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

In the matter of the application of Wells Fargo Bank, National Association, *et al.*, Petitioners, For Judicial Instructions under CPLR Article 77 on the Administration and Distribution of a Settlement Payment.	Index No. 657387/2017 IAS Part 60 Hon. Marcy S. Friedman **REPLY MEMORANDUM OF LAW OF U.S. BANK NATIONAL ASSOCIATION, IN ITS CAPACITY AS TRUSTEE FOR THE NIM TRUSTS, AND POETIC AND PROPHET, ON THE APPLICATION OF THE "RETIRED CLASS PROVISION"**

TABLE OF AUTHORITIES

Page(s)

Cases

TABLE OF CONTENTS

Respondents U.S. Bank National Association ("U.S. Bank"), solely in its capacity as Indenture Trustee for the NIM Trusts listed on Exhibit A (the "NIM Trusts"), and solely at the direction of Respondents HBK Master Fund LP ("HBK"), Poetic Holdings VI LLC and Poetic Holdings VII LLC (together, "Poetic") and Prophet Mortgage Opportunities LP ("Prophet"), together with Poetic and Prophet as certificateholders in the Settlement Trusts listed on Exhibit B, jointly submit this opposition memorandum of law, along with the affirmation of Donald Hawthorne and the exhibits attached to it ("Hawthorne Aff.").[1]

INTRODUCTION

Respondents' Opening Memorandum of Law On The Application Of The "Retired Class Provision" (Dkt. 563) ("Opening Mem.") set out the position of Poetic, Prophet and HBK on the questions raised by the Petition relating to the "Retired Class Provision" that appears in each of

[1] Pursuant to the Court's order dated September 14, 2018 (the "Substitution Order") and at the direction of Respondents HBK, Poetic and Prophet (each in their capacities as holders of notes issued by the NIM Trusts), U.S. Bank, solely in its capacity as Indenture Trustee under the NIM Trusts referenced on Exhibit A to Respondents' Opening Memorandum of Law, has substituted into this proceeding in place of Respondents HBK, Poetic and Prophet. This Joint Reply Memorandum of Law addresses only issues relating to the Retired Class Provision and reflects the positions of HBK, Poetic and Prophet. U.S. Bank, in its capacity as Indenture Trustee for certain of the NIM Trusts, at the direction of HBK, (a) submitted a separate memorandum of law addressing questions raised in the Petition regarding whether to pay first or write up first the Settlement Trusts (the "Order of Payment Issue") in which HBK holds interests (the "HBK Memorandum of Law") and (b) will submit a separate opposition memorandum of law further addressing the Order of Payment Issue with respect to the same Settlement Trusts in which HBK holds interests (the "HBK Opposition Memorandum of Law" and together with the HBK Memorandum of Law, the "HBK Memoranda"). U.S. Bank, in its capacity as Indenture Trustee for certain other NIM Trusts, at the direction of Poet and Prophet and jointly with Poetic and Prophet, (a) also submitted a memorandum of law addressing the Order of Payment Issue in relation to certain other Settlement Trusts in which Poetic and Prophet hold interests (the "Poetic/Prophet Memorandum of Law") and (b) will submit an opposition memorandum of law further addressing the Order of Payment issue with respect to the same Settlement Trusts in which Poetic and Prophet hold interests (the "Poetic/Prophet Opposition Memorandum of Law" and together with the Poetic/Prophet Memorandum of Law, the "Poetic/Prophet Memoranda"). The Poetic/Prophet Memoranda and the HBK Memoranda may, in some respects, advance contrary positions relevant to the Order of Payment Issue; however, as contemplated by the Substitution Order, U.S. Bank has taken appropriate measures to address any potential or actual conflicts of interest. Additionally, U.S. Bank's capacity in its role as NIM Trustee hereunder is a separate and distinct capacity from that of U.S. Bank in its role as Petitioner and Trustee of the Settlement Trusts.

the Settlement Trusts in which Poetic, Prophet, and HBK hold interests. In short, that position is that the Retired Class Provision means what it says and should be enforced accordingly, and that classes of certificates in those Settlement Trusts that have been reduced to zero balance ("Zero Balance Classes") are retired and are no longer entitled to distributions, including any distributions relating to the JP Morgan Settlement, and that such classes are not entitled to be written up.

Certain other Respondents have taken the opposite position, arguing that Zero Balance Classes **should** be entitled to distributions notwithstanding the Retired Class Provision. This Memorandum responds to those arguments.[2]

First, for a variety of reasons, each of those Respondents argues that the Retired Class Provision does not mean what it plainly says. However, for the reasons given below, those arguments only serve to underscore the Retired Class Provision's plain meaning.

