SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK IAS PART 60

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 Distribution of a Settlement Payment.	Index No. 657387/2017 (Friedman, J.)

OPPOSITION MEMORANDUM OF LAW OF U.S. BANK NATIONAL ASSOCIATION, AS TRUSTEE OF THE NIM TRUSTS HOLDING INTERESTS IN THE HBK SETTLEMENT TRUSTS REGARDING THE PAY FIRST, WRITE-UP SECOND ISSUE

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Respondent U.S. Bank National Association ("U.S. Bank"), solely in its capacity as Indenture Trustee for the NIM Trusts listed on Exhibit 10 to the Affirmation of Seth D. Allen dated September 14, 2018, ("Allen Affirm.") [Dkt. No. 574], and solely at the direction of Respondent HBK Master Fund LP ("HBK"), submits this opposition memorandum of law, along with the Opposition Affirmation of Seth D. Allen, and the exhibits attached to it ("Allen Opp. Affirm."), in further support of HBK's motion regarding the distribution of funds to the trusts listed in Exhibit 1 to the Allen Affirm. (the "HBK Settlement Trusts") in this proceeding[1] regarding the issues raised in paragraphs 21 through 48 of the Petition (the "Order of Payment Issue").[2]

PRELIMINARY STATEMENT

In its opening Memorandum of Law Regarding The Pay First, Write-Up Issue, HBK, through U.S. Bank as NIM Trustee, set forth a simple rule for the distribution of funds to the

[1] Pursuant to the Court's order (Dkt. No. 471) (the "Substitution Order") and at the direction of Respondent HBK, U.S. Bank, solely in its capacity as Indenture Trustee under the NIM Trusts referenced on Exhibit 10 hereto (which hold a direct interest in the HBK Settlement Trusts), has substituted into this proceeding in place of Respondent HBK. This opposition memorandum of law addresses only the Order of Payment Issue and it reflects the position of HBK as set forth in its initial Answer (Dkt. No. 78) and Memorandum of Law (Dkt. No 573). U.S. Bank, in its capacity as Indenture Trustee under certain other NIM Trusts, has also substituted into this proceeding on behalf of Respondents Poetic Holdings VI LLC, Poetic Holdings VII LLC (collectively, "Poet") and Prophet Mortgage Opportunities Fund LLP ("Prophet"). At the direction of Poet and Prophet and jointly with Poet and Prophet, U.S. Bank previously submitted a memorandum of law with respect to these same issues (the "Poet/Prophet Memorandum of Law") and will likewise submit an opposition memorandum of law (the "Poet/Prophet Opposition"). The Poet/Prophet Memorandum of Law and the Poet/Prophet Opposition, in some respects advanced, or will advance, as applicable, positions contrary to those asserted herein; however, as contemplated by the Substitution Order, U.S. Bank has taken appropriate measures to address any potential or actual conflicts of interest. Furthermore, 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.

[2] All capitalized terms in this memorandum have the meaning given to them in the Petition, unless otherwise specified.

HBK Settlement Trusts: apply the plain terms of the HBK Settlement Trust PSAs and decline to rewrite them.

Various Respondents would instead prefer that the Court relieve them from the bargain they struck. Several Respondents have, as predicted, asserted arguments based the parties' expectations or commercial reasonableness. In essence, these Respondents argue that the Court should rewrite the HBK Settlement Trust PSAs by either misreading various provisions or ignoring them entirely, claiming that the results of applying the plain terms of the HBK Settlement Trust PSAs would create a result that the parties to the PSAs could not possibly have expected. However, as Justice Scarpulla stated in a prior Article 77 Proceeding involving similar facts, where the contracts' provisions are unambiguous and clear, extrinsic evidence—such as commercial reasonableness and the parties' expectations—is inadmissible. Moreover, such arguments are particularly improper here, where the parties arguing commercial reasonableness or expectations of the parties have intentionally avoided the development of a factual record by proceeding without discovery.

In addition, even if the arguments were (1) relevant and (2) supported with a factual record, Respondents are not parties to the HBK Settlement Trust PSAs and the Settlement Agreement; indeed, the parties to the HBK Settlement Trust PSAs are not even parties in this action. Moreover, the Settlement Agreement expressly states that it is not intended to amend any provision of the Governing Agreements and directs the Trustees to distribute the settlement funds "in accordance with the distribution provisions of the Governing Agreements." The Court should ignore any appeals to commercial reasonableness or the parties' expectations and refuse to rewrite the HBK Settlement Trust PSAs, which by their plain terms require the settlement

funds to be applied using the Pay First, Write-Up Second Method, recognizing any overcollateralization created by the payment of the settlement funds, whether transient or not.

In addition to their improper reliance on commercial reasonableness and expectations Respondents make several crucial errors in their opening briefs:

First, various Respondents misinterpret the definition of Certificate Principal Balance to argue that it supports the Write-Up First, Pay-Second method. Rather than support their argument, a plain reading of the definition of this term, which directly incorporates Section 5.04(b) of the HBK Settlement Trust PSAs, mandates the Pay First, Write-Up Second Method.

Second, various Respondents misread of the definition of Current Interest. However, a plain reading of the definition of this term requires the trustee to compute Current Interest using the Certificate Principal Balance immediately prior to the Distribution Date, which supports the Pay First, Write-Up Second Method.

