA"), which governs, unambiguously requires that the Certificate Principal Balance be written up by the amount of the Settlement Payment – which is a

“Subsequent Recovery” under the PSA – before distributions are made to certificateholders. Second, the Settlement Agreement also unambiguously instructs write-up to occur after distribution of the Settlement Payment to the Settlement Trusts but before distribution to certificateholders. Third, use of the “Pay First” method would lead to commercially unreasonable results that could not have been intended.

In § 3.06(a) of the Settlement Agreement, it was agreed that a Settlement Payment is to be treated as though it were a Subsequent Recovery under the applicable PSAs: “Each Trust’s Allocable Share shall be deposited into the related Trust’s collection or distribution account ... as though such Allocable Share was a ‘subsequent recovery’....” The definition of “Certificate Principal Balance” in the PSA for SACO 2005-9² unambiguously requires that amounts received as Subsequent Recoveries be added to increase the Certificate Principal Balance before they are paid out to certificateholders. Thus, the Write-Up First Method must be used for SACO 2005-9.

Because the amounts of any distributions of principal under this PSA depends on the Certificate Principal Balance as of the applicable Distribution Date, the PSA’s definition of Certificate Principal Balance is critical. This definition unambiguously requires that the Certificate Principal Balance of the certificate held by DESCO be written up by the Settlement Payment before distributions are made under the applicable distribution provisions. The definition of Certificate Principal Balance, as of any Distribution Date, is comprised of four primary components:

² See Exhibit 1 to the Affidavit of Sandeep Bharatwaj dated January 29, 2018 (“Bharatwaj Aff.”), submitted herewith.

1. The “Initial Certificate Principal Balance,” which is the Principal Balance as of the closing date of the securitization in 2005; plus
2. “*any Subsequent Recoveries added to the Certificate Principal Balance*” (emphasis added) – which is the write-up; minus
3. All amounts “previously distributed” on the Certificate “in reduction of the Certificate Principal Balance;” minus
4. “any applied Realized Loss Amounts allocated to such Certificate ... on previous Distribution Dates.”

The timing of the addition or subtraction of each component is clearly specified. The definition of Certificate Principal Balance makes clear that the last two components are subtracted only to the extent that amounts were “previously” distributed or allocated. There is no such limitation with respect to Subsequent Recoveries. Thus, Subsequent Recoveries received for purposes of distribution on a particular Distribution Date are to be included in the calculation of Certificate Principal Balance, and because Certificate Principal Balance must be calculated before any distribution can occur, the write-up must occur before distribution of the Settlement Payment.³

The language of the Settlement Agreement also clearly supports the Write-Up First Method required by the PSA. Section 3.06(b) of the Settlement Agreement provides: “After the distribution of the Allocable Share *to a Settlement Trust* ..., the

³ Accordingly, courts that have considered PSA language such as that for SACO 2005-9 have concluded that the Write-Up First Method is required to be used. *See cases cited in* Petition at 28, n. 22. *In re Bank of New York Mellon*, Index No. 150973/2016 (N.Y. Sup. April 4, 2017) (“*Countrywide*”), is not to the contrary. *Countrywide* implemented the Pay First Method but under very different PSA and settlement agreement language that plainly required use of the Pay First Method, unlike the language here requiring use of the Write-Up First Method.

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” In plain language, the write-up is to occur after the Settlement Trust received the funds – but before those funds are distributed to investors. Were it otherwise, § 3.06(b) would say “after the distribution of the Allocable Share *to investors*” -- but it states the opposite, that the write-up comes first.

Finally, besides being contrary to the PSA and the Settlement Agreement, use of the Pay First Method would lead to commercially unreasonable results that could not have been intended. The Petition itself identifies a number of these results. For example, the Pay First Method (i) may cause Settlement Trusts to appear to be temporarily overcollateralized (Petition ¶¶ 28-29); (ii) may cause more junior holders to be favored over more senior holders, where that was not the parties’ intent (*id.* ¶¶ 32-33); and (iii) may lead to confusion as to how to distribute any portion of the Settlement Payment that exceeds the then-outstanding aggregate certificate principal balances of the classes of certificates of such Settlement Trust (*id.* ¶¶ 38-39).