Second, Tilden Park argues that the Settlement Agreement "override[s] the Retired Class Provision" and that the Settlement Agreement requires that Zero Balance Classes be revived, regardless of what the Retired Class Provision in any Settlement Trust's PSA may say. *See* Opening Merits Brief of Tilden Park ("Tilden Park Mem.") at 23. This argument misconstrues both the Settlement Agreement and its relationship to the PSAs.

[2] This memorandum responds primarily to arguments made in the memoranda of law of Tilden Park (Dkt. 515); Nover Ventures (Dkt. 600); Olifant (Dkt. 545); and DW Partners and Ellington (Dkt. 645). Respondents DE Shaw and Strategos filed statements adopting certain relevant parts of Tilden Park's memorandum. (Dkt. 516, 517.) Poetic and Prophet hold no interests in any of the Settlement Trusts in which Tilden Park, Strategos, Ellington, or DW Partners hold interests. HBK holds no interests in any of the Settlement Trusts in which Olifant, DE Shaw or Ellington hold interests. Poetic, Prophet, and HBK take no position on whether the Retired Class Provision should or should not be enforced with respect to any of the Trusts in which they do not hold interests (whether through ownership of certificates or through NIM Trust holdings). Poetic, Prophet, and HBK address the arguments of other Respondents with whose holdings theirs do not overlap only to the extent that the Court might consider their reasoning applicable to the Settlement Trusts in which Poetic, Prophet and HBK **do** hold interests.

Finally, the Institutional Investors and AIG argue, correctly, that the Retired Class Provision is "not ambiguous," does not "conflict in any way with the Settlement Agreement," and that the Trustees should therefore "apply the Retired Class Provision." *See* Opening Brief of the Institutional Investors and AIG ("II Br.") at 25. However, the Institutional Investors suggest that there may be "one caveat to this rule"—that, under certain circumstances, when making distributions of the Settlement Payment to some Settlement Trusts, the Trustees may have to write up retired classes notwithstanding the Retired Class Provision, "in order to keep the Trust's assets and liabilities in balance." *Id.* at 25 n. 58. For the avoidance of any doubt, we write to clarify that, for the reasons given below, that "caveat" is unnecessary, at least as to the Settlement Trusts in which Poetic, Prophet and HBK hold interests. In fact, the PSAs for those Trusts clearly provide for what to do in the event that application of the Subsequent Recoveries results in overcollateralization.

ARGUMENT

I. THE RETIRED CLASS PROVISION'S MEANING IS PLAIN: ZERO BALANCE CLASSES ARE NEVER AGAIN ENTITLED TO DISTRIBUTIONS OR WRITE-UPS

The Retired Class Provision appears in the section of the PSAs titled "Distributions," following the provisions that set out the "waterfall" of distributions that the Trustee must make to each class of certificates on any given Distribution Date. It provides that:

> In addition, notwithstanding the foregoing [i.e., the provisions of the waterfall] on any Distribution Date after the Distribution Date on which the Certificate Principal Balance of a [Class of A, M, or B Certificates] has been reduced to zero, that Class of Certificates will be retired and will no longer be entitled to distributions, including distributions in respect of Prepayment Interest Shortfalls or Basis Risk Shortfall Carry Forward Amounts.

This language is clear. Once a class of A, M or B certificates has been reduced to zero balance (a "Zero Balance Class"), then on **any** Distribution Date after that event, it will be

retired, and it will no longer be entitled to distributions. Moreover, as the Petition recognizes, the plain text of the Retired Class Provision makes no distinction between "whether the Zero Balance Classes have been reduced to zero as a result of realized losses or because they have been paid in full as to their initial certificate principal balance." *Id.*

A. The Retired Class Provision is Clear And Express, and Nothing in the PSAs' Write-Up Provisions Creates Any Exception To It.

Tilden Park, Nover, and DW all argue that nothing in the PSAs for the Trusts at issue expressly precludes Zero Balance Classes from being written up. *See* Tilden Park Mem. at 23 ("the plain text of the Retired Class Provision does not prohibit *writing up* such certificates") (original emphasis); Nover Mem. at 12 ("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."); DW Mem. at 18 n.10 ("nothing in these provisions, or anywhere else in the Governing Agreements, says that [zero balance] certificates may not be written up on account of Subsequent Recoveries."). It is certainly true that the PSAs do not, in so many words, say "zero balance classes may not be written up." But they don't need to. The PSAs *do* say, quite plainly and expressly, first that such classes are retired, and second that they may not ever again receive distributions. For the reasons set forth in Respondents' Opening Memorandum, it would make no sense to write up Zero Balance Classes to reflect amounts that, by the plain terms of the Retired Class Provision, they can never be entitled to receive. Opening Mem. at 5-10.