Third, various Respondents improperly rely on the definition of Realized Losses in the HBK Settlement Trust PSAs, which do not contradict the plain terms of the distributions provision (Section 5.04). Indeed, to the extent the definition of Realized Losses is relevant at all to the question of the proper order of payment and write-up of the settlement funds, it supports, rather than contradicts, that the HBK Settlement Trust PSAs require the Pay First, Write-Up Second Method.

Fourth, while correctly arguing that the Pay First, Write-Up Second Method applies to the HBK Settlement Trusts, the Institutional Investors and AIG then ask the Court to ignore the provisions of the HBK Settlement Trust PSAs requiring the calculation of overcollateralization and the creation of the Overcollateralization Release Amount. Their principal argument is that applying the plain meaning of these provisions would be unfair, unreasonable and absurd.

However, as with other appeals to commercial reasonableness or fairness, it is not for this Court to re-write the unambiguous terms of the HBK Settlement Trust PSAs simply because these Respondents are unhappy with the benefit of their considered bargain, and the Court should reject any invitation to do so.

Accordingly, the Court should order that the Allocable Share of the settlement funds be distributed to the HBK Settlement Trusts using the Pay First, Write-Up Second Method, recognizing any overcollateralization created by the payment of the settlement funds, whether transient or not.

ARGUMENT

I. THE COURT SHOULD REJECT APPEALS TO EXPECTATIONS OR COMMERCIAL REASONABLENESS IN INTERPRETING THE AGREEMENTS AT ISSUE HERE

Many Respondents—particularly those taking textually indefensible positions such as ignoring the HBK Settlement Trusts' provisions regarding the calculation of overcollateralization and Excess Spread—seek to sway the Court with arguments based on the parties' expectations and notions of commercial reasonableness. (Institutional Investors and AIG Br. at 3, 18 – 21; GMO (but not with respect to HBK Settlement Trusts) Br. at 4 – 5; Nover Br. at 10 – 13 (arguing that the parties to the PSAs did not intend for retired classes to be ineligible to be written up), 14 (arguing that writing up classes of certificates second would be absurd and "contrary to the reasonable expectations of investors and drafters of the Settlement Agreement"); Olifant (but not with respect to HBK Settlement Trusts) Br. at 10 – 11 (paying first "would lead to commercially unreasonable results that, as Petitioners highlight in the Petition, could not have been intended by the parties").

Respondents' self-serving conceptions of "fairness" are irrelevant where, as here, a binding agreement governs the signatories' obligations. The Court should reject all such appeals

and should instead—like Justice Scarpulla in a prior Article 77 proceeding—"not look beyond the four corners of the relevant agreement to determine the parties' intent, when the contract language itself is clear." *Matter of Bank of N. Y. Mellon*, 56 Misc. 3d 210, 224 (Sup. Ct. N.Y. Cty. 2017), (the "BoNYM Article 77 Proceeding"); *see also Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569 – 70 (2002) ("[I]f the agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity").

First, the distribution, write-up and write-down provisions of the HBK Settlement Trusts are unambiguous, and extrinsic evidence is neither necessary nor admissible for the Court to interpret them. *See W.W.W. Assoc., Inc. v. Giancontieri*, 77 N.Y.2d 157, 162 (1990) ("A familiar and eminently sensible proposition of law is that, when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing.")

Second, even if the Court were to find the HBK Settlement Trust PSAs to be ambiguous—and they are not—the Court still should reject Respondents' various appeals to expectations and reasonableness. Arguments based on the contracting parties' intentions or commercial reasonableness are particularly inappropriate here, because the same parties who now seek to rely on intent or reasonableness neither sought nor gave discovery regarding those topics. Not only do they ask the Court to rewrite unambiguous agreements based on facts outside the agreements, they are trying to do so without discovery or supporting facts. As a result, even if extrinsic evidence were otherwise admissible, the parties have none to provide. *See Am. Exp. Bank Ltd. v. Uniroyal, Inc.,* 164 A.D.2d 275, 277 (1st Dep't 1990) ("[I]f it is

necessary to refer to extrinsic facts, which may be in conflict, to determine the intent of the parties, there is a question of fact, and summary judgment should be denied."); *Greater N. Y. Mut. Ins. Co. v. ERE LLP*, 125 A.D.3d 417, 419 (1st Dep't 2015) ("Where, as here, ERE argues that reference to extrinsic facts is necessary to determine the intent of the parties with regard to the waiver of subrogation provisions in ERE's leases with 440 Realty and 432 Park Avenue South, summary judgment must be denied."); *Merchants Bank of N. Y. v. Gold Lane Corp*., 28 A.D.3d 266, 268 – 69 (1st Dep't 2006) ("Where factual issues exist as to the commercial reasonableness of any aspect of the sale, summary judgment must be denied.").

The lack of discovery is particularly damaging with respect to the question of commercial reasonableness, which is an issue not just for fact discovery, but can benefit from expert discovery as well. *Shimamoto v. S&F Warehouses, Inc.,* 257 A.D.2d 334, 340 (1st Dep't 1999), *aff'd as modified and remanded*, 99 N.Y.2d 165 (2002) (When determining commercial reasonableness "expert professional witnesses might shed light on relevant matters such as the custom and usage in the trade."). Because these Respondents make fact-based arguments without any supporting facts—much less without a developed record with thorough discovery and cross examination—the Court should reject these arguments. *See, e.g.*, *Cent. Budget Corp. v. Garrett*, 48 A.D.2d 825, 826 (2d Dep't 1975) ("[W]e require some affirmative showing that the terms of the disposition were, in fact, commercially reasonable and hold that, in the absence of such a showing, we will be compelled to deny recovery. . . .").