As to SACO 2005-9, under the Pay First Method the seniormost bonds would be paid off from the Settlement Payment and the M1 bonds (which DESRP holds) would be paid a certain amount, but there would be remaining cash that could be deemed “excess cashflow” and directed toward the residual interests, which is not only a commercially unreasonable result but directly contradicts the Settlement Agreement. *See* Settlement Agreement §§ 3.06(a) and (b). Under the Write-Up First Method, this problem is avoided. The M1 bonds will be written up; the seniormost bonds will still be

paid off; the Settlement Agreement is complied with as concerns residual interests; and the Retired Class Provision issue (discussed below) is avoided.

Using the Write-Up First Method avoids the unintended and unreasonable results that would result from using the Pay First Method; and New York law is clear that “a contract should not be interpreted to produce an absurd result, one that is commercially unreasonable, or one that is contrary to the intent of the parties.” *Cole v. Macklowe*, 99 A.D.2d 595 (1st Dep’t 2012).

In summary, the Court should resolve the Exhibit D issue by instructing the Trustee to apply the Write-Up First Method to SACO 2005-9.

B. If the “Retired Class Provision” Issue Is Not Moot After the Write-Up Issue Is Determined, the “Retired Class Provision” Should Not Be Given Effect with Respect to SACO 2005-9

DESRP believes that the so-called “Retired Class Provision” issue (Exhibit G) will be moot with respect to SACO 2005-9 once the Write-Up First Method is used, as it must be for the reasons set forth above. The Retired Class Provision can only even arguably apply in the circumstance where the Certificate Principal Balance of a certificate “has been reduced to zero” (PSA § 5.04(a)), and once the Certificate Principal Balance of the certificate held by DESCO is written up using the Write-Up First Method, that circumstance will not exist. However, to the extent the Retired Class Provision issue may still be relevant, it is DESCO’s position that the Retired Class Provision should not be given effect with respect to SACO 2005-9.

The Retired Class Provision is found in § 5.04(a) of the PSA for the SACO 2005-9 Settlement Trust. The Subsequent Recoveries provision, however, is

found in § 5.04(b). Understanding the interplay of these two provisions is crucial.

Section 5.04(a) concerns three types of distributions:

- Interest (§ 5.04(a)(1));
- Principal (§ 5.04(a)(2)); and
- Excess Cashflow (§ 5.04(a)(3)).

Subsequent Recoveries are not referred to anywhere in § 5.04(a). The Retired Class

Provision comes at the end of § 5.04(a).

Section 5.04(b) then commences with the words “***In addition to the foregoing distributions ...***,” and proceeds to cover the subject of Subsequent Recoveries, which are not referred to in § 5.04(a):

(b) ***In addition to the foregoing distributions, with respect to any Subsequent Recoveries***, the Master Servicer shall deposit such funds into the Protected Account pursuant to Section 4.01(b)(iii). If, after taking into account such Subsequent Recoveries, the amount of a Realized Loss is reduced, ***the amount of such Subsequent Recoveries will be applied to increase the Certificate Principal Balance of the Class of Certificates with the highest payment priority to which Realized Losses have been allocated***, but not by more than the amount of Realized Losses previously allocated to that Class of Certificates pursuant to Section 5.05; provided, however, to the extent that no reductions to a Certificate Principal Balance of any Class of 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 increase the Certificate Principal Balance of the Class of Certificates with the next highest payment priority, up to the amount of such Realized Losses previously allocated to that Class of Certificates pursuant to Section 5.05, and so on.*** 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 Certificate of such Class in accordance with its respective Percentage Interest. [Emphasis added.]

Thus, § 5.04(b) unambiguously directs a write-up based on Subsequent Recoveries, and distributions will flow accordingly. This is not inconsistent with § 5.04(a), which has nothing to do with Subsequent Recoveries. Once the § 5.04(b)

Subsequent Recovery write-up takes place, the condition that would otherwise trigger the Retired Class Provision – that “the Certificate Principal Balance of ... Class M ... Certificates has been reduced to zero” -- is no longer in effect, and thus the Retired Class Provision itself is no longer in effect.