Moreover, while it is true that the write-up provisions of the PSAs do not contain the magic words "Zero Balance Classes may not be written up," the write-up provisions are in fact quite consistent with the Retired Class Provision. Certainly, nothing in those provisions says that Zero Balance Classes *may* be written up. Instead, they say that:

> In addition to the foregoing distributions, with respect to any Subsequent Recoveries, the Master Servicer shall deposit such

> funds into the Protected Account . . . . 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. . . .

BSABS 2005-HE3 PSA 5.04(b) (emphasis added).

This language does not say or imply that Zero Balance Classes shall be entitled to write ups. It simply specifies the order in which write-ups will be applied—first, to the "Class of Certificates with the highest payment priority to which realized losses have been allocated," then down the waterfall to "the Class of Certificates with the next highest payment priority . . . and so on." If a Class of A, M, or B certificates is not retired, these provisions set out the priority in which it may be written up. But a Zero Balance Class does not have a "payment priority" at all, because it has been retired, and because it is not entitled to any future payments. It is therefore not entitled to write-ups. There is no conflict between the write-up provisions and the Retired Class Provision.

Nover argues that "had the drafters intended that the Retired Class Provision preclude the subsequent write-up of certificates, the Governing Agreements would have so provided . . . when the drafters of Governing Agreements intended that only certain certificates should be written-up, they include clear and specific language relating thereto." Nover Mem. at 12. Similarly, Tilden Park points to "other non-JPM PSAs [that] **do** explicitly limit write-ups to bonds that are still 'outstanding' and with a nonzero balance," and argues that "[t]he absence of such terms in the trusts at issue here shows that write-ups were meant to apply to all bonds, regardless of balance." Tilden Park Mem. at 24 (original emphasis). But the Retired Class Provision Trust PSAs do provide, as plainly as they can, that a class of A, M or B certificates that has once gone

to zero balance will, on any Distribution Date after that event, be retired, and will no longer be entitled to distributions. In the face of that clear and absolute language, if the drafters of the PSAs had intended that the very next provision of the contracts should undo the Retired Class Provision and allow those classes to be un-retired, they would surely have said so explicitly.

There should be no need to consider extrinsic evidence of the kind offered by Tilden Park, given the clear and unambiguous character of the Retired Class Provision. *See Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569 (2002) ("Extrinsic evidence of the parties' intent may be considered only if the agreement is ambiguous, which is a question of law for the courts to decide."). Nevertheless, to the extent such evidence could be relevant, it is significant that there are other PSAs, drafted at the same time as the PSAs in dispute here, that **do** quite explicitly provide that classes that have been reduced to zero balance can be written up again. For example, the write-up section of the Settlement Trust JPMAC 2005-FLD1 PSA provides that "With respect to any Class of Certificates to which an Applied Loss Amount has been allocated **(including any such Class for which the related Class Principal Amount has been reduced to zero)**, the Class Principal Amount of such Class will be increased on each Distribution Date by the amount of [subsequent recoveries] . . . ." (emphasis added). *See* Hawthorne Aff. Ex. 1 (JPMAC 2005-FLD1 PSA 4.04(d)). In other cases, the drafters of PSAs expressly stated, in their equivalent of the "Retired Class Provision," that it does **not** restrict a class that has been reduced to zero balance from receiving distributions to the extent they result from Subsequent Recoveries. For example, the PSA for Residential Asset Mortgage Products ("RAMP") 2005-EFC4, a non-JP Morgan deal, contains a provision in its "Distributions" section stating that: "Notwithstanding the foregoing clauses (c) and (d) [i.e., the waterfall provisions], upon the reduction of the Certificate Principal Balance of a Class of Class A and Class M Certificates to

zero, such Class of Certificates will not be entitled to further distributions pursuant to Section 4.02 **(other than in respect of Subsequent Recoveries)**." *See* Hawthorne Aff. Ex. 2 (RAMP 2005-EFC4 PSA 4.02(e) (emphasis added)).[3] The absence of such language in the Retired Class Provision Trusts, coupled with the very clear language of the Retired Class Provision itself, is telling.[4]

In any case, even if a Zero Balance Class were to be written up—which it should not be—nothing about that write-up could reverse its ineligibility for distributions. Nover argues 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." Nover Mem. at 12. Tilden Park, similarly, argues that "if 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." Tilden Park Mem. at 23 (quotation marks

[3] By contrast, another RFC-sponsored securitization, RASC Series 2006-KS8 Trust, has the same provision but without the highlighted carve-out for subsequent recoveries. In that trust, the Class M2 was fully written-down in July 2013, and when the principal portion of the RFC settlement payment was distributed to the trust in May 2014, zero balance classes such as the M2 did **not** receive distributions or write-ups. Instead, the Class M1, being the only outstanding tranche with losses, was written up in full and the remaining amounts were not applied to any class of the trust, which resulted in an increase of overcollateralization. *See* Hawthorne Aff. Ex. 3 (2006-KS8 PSA 4.02(d)), 4.