Arguments based on the intentions of the parties to the Settlement Agreement and the HBK Settlement Trust PSAs fare no better. At best, the Court has one party—the Institutional Investors—making self-serving arguments regarding what they now want the agreement to mean. And they have not even tried to support their arguments with an evidentiary affidavit

describing their intentions when they negotiated the Settlement Agreement over four years ago. For the same reasons, any arguments relating to the intent behind the terms of the HBK Settlement Trust PSAs are similarly flawed.

The argument regarding the HBK Settlement Trust PSAs is worse yet. **None** of the Respondents are parties to the HBK Settlement Trust PSAs, and no Respondent has submitted evidence with respect to the intent of the draftors of the HBK Settlement Trust PSAs

Just as baseless is some Respondents' reliance on judgments entered on consent as evidence of anything more than the fact that for different trusts, with different governing agreements, some parties decided to agree to a certain method of distributing settlement funds. (*See, e.g.*, Institutional Investors and AIG Br. at 20 – 21 (asking the Court to take as persuasive authority judgments entered on consent but ignore Justice Scarpulla's ruling with respect to the trusts that did not settle); Olifant (but not with respect to HBK Settlement Trusts) Br. at 6 – 10 (relying on settlements and trustee petitions to approve settlements).)

II. BOTH THE SETTLEMENT AGREEMENT AND THE HBK SETTLEMENT TRUST PSAS REQUIRE DISTRIBUTIONS TO BE MADE TO CERTIFICATEHOLDERS FIRST, FOLLOWED BY THE ACCOUNTING WRITE-UP OF CERTIFICATE BALANCES SECOND

A. The HBK Settlement Trust PSAs Govern the Sequence of Payment and Write-Up.

The question before the Court is how the trustees of the HBK Settlement Trusts should distribute the trusts' Allocable Share, which, under the Settlement Agreement, is to be distributed "as though such Allocable Share was a 'subsequent recovery' relating to principal proceeds available for distribution on the immediately following distribution date." (Settlement Agreement § 3.06(a).) The only appropriate way to determine how to distribute an HBK Settlement Trust's Allocable Share is to use the distribution provisions in Section 5.04(a) of the HBK Settlement Trust PSAs. (*See id*. § 3.06(a) (requiring the distribution of a trust's Allocable

Share "in accordance with the distribution provisions of the Governing Agreements"); *see also id.* § 7.06 ("[T]his Settlement Agreement reflects a compromise of disputed claims and is not intended to, and **shall not be argued or deemed to constitute**, an amendment of **any term** of any Governing Agreement.") (emphasis added).) The HBK Settlement Trust PSAs require the trustee to pay distributions under Section 5.04(a) of the PSAs before writing-up accounts under Section 5.04(b).

Thus, HBK joins Tilden Park in arguing that the distribution provisions of the HBK Settlement Trust PSAs determine the question of whether to pay first (Tilden Br. at 10 – 11), but disagrees with Tilden Park on the order of payment to the HBK Settlement Trusts, because Tilden Park has misinterpreted the HBK Settlement Trust PSAs in arguing that they should be written up before the Allocable Share is distributed to the trusts (*id.* at 14 – 16; *see also* Nover Br. at 14 – 18 (arguing that the PSAs provide for an accounting write-up of certificates before a trust's Allocable Share is distributed to certificateholders)). HBK agrees with Section II of the Institutional Investors and AIG brief that the Allocable Share should be distributed to certificateholders first under Section 5.04(a) of the HBK Settlement Trust PSAs before the accounting balances of the trusts' classes are written-up to account for Subsequent Recoveries under Section 5.04(b). (Institutional Investors and AIG Br. at 6 – 13.)

HBK parts ways with the Institutional Investors and AIG on the pay first question on the issue of whether the Settlement Agreement, rather than the HBK Settlement Trust PSAs, should control Allocable Share distributions. (Institutional Investors and AIG Br. at 4 – 6; *see also* (Ambac (but not with respect to HBK Settlement Trusts) Br. at 8 – 9; D.W. Partners and Ellington (but not with respect to HBK Settlement Trusts) Br. at 22 n.14; Nover Br. at 19 – 20, all arguing that the Settlement Agreement controls how the Allocable Share should be

distributed.).) And, as discussed below, HBK disagrees with the argument by the Institutional Investors and AIG that the Court should ignore the distribution provisions of the HBK Settlement Trust PSAs relating to overcollateralization. (Institutional Investors and AIG Br. at 14 – 21.)

If the Court were to rely on the Settlement Agreement in determining the order of payment and write-up, HBK agrees with the Institutional Investors and AIG that the Settlement Agreement—like the HBK Settlement Trust PSAs—requires the trustee to pay distributions under Section 5.04(a) of the PSAs before writing-up accounts under Section 5.04(b). Section 3.06(a) of the Settlement Agreement requires that "[e]ach Trust's Allocable Share" be deposited in the trust's "collection or distribution account." (Allen Affirm. Ex. 2, Settlement Agreement § 3.06(a).) Section 3.06(a)'s first sentence provides that the deposit shall be "for further distribution to Investors" (*id.*), while its last sentence requires the trustee to "**distribute** each Settlement Trust's Allocable Share" (*id.* (emphasis added)). Thus, Section 3.06(a) requires not just the deposit of the Allocable Share into a trust's accounts but also the Allocable Share's distribution to certificateholders "in accordance with the distribution provisions of the Governing Agreements . . . as though" the payment "was a Subsequent Recovery." (*Id.*) Only **after** these distributions are made—that is, after the trustee pays first—does Section 3.06(b) provide for the write-up of certificates.