Section 5.04(b) is specific to the subject of Subsequent Recoveries, which, as previously shown, is what the Settlement Payments are under both the Settlement Agreement and the applicable PSAs. Under settled New York law, it therefore controls over § 5.04(a), which is a general provision as to distributions. “[S]pecific terms in a contract will override the general,’ including when the specific and general provisions appear to conflict.” *Ocwen Loan Servicing LLC v. ResCap Liquidating Trust*, 533 B.R. 379, 399 (Bkr. S.D.N.Y. 2015), citing *Muzak Corp. v. Hotel Taft Corp.*, 1 N.Y.2d 42, 47 (1956) (“Even if there was an inconsistency between a specific provision and a general provision of a contract (we find none), the specific provision controls”); and *Isaacs v. Westchester Wood Works, Inc.*, 278 A.D.2d 184, 185 (1st Dep’t 2000).

Finally, as noted, the application of the Retired Class Provision in these circumstances could lead to excess cashflow that would otherwise go to holders of residual interests – a commercially unreasonable result that was obviously not intended. See Settlement Agreement §§ 3.06(a) and (b).

In summary, the Retired Class Provision does not preclude M class holders such as DESRP from receiving their portion of the Settlement Payment with respect to the SACO 2005-9 Settlement Trust, and should not be applied.

III. The Subsequent Recovery Write-Up Instructions Should Apply to the Senior Classes of the GPMF 2005-AR2 Settlement Trust

The Write-Up First Method should be used for the GPMF 2005-AR2 Settlement Trust for substantially the same reasons as set forth in Point II, above, with respect to the SACO 2005-9 Settlement Trust. The four components of “Current Principal Amount” are – subject to the further issue discussed below – substantially identical and the order of operations is the same. Thus, it is DESRP’s position that the Write-Up First Method is required for this Settlement Trust.

The GPMF 2005-AR2 Settlement Trust involves the additional issue, identified on Exhibit E to the Petition, as to whether the Subsequent Recovery write-up instructions should apply to the senior classes of the Settlement Trust, such as the A2 position that DESRP holds. The Subsequent Recovery write-up instructions should apply to the senior classes, for the following reasons.

The source of the issue that Petitioners have identified with respect to GPMF 2005-AR2 is the definition of “Current Principal Amount” in the PSA, which states in relevant part:

With respect to any Class A, Class X or Subordinate Certificate as of any Distribution Date, the initial principal amount of such Certificate plus the amount of any Net Deferred Interest allocated thereto on the related Distribution Date and all previous Distribution Dates plus, *in the case of the Subordinate Certificates*, any Subsequent Recoveries added to the Current Principal Amount of such Certificates pursuant to Section 6.02(h) hereof, and reduced by (i) all amounts distributed on previous Distribution Dates on such Certificate with respect to principal, (ii) the principal portion of all Realized Losses ... allocated prior to such Distribution Date to such Certificate, taking account of the Loss Allocation Limitation, and (iii) in the case of a Subordinate Certificate, such Certificate’s pro rata share, if any, of the applicable Subordinate Certificate Writedown Amount for previous Distribution Dates. [Bharatwaj Aff. Exh. 2 at 9, emphasis added.]

In this definition, Subsequent Recoveries are associated only with the Subordinate Certificates. However, this is an omission, not an affirmative statement that senior certificates do not participate with respect to Subsequent Recoveries. As would be expected, Subsequent Recoveries in fact do inure to the benefit of senior certificateholders, through the definition of “Senior Optimal Principal Amount” (which includes Subsequent Recoveries; *see* PSA at 33-34, clause (iv)) and, in turn, through the distribution or “waterfall” provisions of § 6.01 (*see* PSA at 83-84. §§ 6.01(A), clause “*fourth*,” and 6.01(C) (referring to the Senior Optimal Principal Amount). The question is whether the senior certificateholders of GPMF 2005-A2 should be excluded from the benefits of the Settlement Agreement given the ambiguity of these provisions read as a whole. DESRP submits that they should not be.