[4] Tilden Park also refers to "a recent state-court instruction proceeding concerning BSABS 2007-AQ2, which had had a retired-class provision in its PSA [and where] a trustee implementing a substantially similar settlement agreement wrote up bonds with zero balances." Tilden Park Mem. at 24. But that was a trust instruction proceeding at which ultimately Tilden Park was the only party asserting an interest, resolved by a consensual order similar to the severance orders that have so far been entered in this proceeding. Far more telling, if the Court were to consider such extrinsic evidence, are the numerous occasions on which Trustees administering trusts with retired class provisions in the ordinary course and outside the context of instruction proceedings have received subsequent recoveries, and have not written up or made distributions to zero balance classes. For example, in BSMF 2007-SL2, the Class 2A was reduced to zero in June 2013. Subsequently, the trust received a Subsequent Recovery of $5950, as reflected in that trust's remittance reports for the date November 2013. On the next distribution date, as reflected in the remittance reports, the Trustee distributed those funds, not to the retired Class 2A, but to the next class in the waterfall, the Class 1A in conjunction with the Subsequent Recoveries received in Group 1. *See* Hawthorne Aff. Ex. 5 (excerpts of BSMF 2007-SL2 PSA); Ex. 6 (relevant remittance reports for 2007-SL2).

omitted). But that ignores the plain text of the contracts. The Retired Class Provision says that Zero Balance Classes will no longer be entitled to distributions, on any subsequent Distribution Date. It does not say that Zero Balance Classes are not entitled to distributions while their balance **remains** zero.[5] If the Zero Balance Classes in the Retired Class Provision Trusts were to be written up tomorrow, it would not alter the fact that every future Distribution Date is indisputably a Distribution Date after the Distribution Date on which those classes were reduced to zero, and therefore a date on which those classes are not entitled to distributions. The reversal of an applied realized loss does not reverse the passage of time.

All the arguments on this point made by Nover, Tilden Park, and DW are fundamentally similar. They argue that the absence of absolutely express language precluding write-ups to zero balance classes in the PSAs' write-up provisions should be treated as implicitly overriding the clear, express language of the Retired Class Provision. This is simply backwards as a matter of contractual interpretation. The Retired Class Provision is clear and plain, and if the PSAs' drafters had intended the write-up provisions to undo it, they would have said so, with equal clarity. They did not need to expressly address Zero Balance Classes in the write-up provisions of the PSAs—effectively, to superfluously say the same thing twice—since the write-up provisions can and should be interpreted in a manner that is consistent with the plain text of the Retired Class Provision. *See Natixis Real Estate Capital Tr. 2007-HE2 v. Natixis Real Estate Holdings, LLC*, 50 N.Y.S.3d 13, 18 (1st Dep't 2017) ("contract provisions should be

[5] Tilden says that "these [Retired Class] provisions merely state that certificates are deemed 'retired' and are 'no longer . . . entitled to distributions,' when their balance is zero." Tilden Park Mem. at 23. But this is not accurate; in fact, the Retired Class Provision states that certificates in the applicable classes are retired and no longer entitled to distributions not only "when their balance is zero" but also on **any** Distribution Date **after** their balance has been reduced to zero.

harmonized, if reasonably possible, so as not to leave any provision without force and effect . . . .").

B. No Other Provision Of The PSAs Is Inconsistent With The Retired Class Provision

Nover, Tilden Park, DW and Olifant also refer to other provisions of the PSAs, which they argue imply that Zero Balance Classes should be written up. However, none of these provisions are inconsistent with the Retired Class Provision or call its meaning into question.

a. The Definition of "Certificate Principal Balance".

Nover points to the definition of "Certificate Principal Balance" for BSABS 2005-AC7, which defines Certificate Principal Balance as consisting of:

> 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 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.

See Nover Mem. at 11. This definition, and others like it, simply sets out the components that go into the calculation of Certificate Principal Balance (initial balance, plus write ups, minus distributions and write-downs for realized losses). It does not provide that any particular certificate is actually entitled to write-ups on any particular date. Rather, it allows the Trust to properly account for any write-ups that a class receives, if and when a class receives such a write-up consistent with the other provisions of the PSAs.

b. The "Final Distribution On The Certificates" Section.