B. The HBK Settlement Trust PSAs Require the Trustee to Pay Distributions Under Section 5.04(a) Before Writing-up Accounts Under Section 5.04(b).

The HBK Settlement Trust PSAs require the trustee to distribute funds to certificateholders before the trustee adjusts the book balances of each class of bonds to account for, among other things, the distributions the trustee has made, Subsequent Recoveries the trusts have received and Realized Losses the trusts have incurred.

The HBK Settlement Trust PSAs include Subsequent Recoveries in Principal Funds which are to be applied in the specific order set forth in the PSAs: first, in Section 5.04(a)(1) to constitute any Overcollateralization Release Amount; then in Section 5.04(a)(2) to pay down principal; and finally, if there are any Principal Funds left, in Section 5.04(a)(4) (along with the Overcollateralization Release Amount) to pay down Applied Realized Loss Amounts on nonretired senior certificates, make other distributions, and then pay Class C certificates. Once that process is complete, Section 5.04(b) tells the trustee how to write-up Certificate Principal Balance to account for Subsequent Recoveries, and Section 5.05 tells the trustee how to write-down Certificate Principal Balance to account for Realized Losses.

Section 5.04(b) of the HBK Settlement Trust PSAs provides:

> 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.

(Allen Affirm. Ex. 5.)

Section 5.04(b) relates to accounting—the adjustment of Certificate Principal Balances to account for Subsequent Recoveries—not to distributions. Distributions are governed by Section

5.04(a). Section 5.04(b) requires the trustee to make distributions pursuant to Section 5.04(a), before it does the Section 5.04(b) write-up.

If a trustee processed the write up under Section 5.04(b) before distributing Principal Funds under Section 5.04(a), the trustee would have to ignore the introductory clause of Section 5.04(b), requiring certificates to be written up only if, "**after** taking" Subsequent Recoveries "**into account**," "the amount of a Realized Loss is reduced." (Emphasis added). A trustee cannot determine whether the condition precedent represented by the introductory clause of Section 5.04(b) is met except by paying distributions first, under Section 5.04(a). There is nothing suggesting that Section 5.04(b) should be applied before Section 5.04(a).

The language of Section 5.04(b) also sets forth this same order of operations. **First**, the accounting write-up required by Section 5.04(b) occurs "in addition to the foregoing distributions." So, the trustee must make the required "foregoing distributions" and only then, in addition, writes-up. The write-up first argument ignores this clause or, worse, seeks to rewrite it to say "**before** the foregoing distributions."

Second, the assessment of whether "the amount of a Realized Loss is **reduced**" is performed "**after** taking into account" Subsequent Recoveries, which are distributed in the payment waterfall as part of Principal Funds. (Section 5.04(b) (emphasis added).) Thus, the distribution is first and the assessment is "after." If a "Realized Loss **is** reduced" (present tense) by the Subsequent Recoveries, then Subsequent Recoveries "**will be** applied" (future tense) under Section 5.04(b) to write-up Certificate Principal Balances. (*Id*.)

C. The Definition of Certificate Principal Balance Does Not Rewrite the Write-up Provisions of Section 5.04(b).

Respondents misconstrue the absence of the phrase "on previous Distribution Dates" in connection with "Subsequent Recoveries added to the Certificate Principal Balance."

1. The Definition of Certificate Principal Balance Refers to Section 5.04(b), Which Provides That Subsequent Recoveries Are Accounted for After Distributions Are Made.

Several Respondents look to the definition of Certificate Principal Balance as evidence that the HBK Settlement Trust PSAs require the trustee to account for Subsequent Recoveries and write-up Certificate Principal Balances before distributing funds to certificateholders (the "Certificate Principal Balance Argument"). (Tilden Br. at 11, 15 – 16; Nover Br. at 15 – 16; *see also* D.W. Partners and Ellington (but not with respect to HBK Settlement Trusts) Br. at 23); Olifant (but not with respect to HBK Settlement Trusts) Br. at 4 – 5); Poetic/Prophet (but not with respect to HBK Settlement Trusts) Br. at 3 – 5).) These Respondents misinterpret the definition of Certificate Principal Balance.

The Certificate Principal Balance Argument hinges on the presence or absence of the phrase "on previous Distribution Dates" when attempting to justify which Subsequent Recoveries should be included in the "Certificate Principal Balance." (Tilden Br. at 15 – 16.) Nover goes further and rewrites the HBK Settlement Trust PSAs to read "Subsequent Recoveries received since the last distribution date," but that is not what the PSAs say. (Nover Br. Br. at 16.)