First, writing up the senior certificates is consistent with the intent of the parties to the transaction as set forth in the prospectus supplement for GPMF 2005-A2. In the very first paragraph under the heading “DESCRIPTION OF THE CERTIFICATES,” the prospectus supplement states: “*The certificates designated as senior certificates will have a payment priority over the certificates designated as subordinate certificates*” Bharatwaj Aff. Exh. 5 at S-4, emphasis added. Excluding the senior certificates from the benefit of the Settlement Agreement violates this clear statement of intent by taking away that payment priority. Doing that in the name of contract interpretation does not make it any more valid – it seems clear that any anomalous language in the PSA is there because, at the time of its drafting, no one anticipated the possibility of losses in the magnitude that occurred.

Second, writing up the senior certificates is consistent with the Trustee's own practical construction of the PSA, since *the senior certificates have already been written up by the Trustee for Subsequent Recoveries*. See Bharatwaj Aff. ¶ 5 and Exh. 6. That DESRP and the Trustee read the PSA the same way is strong confirmation that DESRP's reading of the PSA is correct. See, e.g., *Allen v. Westpoint-Pepperell, Inc.*, 1996 U.S. Dist. LEXIS 6*, 12 (S.D.N.Y. 1996) ("Conduct subsequent to the date of the contract is relevant in discerning ... intent"); *USA Network v. Jones Intercable, Inc.*, 729 F. Supp. 304, 310 (S.D.N.Y. 1990) (party's "conduct ... is convincing proof" of the meaning of contract terms); *Webster's Red Seal Publications, Inc. v. Gilberton World-Wide Publications, Inc.*, 67 A.D.2d 339 (1st Dep't 1979), *aff'd*, 53 N.Y.2d 643 (1981) (finding practical construction based on conduct).

Third, consistent with the foregoing, writing-up of the senior certificates is called for by § 3.06(b) of the Settlement Agreement ("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"); while the Settlement Agreement does not supplant the PSA, it shows the understanding of many industry participants as to how the PSA is to be applied in this circumstance.

Thus, the Subsequent Recovery write-up instructions in the Settlement Agreement should apply to the senior classes of GPMF 2005-A2.

IV. The Write-Up First Method Should Be Used for SAMI 2006-AR7 and SAMI 2007-AR1, and Subsequent Recoveries Applied in the Reverse Order of Realized Losses

The Write-Up First Method should be used for the two DESRP-owned SAMI Settlement Trusts (SAMI 2006-AR7 and SAMI 2007-AR1), for the same reasons as set forth in Point II above for SACO 2005-9. The definitions of “Certificate Principal Balance” for these two Settlement Trust (Bharatwaj Aff. Exhs. 3 and 4) are substantially identical to that for SACO 2005-9. The same four components are present and follow the same order of operations. The same considerations are also present in terms of the Settlement Agreement and the unreasonable, unintended results that would follow from applying the Pay First Method.

In addition, although these two SAMI Settlement Trusts are included on Exhibit F, there really is no issue as to how to apply the Subsequent Recoveries in the writing-up process: they should be applied in the reverse order of realized losses. There is no other logical outcome.

Section 6.02 of the PSAs for these SAMI Settlement Trusts is entitled “Allocation of Losses and Subsequent Recoveries on Certificates.” However, the text of § 6.02 is completely silent as to Subsequent Recoveries. The ordinary way to apply Subsequent Recoveries – as reflected in the express terms of the Settlement Agreement itself, which was the product of the work of many industry participants – is “*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” Settlement Agreement, § 3.06(b) (emphasis added). This is also the most logical approach. In the

absence of any indication that the drafters of the PSAs for these SAMI Settlement Trusts intended anything different, that approach should be followed here.

V. Conclusion


For the foregoing reasons, the Court should rule as to the DESRP-owned Settlement Trusts as follows:

- (i) Direct that the Write-Up First Method be used as to SACO 2005-9; and, if not moot after such ruling, direct that the Retired Class Provision should not be given effect for SACO 2005-9;
- (ii) Direct that the Write-Up First Method be used as to GPMF 2005-AR2, and that the Subsequent Recovery write-up instructions be utilized with respect to the senior classes of GPMF 2005-AR2; and
- (iii) Direct that the Write-Up First Method be used as to SAMI 2006-AR7 and SAMI 2007-AR1, and that Subsequent Recovery write-ups shall occur in reverse order from the allocation of realized losses.

Dated: January 29, 2018

Respectfully submitted,

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