Nover, DW and Olifant each point to a section of the PSAs titled "Final Distribution On The Certificates," which provides that:

> [i]f on any Determination Date . . . the Trustee determines that a Class of Certificates shall be retired after a final distribution on such Class, the Trustee shall notify the related Certificateholders within five (5) Business Days after such Distribution Date that the final distribution in retirement of such Class of Certificates is scheduled to be made . . .

and that

> [a]ny final distribution made pursuant to the immediately preceding sentence will be made only upon presentation and surrender of the related Certificates at the Corporate Trust Office of the Trustee.

See Hawthorne Aff. Ex. 7 (BSABS 2005-HE3 PSA Section 10.02). Nover, DW and Olifant argue that this provision implies that "retirement" occurs only when a final distribution is made, and only when the formalities of presentation and surrender of certificates are observed. But that is not what the PSAs say. The "Final Distribution" section sets out **one** of the ways in which a class of certificates may enter a state of retirement—"[i]f . . . the Trustee determines that a Class of Certificates shall be retired after a final distribution on such Class." However, nothing in the text of the "Final Distribution" section claims that it is exclusive, or that it sets out the only set of circumstances under which a class of certificates may enter retirement. The Retired Class Provision sets out another set of circumstances under which a class is retired—if the balance of that class is reduced to zero, including as a result of allocations of realized losses, rather than through a final distribution.

There is no conflict between the Retired Class Provision and the provisions of the Final Distribution section. Both can, and should, be applied in accordance with their terms. *See Natixis Real Estate Capital Tr. 2007-HE2,* 50 N.Y.S.3d at 18 (construing separate PSA sections each addressing different circumstances under which the Securities Administrator may be required or permitted to take action as "complementary" rather than "conflicting," and giving full effect to both).

Furthermore, even if the meaning of the word "retired" were not clear, the Retired Class Provision would still be quite clear. It says that a class that has been reduced to zero balance "will be retired **and** will no longer be entitled to distributions . . . ." (emphasis added). Even if there were some doubt as to the meaning of "retired," the fact that a Zero Balance Class is "no longer be entitled to distributions" could not possibly be plainer.

Similarly, Tilden Park points to the definition of "Outstanding," to argue that a bond that has not been "canceled" (a term which is not defined in the PSAs), "delivered . . . for cancellation," or exchanged for a new bond remains "outstanding." "Thus," Tilden Park argues, "a 'retired' but still 'outstanding' bond does not somehow lose all rights; rather, it loses only those rights that the Governing Agreements say it loses— in this case, the right to receive distributions while its balance is zero." Tilden Park Mem. at 24. But, as discussed above, the Retired Class Provision does not say that a bond loses the right to receive distributions "**while** its balance is zero;" it says that it loses the right to receive distributions on any date **after** its balance is reduced to zero. Whether or not a bond may be "retired" while still remaining for certain definitional purposes "outstanding" is irrelevant to the issue at hand: the PSAs are absolutely clear that such a bond is never again entitled to distributions.

C. The Retired Class Provision Is Neither "Absurd" Nor "Commercially Unreasonable".

Nover argues that "[t]he Court . . . should avoid interpreting [the Retired Class Provision] as precluding payment to zero-balance certificates because it would lead to an absurd and commercially unreasonable result." Nover Mem. at 10-11. However, because the Retired Class Provision is unambiguous, whether it is commercially reasonable is irrelevant. *See Fundamental Long-Term Care Holdings LLC v. Cammeby's Funding LLC*, 20 N.Y. 3d 438, 445 (2013) ("an inquiry into commercial reasonableness is only warranted where a contract is ambiguous. Here,

the option agreement is unambiguous, and therefore its reasonableness is beside the mark."). And the Retired Class Provision comes nowhere near the "high bar" that "New York's Court of Appeals . . . has set for declaring a contract absurd." *Warberg Opportunistic Trading Fund, L.P. v. GeoResources, Inc.*, 973 N.Y.S.2d 187, 192 (1st Dep't 2013); *see also In re Bank of New York Mellon,* 56 Misc.3d 210, 51 N.Y.S.3d 356, 366 (N.Y. Sup. Ct. 2017) ("Even if this distribution can be characterized as unusual, terms that are 'novel or unconventional' do not render a result absurd." (quoting *Matter of Wallace v. 600 Partners Co.*, 86 N.Y.2d 543 (1995))).[6] The Retired Class Provision is not only not absurd, it is not even unusual, novel or unconventional, since, as even Tilden Park asserts, "other non-JPM PSAs . . . ***do*** explicitly limit write-ups to bonds that are still 'outstanding' and with a nonzero balance."[7]