The entire definition of Certificate Principal Balance is:

> As to any Certificate (other than the Class CE Certificates or Class R Certificates) and as of any Distribution Date, the Initial Certificate Principal Balance of such Certificate plus, in the case of a Class A Certificate and Class M Certificate, any Subsequent Recoveries added to the Certificate Principal Balance of such Certificate pursuant to Section 5.04(b), 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 5.04, and (ii) any Applied Realized Loss Amounts allocated to such Certificate on previous Distribution Dates. As to the Class CE Certificates and as of any Distribution Date, an amount equal to the Uncertificated Principal Balance of the Class CE Interest.

(Allen Opp. Affirm. Ex. 1.) What Respondents relying on the definition of Certificate Principal Balance argue is that the definition says neither "on previous Distribution Dates" nor "on this Distribution Date." This argument ignores what the definition of Certificate Principal Balance does say, which is that "Subsequent Recoveries added to the Certificate Principal Balance of such Certificate **pursuant to Section 5.04(b)**." (Emphasis added). Thus, to know whether Subsequent Recoveries for the current Distribution Date are added to the Certificate Principal Balance before or after distributions are paid, the Court need not look to a dubious application of the *expressio unius* principle (*see* Tilden Br. at 16), but rather need only refer to Section 5.04(b), which, as discussed above, mandates Pay First, Write-Up Second.

2. <u>The Definition of Current Interest Shows Why the Subsequent Recoveries Used to Calculate Certificate Principal Balance Are the Subsequent Recoveries Applied Pursuant to Section 5.04(b) on the Preceding Distribution Date.</u>

The write-up first argument's reliance on the definition of Current Interest shows how the write-up first argument fails, not how it succeeds.

First, one need only look to the definition of Current Interest to see why this is so.

Current Interest is defined as:

> As of any Distribution Date, with respect to the Certificates and interests of each class (other than the Class P Certificates, Class P Interest, the Residual Interests and the Residual Certificates), (i) the interest accrued on the **Certificate Principal Balance** or Certificate Notional Amount or Uncertificated Notional Amount, as applicable, **during the related Accrual Period** at the applicable Pass-Through Rate plus any amount previously distributed with respect to interest for such Certificate or interest that has been recovered as a voidable preference by a trustee in bankruptcy minus (ii) the sum of (a) any Prepayment Interest Shortfall for such Distribution Date, to the extent not covered by Compensating Interest and (b) any Relief Act Interest Shortfalls during the related Due Period, provided, however, that for purposes of calculating Current Interest for any such class, amounts specified in clause (ii) hereof for any such Distribution Date shall be allocated first to the Class CE Certificates and the Class CE Interest in reduction of amounts otherwise distributable to such Certificates and interest on such Distribution Date and then any excess shall be allocated to each Class of Class A Certificates and Class M

> Certificates pro rata based on the respective amounts of interest accrued pursuant to clause (i) hereof for each such Class on such Distribution Date.

(Allen Opp. Affirm. Ex. 2 (emphasis added).) The definition refers to "interest accrued on the Certificate Principal Balance" and does not specify that it is the Certificate Principal Balance immediately prior to the Distribution Date (that is, the Certificate Principal Balance relating to the relevant Accrual Period, after the trustee had made distributions, written-up to account for Subsequent Recoveries or written-down to account for Realized Losses applied on the previous Distribution Date). Based on the logic of the Certificate Principal Balance Argument advanced by certain Respondents, a trustee must use the Certificate Principal Balance on the current Distribution Date (inclusive of any write-ups as of that Distribution Date) in computing Current Interest because there is no clarifying statement that the Certificate Principal Balance used to compute Current Interest is the Certificate Principal Balance immediately prior to the Distribution Date. But of course, that is wrong.

Current Interest for the Accrual Period between the current Distribution Date and last Distribution Date is computed using a trust's Certificate Principal Balance immediately prior to the current Distribution Date, not the new one calculated on the Distribution Date. One would not compute interest for the Accrual Period—which ends prior to the Distribution Date[3]—using

[3] Accrual Period is defined as:

> With respect to the Certificates (other than the Class CE, Class P and the Residual Certificates) and any Distribution Date, the period from and including the immediately preceding Distribution Date (or with respect to the first Accrual Period, the Closing Date) to and including **the day prior to such Distribution Date**. With respect to the Class CE Certificates and the Class CE Interest and any Distribution Date, the calendar month immediately preceding such Distribution Date. All calculations of interest on the Certificates (other than the Class CE, Class P and the Residual Certificates) will be made on the basis of the actual number of days elapsed in the related Accrual Period. All calculations of interest on the Class

a Certificate Principal Balance for a Distribution Date that was **after** the end of the Accrual Period and using the interest rate for two business days **before** the Accrual Period began (that is, over a **month** before the current Distribution Date[4]).

Second, because the Certificate Principal Balance used to compute Current Interest is the Certificate Principal Balance immediately prior to the Distribution Date, to adopt the Certificate Principal Balance Argument would mean that interest would be calculated and distributed in Section 5.04(a)(1) using the Certificate Principal Balance immediately prior to the Distribution Date, but then, when it comes to distributing principal in Section 5.04(a)(2), the trustee would switch to using a Certificate Principal Balance adjusted for Subsequent Recoveries. Using different Certificate Principal Balances for interest and principal distributions would be both an absurd, and an inconsistent—and thus impermissible—reading of the HBK Settlement Trust PSAs. *See Rubin v. Baumann*, 148 A.D.3d 556, 556, 52 N.Y.S.3d 3, 4 (1st Dep't 2017) ("[A] contract should not be interpreted to produce an absurd result."); *Marin v. Constitution Realty, LLC*, 128 A.D.3d 505, 515, 11 N.Y.S.3d 550, 559 (1st Dep't. 2015) (contracts should be interpreted to avoid inconsistencies).

Third, the Certificate Principal Balance Argument also ignores the reason for including "on previous Distribution Dates" in the definition of Certificate Principal Balance for prior

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> CE Interest and the Class CE Certificates will be made on the basis of a 360-day year consisting of twelve 30-day months.

(Allen Opp. Affirm. Ex. 3 (emphasis added).)

[4] Interest Determination Date is defined as:

> [T]he second LIBOR Business Day **preceding the commencement** of each Accrual Period.

(Allen Opp. Affirm. Ex. 4 (emphasis added).)

distributions and Applied Realized Loss Amounts, but not for Subsequent Recoveries. The point of the qualifier is not to make clear that Certificate Principal Balance is computed using prior distributions or Applied Realized Loss Amounts **for** the preceding Distribution Date rather than the current one, as Nover argues. Rather, the point of the qualifier is that the Certificate Principal Balance is computed after accounting for "all amounts distributed with respect to such Certificate in reduction of the Certificate Principal Balance" on all previous Distribution Dates and "any Applied Realized Loss Amounts allocated" on all "previous Distribution Dates. In other words, the qualification is necessary to make clear that **all** previous distributions and Applied Realized Loss Amounts allocated and **all** previous distributions made are considered in calculating the Certificate Principal Balance. Such a clarification is unnecessary for Subsequent Recoveries as it is a component of Applied Realized Losses, so there is none, just as there is no clarification in the definition of Current Interest that it is computed using the Certificate Principal Balance immediately prior to the Distribution Date.

Fourth, the argument that the final two sentences in 5.04(b) would be superfluous if a trustee had to pay distributions before writing-up the trust to account for Subsequent Recoveries (Nover Br. at 17 – 18), is wrong. Those sentences, which provide:

> Holders of such Certificates will not be entitled to any payment in respect of Current Interest on the amount of such increases for any 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.

prohibit the payment of interest on Subsequent Recoveries on **any** Distribution Date. That is, they make clear that no Current Interest, and hence no future Interest Carry Forward Amount, will **ever** apply to increases in balance due to Subsequent Recoveries. Otherwise, a certificateholder might argue that it was entitled to interest on the written-up Subsequent Recovery amount from the date it was written off. Thus, the purpose of these two sentences,

which are not superfluous to any other provision in the PSAs, is to make clear that the certificateholders are only entitled to interest on the Certificate Principal Balance (inclusive of the written-up amount) occurring **after** the write-up, not before.

D. The Definition of Realized Losses Does Not Rewrite the Write-up Provisions of Section 5.04(b).

Because it is Section 5.04(b), not application of the *expressio unius* rule, that determines when the HBK Settlement Trusts should be written-up, Tilden Park's references to (1) the allocation of Realized Losses after distributions and (2) the addition of the phrase "on previous Distribution Dates" to the definition of Certificate Principal Balance for the trusts it agrees are Pay First, Write-Up Second are beside the point.[5] (Tilden Br. at 15 – 17; Olifant (but not with respect to HBK Settlement Trusts) Br. at 5 – 6); Poetic/Prophet (but not with respect to HBK Settlement Trusts) Br. at 5).)

To the extent the Court finds the treatment of Realized Losses to be relevant, it confirms that distributions should be made to certificateholders of the HBK Settlement Trusts first, before the trustee writes-up (or down) Certificate Principal Balances.

First, just as the application of Subsequent Recoveries under Section 5.04(b) is Pay First, Write-Up Second, the application of Realized Losses under Section 5.05 is pay first, write-down second. That is, all accounting true-ups occur after distributions are made.

Second, the addition of language explicitly requiring Realized Losses "to be allocated to the Certificate Principal Balances" "after the actual distributions" are made does not mean that

[5] D.W. Partners and Ellington suggest (for a bond that is not one of the HBK Settlement Trusts) that "after taking into account such Subsequent Recoveries, the amount of a Realized Loss is reduced" means only that "[a] calculation is then applied to determine whether such Subsequent Recoveries would reduce the amount of Realized Losses to the Certificates." (D.W. Partners and Ellington Br. at 21 – 22.) This ignores that under Section 5.05, Realized Losses are not accounted for until after distributions are made.

the allocation otherwise would be before distributions are made (or, more to the point, that write-ups for Subsequent Recoveries should be done before distributions are made). Rather, this qualification regarding which Certificate Principal Balance to use is necessary because of the idiosyncratic way Realized Losses are allocated.

Like Subsequent Recoveries, Realized Losses are allocated after distributions are made. But the final sentence of Section 5.05 provides that "[a]ll references above to the Certificate Principal Balance of any Class of Certificates shall be to the Certificate Principal Balance of such Class **immediately prior to the relevant Distribution Date**, before reduction thereof by any Realized Losses, in each case to be allocated to such Class of Certificates, on such Distribution Date to be made." (§ 5.05 (Allen Opp. Affirm. Ex. 8 (emphasis added).) Realized Losses are allocated **after** distributions, but the allocation of Realized Losses is based on the Certificate Principal Balance immediately **prior** to the relevant Distribution Date—a different number than the one existing after distributions are made on a Distribution Date. Thus, Subsequent Recoveries and Realized Losses are both allocated **after** distributions are made, resulting in a Certificate Principal Balance post-distribution date; however, the allocation of Realized Losses is based not on this **new** Certificate Principal Balance, but on the Certificate Principal Balance **before** the distributions are made. Because Realized Losses are using a different balance to calculate allocation, it is necessary for the HBK Settlement Trust PSAs to specify which balance to use for that calculation, whereas this is not the case for Subsequent Recoveries.