In fact there are sound commercial reasons for structuring certain deals with a Retired Class Provision. Securitizations are structured in many different ways, and each structure allocates risks and protections among the various tranches of certificates in different ways; pooling risk and parceling it out among different tranches, some riskier and some less risky, is the point of a securitization. Structuring a deal with a Retired Class Provision is to the advantage of the seniormost tranches in those deals, which benefit from the permanent retirement of more junior tranches, as write-ups to interest-bearing junior bonds would result in interest payments going to those bonds that would otherwise be paid to the senior tranches. It is also to the potential benefit of the non-interest bearing classes in those deals, the Class C / CE, which are

[6] *Matter of Wallace* concerned a commercial lease provision that appeared to postpone the determination of the tenant's rent for the first renewal term until 32 years after the term began—effectively freezing the rent for 32 years but exposing the tenant to a wildly unpredictable retroactive lump sum obligation 32 years in the future. The Retired Class Provision is not remotely as "novel or unconventional" as this arrangement, which the *Wallace* court nevertheless enforced in accordance with its terms.

[7] Tilden Park Mem. at 24 (original emphasis). Tilden Park cites GEWMC 2006-1 as an example.

excluded from the Retired Class Provision (which by its terms applies only to the A, M, or B certificates) and therefore may receive those write-ups instead.

Of course, there is also nothing unreasonable or absurd about structuring a deal without a Retired Class Provision. Different securitizations allocate risks among their various tranches in different ways, and sophisticated investors can pick and choose among securitizations and among the different tranches in them based on their risk preferences, investment goals, and models of what the future will hold.

The holders of certificates in the Settlement Trusts are sophisticated parties, and the presence of the Retired Class Provision in the PSAs was no secret. Nover complains that enforcement of the Retired Class Provision will prevent retired classes from benefiting from the JP Morgan Settlement. Nover Mem. at 11. However, the fact that enforcement of the Retired Class Provision turns out to be to the *ex post* detriment of the holders of certain classes of certificates—under the circumstances of the JP Morgan Settlement, and years after the deals were closed—is no reason to nullify it. *See Fundamental Long Term Care Holdings,* at 445-46 ("In any event, parties enter into option agreements for all sorts of reasons, and, as noted earlier, this agreement was executed by sophisticated, counseled parties.")

II. THE SETTLEMENT AGREEMENT DOES NOT "OVERRIDE" THE RETIRED CLASS PROVISION.

Tilden Park makes an additional argument: that regardless of the language of the Retired Class Provision or the PSAs, the Settlement Agreement "override[s]" the PSAs and requires that retired classes be written up and be entitled to distributions. This argument fails for at least two reasons.

First, the Settlement Agreement **cannot** "override" the clear terms of the PSAs. By its terms, the Settlement Agreement "is not intended to, and shall not be argued or deemed to

constitute, an amendment of any term of any Governing Agreement." Settlement Agreement § 7.05.[8] Therefore, as the Institutional Investors and AIG argue, to the extent any PSA's scheme for distribution is in clear conflict with the Settlement Agreement, the PSAs control and "the Trustees should simply follow the Governing Agreements." II Mem. at 24; *see also* Institutional Investors' Answer (Dkt. 136) at 8 ("in the event of an actual conflict between the Settlement Agreement and the Governing Agreements, the Governing Agreements should control.").[9] The Retired Class Provision is clear and unambiguous. To the extent that the Settlement Agreement could be construed to provide for an order of distribution that, if followed, would "override" the Retired Class Provision, the Retired Class Provision controls.

Second, nothing in the Settlement Agreement purports to override the Retired Class Provision, so there is no conflict to resolve. The Settlement Agreement provides that "distribution" of the Settlement Payment shall be "in accordance with the distribution provisions of the Governing Agreements." Settlement Agreement § 3.06(a). Tilden Park acknowledges

[8] Despite its position here, in its answer in the Countrywide Article 77 proceeding, Tilden Park relied on a substantially similar provision in the Countrywide Settlement when arguing that distributions should follow the terms of the PSAs. *See* Tilden Park's March 4, 2016 Memorandum of Law In Support of Answer to the Petition, No. 150973/2016 (Dkt. 32) at 10 ("As the Petition notes, the Settlement Agreement makes clear that no part of the Agreement, including the provisions concerning the distribution of the Allocable Shares and writing up of certificate principal balances, amends the Governing Agreements for the Covered Trusts"). The Petitioner in that proceeding, Bank of New York Mellon, similarly noted that the Countrywide "Settlement Agreement, by its terms … cannot amend or be construed as amending the Governing Agreements. In other words, the [Countrywide] Settlement Agreement permits "write up first and pay second" only if the Governing Agreements … are interpreted as directing the Trustee to "write up first and pay second.'" *Id.*, Verified Petition, (Dkt. 1) ¶10.