III. THAT CERTAIN RESPONDENTS DISLIKE THE CONSEQUENCES OF THE HBK SETTLEMENT TRUST'S PROVISIONS REGARDING THE CALCULATION OF EXCESS SPREAD IS NO REASON TO IGNORE OR REWRITE THE PSAS

The requirement that the Overcollateralization Release Amount be calculated and, if applicable, included in Excess Cashflow is unambiguous. After Interest Funds are used to pay interest, and **before** the trustee makes any principal payments pursuant to Section 5.04(a)(2), a calculation needs to occur to determine whether, after the Principal Funds (which include the Allocable Share) are paid, the book balances of the bonds would be less than the sum of the value of the underlying collateral plus an allowance for overcollateralization (the Overcollateralization Target Amount).[6] If so, the Principal Funds are adjusted so that after principal payments are made in Section 5.04(a)(2), the book balances equal the collateral value plus the Overcollateralization Target Amount. This balance is maintained by placing the balance of the funds—the Overcollateralization Release Amount[7]–into Excess Cashflow where it is used

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[6] Any Excess Spread to the extent necessary to meet a level of overcollateralization equal to the shall be the Extra Principal Distribution Amount and will be included as part of the Principal Distribution Amount. Any Remaining Excess Spread together with any Overcollateralization Release Amount shall be applied as Excess Cashflow and distributed pursuant to clauses (4)(A) through (H) below. (Section 5.04(a)(1).)

[7] *See* definition of Overcollateralization Release Amount:

> With respect to any Distribution Date, the lesser of (x) the Principal Remittance Amount for such Distribution Date and (y) the excess, if any, of (i) the Overcollateralization Amount for such Distribution Date (assuming that 100% of the Principal Remittance Amount is applied as a principal payment on such Distribution Date) over (ii) the Overcollateralization Target Amount for such Distribution Date (with the amount pursuant to clause (y) deemed to be $0 if the Overcollateralization Amount is less than or equal to the Overcollateralization Target Amount on that Distribution Date).

(Allen Opp. Affirm Ex. 5.)

And definition of Overcollateralization Amount:

> With respect to any Distribution Date, the excess, if any, of the aggregate Stated Principal Balance of the Mortgage Loans as of the last day of the related Due Period

to pay various distributions, including paying down any Applied Realized Loss Amounts on non-retired senior certificates in order of seniority. (*Id.* § 5.04(a)(4).)

A. The Court Should Not Ignore the Unambiguous Terms of the HBK Settlement Trust PSAs Because Certain Respondents Want to Be Paid All, Rather Than Most, of the Settlement Payment.

The principal argument made by Respondents (that want the Court to ignore the terms of the HBK Settlement Trust PSAs requiring the calculation of overcollateralization and the creation of the Overcollateralization Release Amount) is that it is unfair, unreasonable and absurd that money from the settlement would become part of Excess Cashflow and be distributed under Section 5.04(a)(4) to pay-down Applied Realized Loss Amounts on nonretired senior certificates, make other distributions, and then pay Class C certificates. (Institutional Investors and AIG Br. at 3, 18 – 21; GMO (but not with respect to HBK Settlement Trusts) Br. at 4 – 5; Olifant (but not with respect to HBK Settlement Trusts) Br. at 10 – 11 (paying first "would lead to commercially unreasonable results that, as Petitioners highlight in the Petition, could not have been intended by the parties").) Instead, they want all—rather than most—of each trust's Allocable Share to be paid to senior noteholders.

The Court should reject this invitation to rewrite the HBK Settlement Trust PSAs because certain Respondents do not like the result, just as Justice Scarpulla did in the BoNYM Article 77

> (after giving effect to scheduled payments of principal due during the related Due Period, to the extent received or advanced, and unscheduled collections of principal received during the related Prepayment Period, and after reduction for Realized Losses incurred during the related Due Period) over the aggregate Certificate Principal Balance of the Certificates (other than the Class CE Certificates and Class P Certificates) on such Distribution Date (after taking into account the payment of principal (other than any Extra Principal Distribution Amount) on such Certificates).

(Allen Opp. Affirm Ex. 6.)

Proceeding. There—as here—the Institutional Investors, AIG and others argued that the Court should ignore the terms of the relevant settlement agreement and the payment waterfall of the governing agreements because to enforce them by their terms would result in an outcome adverse to such parties' economic interests. *Matter of Bank of N. Y. Mellon*, 56 Misc. 3d at 223. Justice Scarpulla refused, explaining that:

> [I]t is neither an absurd or unenforceable result that the principal distribution amount calculated under the governing agreements may be small in proportion to the entire amount of the allocable share, resulting in the majority of the allocable share to be distributed to certificates with realized losses, particularly because the parties anticipated that this result might occur. Even if this distribution can be characterized as unusual, terms that are "novel or unconventional" do not render a result absurd. Moreover, it is not absurd that, once the principal distribution amount is distributed, it is in fact the senior certificates with realized losses that will be paid first before junior certificates with realized losses.
>
> Lastly, AIG and the institutional investors argue that the settlement agreement's purpose will not be achieved if the allocable share is primarily distributed to junior certificates with realized losses. They argue that the purpose of the settlement agreement is to compensate certificateholders for past and future losses caused by the alleged breaches of representations and warranties, but that the pay first, write up second method will result in a distribution based primarily on past losses only.
>
> While I understand that the plain language of the settlement agreement and governing agreements do not reflect the senior certificateholders' belief as to how allocable shares would be distributed with respect to these few trusts, I may not look beyond the four corners of the relevant agreement to determine the parties' intent, when the contract language itself is clear. Where the "parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing."