[9] Nover does not join Tilden Park's position on this issue. Instead, like the Institutional Investors and AIG, Nover takes the position that Settlement Agreement § 7.05 (reinforced by § 7.13, which provides that the Settlement Agreement supersedes prior agreements, but only subject to § 7.05) requires that "where the Governing Agreements unambiguously dictate how the funds should be dispersed, the Governing Agreements control." *See* Nover Mem. 5, 10. The GMO Funds join the Institutional Investors' memorandum on this issue. GMO Funds' Memorandum of Law at 3 (Dkt. 599) ("GMO Mem.").

that "Section 3.06(a) requires 'distribution' of the Settlement payment on a trust-by-trust basis 'in accordance with the distribution provisions of the Governing Agreements…'" and indeed recognizes that subsection 5.04 of the PSAs, titled "Distributions," in which the Retired Class Provision appears, is such a distribution provision. Tilden Park Mem. at 10-11. The Retired Class Provision, which by its terms addresses which classes are entitled to distributions and which are not, is a distribution provision of the Governing Agreements. Therefore, the Settlement Agreement requires the application of the Retired Class Provision.

Settlement Agreement § 3.06(b) is not to the contrary. As Nover correctly observes, Section 3.06(b)

> 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 § 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 . . . .

Nover Mem. at 9-10 (original emphasis).[10]

Settlement Agreement § 3.06(b) thus provides the order in which write-ups should occur, in the event that any PSAs are silent on that issue. It does not explicitly or implicitly require retired classes to be written up. Since those classes are retired, they are not eligible to be written up, and Section 3.06(b) does not purport to un-retire them, or otherwise address the issue of retirement in any way.[11]

[10] This is consistent with the PSAs for the trusts at issue, which also provide that write-ups should be applied in reverse order.

[11] Tilden Park argues that "Section 3.06(b) draws no distinction between zero-balance bonds and other bonds entitled to a write-up." Tilden Park Mem. at 22. But there's no reason for it to draw that distinction. The Settlement Agreement neither requires nor precludes the write-up of zero balance bonds, leaving that issue to the PSAs of each of the hundreds of securitizations involved in the Settlement.

Moreover, even if Section 3.06(b) **did** require Zero Balance Classes to be written up, and did override the PSAs in that respect, it would not result in Zero Balance Classes being entitled to distributions. For all the reasons given above, even if the balance of such a bond were written up—which it should not be—the PSAs would still provide that it is not be entitled to distributions. As even Tilden Park acknowledges, distributions are controlled by the distribution provisions of the PSAs—and those include the Retired Class Provision.

Fundamentally, Tilden Park's reading of the Settlement Agreement assumes that the Settlement Agreement made a substantial change to the distribution scheme of the PSAs for many trusts, to the advantage of some classes of certificates and the disadvantage of others, through implication and without any explicit disclosure. This is implausible.[12]

The last sentence of Section 3.06(b) itself clarifies that "[f]or the avoidance of doubt, this Subsection 3.06(b) 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)." Section 3.06(a) provides that distribution shall be "in accordance with the distribution provisions of the Governing Agreements," which include the Retired Class Provision. Any reading of Section 3.06(b) which has the effect of requiring distributions of the Settlement Payment to Zero Balance Classes which would not otherwise be entitled to distributions under the PSAs would necessarily affect the distribution of the Settlement Payment, which is foreclosed by the Settlement Agreement's terms.

[12] As the GMO Funds note, the parties to the Settlement Agreement "understood that the Settlement Agreement would have to be implemented in conjunction with hundreds of complex Accepting Trusts containing widely different terms," and therefore "ensured that the new global agreement would preserve the established contractual economic rights of different Certificateholders under each of those trusts. There is no principled reason why the Settlement Agreement should redistribute write-ups across a single trust from one group of Certificateholders to another." GMO Mem. at 3.

III. THE RETIRED CLASS PROVISION SHOULD BE ENFORCED IN ACCORDANCE WITH ITS PLAIN MEANING, AND NO "CAVEAT" IS NECESSARY.

The Institutional Investors and AIG argue that the Retired Class Provision is "not ambiguous," and does not "conflict in any way with the Settlement Agreement," and that the Trustees should therefore "apply the Retired Class Provision." *See* Opening Brief of the Institutional Investors and AIG at 25. For all the foregoing reasons, this is all quite correct.

However, in a footnote to their brief, the Institutional Investors and AIG raise an issue that requires some clarification. They suggest that there is "one caveat to this rule"—that is, the rule that the Retired Class Provision should be enforced as written to prevent write-ups or distributions to Zero Balance Classes—"based on a structural limitation in the trusts. Namely, if the Settlement Payment exceeds the realized losses of the then-outstanding certificates, the Trustees may be required to write-up a written-off certificate in order to keep the Trust's assets and liabilities in balance." The Institutional Investors and AIG note that such a "caveat" was applied in the March 30, 2018, consent order in this proceeding addressing 91 trusts in which the Institutional Investors, AIG and Ellington were the only interested parties. (Dkt. 289).

At least as to the Settlement Trusts in which Poetic, Prophet, and HBK hold interests, there is no need for such a caveat, because all the PSAs for those trusts anticipate the possibility of overcollateralization (i.e., a difference between asset and liability balances) and contain explicit provisions addressing its treatment.[13] (Poetic, Prophet and HBK take no position on

[13] The trusts in which Poetic, Prophet, and HBK hold interests are structured as "overcollateralization" trusts. These structures are constructed such that the balances of the assets and liabilities are not equal at most points in their life. Namely, the structure adjusts overcollateralization ("Overcollateralization Amount") when the difference between the assets and liabilities is not equal to a defined target ("Overcollateralization Target Amount"). There are two mechanisms in the distributions clause to accomplish this, the "Extra Principal Distribution Amount" to increase overcollateralization and the "Overcollateralization Release Amount" to reduce overcollateralization. In structures such as these, there

whether it may or may not be necessary for any other Settlement Trusts). To the extent the Settlement Payment exceeds the realized losses of the then-nonretired certificates, there is no need for the Trustee to revive a Zero Balance Class (contrary to the Retired Class Provision) – rather, the Trustee can and should apply any resulting write-ups to increase the overcollateralization, from which the Class C/CE Certificates derive economic value. The Class C/CE certificates are not retired or excluded from distributions—indeed, they are specifically excluded from the scope of the Retired Class Provision, which by its plain text applies only to Class A, M or B certificates. That is the process already followed in the two severance orders entered into in this proceeding between the Institutional Investors and Poetic and Prophet. *See* Consent Order (BSABS 2005-HE7), April 25, 2018 (Dkt. 357) and Consent Order (BSABS 2005-HE5), June 7, 2018 (Dkt. 424).

The "caveat" proposed by the Institutional Investors, while it is one possible method of balancing the trusts' books, would do so at the expense of requiring the Trustee to disregard the Retired Class Provision in certain situations. There is no need for this sort of fudging: writing up the overcollateralization, as and when necessary, is entirely consistent with the Retired Class Provision and with the plain text of the PSAs.[14]

---

is a Class C/CE which is a beneficiary of this overcollateralization. *See* Hawthorne Aff. Ex. 8 (excerpts of BSABS 2005-HE3 "Definitions" section).

[14] Issues relating to the Order of Payments issue (pay first or write-up first) and to the recognition of overcollateralization in that context are separately addressed in the separate briefs on that issue filed today by US Bank as NIM Trustee at the direction of HBK, and by Poetic and Prophet and US Bank as NIM Trustee at the direction of Poetic and Prophet.

CONCLUSION

For the foregoing reasons, and as set forth in Respondents' Opening Memorandum, Respondents respectfully request that the Court provide the Trustees with the following instructions.

First, Respondents request that the Court instruct the Trustees to enforce the Retired Class Provision, and bar distribution of the Allocable Shares to any applicable classes of certificates whose certificate principal balances have been reduced to zero.

Second, for the avoidance of doubt, Respondents request that the Court instruct the Trustees that the Retired Class Provision also prevents any subsequent distributions to any such Zero Balance Classes.

Third, Respondents request that the Court instruct the Trustees that any such Zero Balance Classes, which are not and will never be entitled to any future distributions, should also not be written up in connection with the Allocable Shares or any other circumstances.

Dated: New York, New York
September 28, 2018

Respectfully submitted,

AXINN, VELTROP & HARKRIDER LLP

/s/ Donald W. Hawthorne
Donald W. Hawthorne
Felix J. Gilman
114 W 47th Street
New York, NY 10036
Tel: 212.728.2200
Fax: 212.728.2201
dhawthorne@axinn.com
fgilman@axinn.com

Counsel for Respondents Prophet Mortgage Opportunities LP, Poetic Holdings VI LLC and Poetic Holdings VII LLC

PERKINS COIE LLP

/s/ Sean Connery___
Sean Connery
Martin E. Gilmore
30 Rockefeller Plaza 22nd Floor
New York, NY 10112-0015
Tel: (212) 261-6823
E-mail SConnery@perkinscoie.com

Attorneys for U.S. Bank as NIM Trustee