Id. at 223 – 225 (internal citations omitted).

B. The HBK Settlement Trust PSAs Require the Trustee to Consider Whether a Trust is Overcollateralized—Even Transiently—and if so, to Constitute an Overcollateralization Release Amount.

The Institutional Investors and AIG make two arguments that "the Settlement Payment cannot create overcollateralization." (Institutional Investors and AIG Br. at 15); both of which

are wrong. The Institutional Investors and AIG first argue that the language of the HBK Settlement Trust PSAs prevent the Settlement Payment from creating overcollateralization. (*Id.* at 16 – 18.) In so doing, they misinterpret the HBK Settlement Trust PSAs.

The Institutional Investors and AIG acknowledge the definition of Overcollateralization Amount, but add steps to its computation that are not present in the HBK Settlement Trust PSAs. (Institutional Investors and AIG Br. at 17 – 18.) The Institutional Investors and AIG rely on Section 5.04(b), which addresses the accounting question of whether, when and how the Certificate Principal Balance of trusts are written up to account for Subsequent Recoveries. They argue that Section 5.04(b) requires an "equal and offsetting write-up" of certificate balances as part of the calculation of the Overcollateralization Amount. (*Id.* at 18.) In other words, the Institutional Investors and AIG are advocating for an improvised exception to the Pay First, Write-Up Second rule: pay a little first using the Certificate Principal Balance immediately prior to the Distribution Date, then write-up just to avoid the creation of an Overcollateralization Release Amount, then go back to the initial Certificate Principal Balances, then finish paying, then apply the actual write-up. Just to state the practical effect of this argument is to show that it has no basis in logic or the language of the HBK Settlement Trusts.

First, as the Institutional Investors and AIG themselves recognize, the HBK Settlement Trusts should be paid first and written-up second. (Institutional Investors and AIG Br. at 4 – 14.) But now they want to craft a special exception for themselves—pay them some; write-up; calculate how much they would be paid based on the written-up Certificate Principal Balances; revert to the initial, un-written-up Certificate Principal Balances for distributions—maximizing the portion of the Allocable Share they receive by paying first but not permitting an overcollateralization release.

Indeed, Nover recognizes that if Allocable Share is paid to certificateholders first, the HBK Settlement Trust PSAs require the constitution of an Overcollateralization Release Amount. (Nover Br. at 20 – 21; *see also* Olifant (but not with respect to HBK Settlement Trusts) Br. at 11 – 13.) It holds this up as a reason to write-up first, but of course, that Nover dislikes the outcome mandated by the HBK Settlement Trust PSAs is no reason to ignore them.

Second, the Institutional Investors' and AIG's suggested "second step"—writing up the Certificate Principal Balance has no basis in the terms of the HBK Settlement Trust PSAs. To calculate the Overcollateralization Amount, a trustee must take "into account the payment of principal," to assess the balance at the end of the distributions between the value of the collateral, the book value of the certificates and the Overcollateralization Target. (Allen Opp. Affirm. Ex. 6.) The HBK Settlement Trust PSAs say nothing about also taking into account the write-up of Certificate Principal Balances after distributions are complete—a write-up that the Institutional Investors and AIG themselves acknowledges happens second, after distributions occur.

Third, the procedure for computing the Overcollateralization Release Amount is explicit about doing the calculation "after taking into account the payment of principal," but says nothing about taking into account write-ups for Subsequent Recoveries (or write-downs for Realized Losses). (Allen Opp. Affirm. Ex. 5.)

Fourth, equally unavailing is Nover's argument that the Court should ignore the HBK Settlement Trust PSAs because the distribution of funds would have been different had it been made "as of the date the Settlement Agreement was executed." (Nover Br. at 21 – 22.) This is again just another way of asking the Court to ignore or rewrite the HBK Settlement Trust PSAs because Nover does not like the result. Justice Scarpulla rejected a similar argument in the BoNYM Article 77 Proceeding. *Matter of Bank of N. Y. Mellon*, 56 Misc. 3d at 226 ("I agree

with AIG and the institutional investors that there is **no support** in the governing agreements for a **distribution to relate back to a prior set of certificate balances**.) (emphasis added).

Fifth, Nover's argument that the Settlement Agreement's requirement that the write-up not affect the distribution of the Settlement Payment (Nover Br. at 22) justifies ignoring the procedure for computing the Overcollateralization Release Amount violates the Settlement Agreement provision upon which Nover purports to rely. What Nover and others want to do is change the distribution of the Settlement Payment to meet their preferences. Writing-up after distribution does not affect the mechanics of the distribution, it just means that it leads to a result that Nover and other junior certificateholders do not like. That is no reason to ignore or rewrite the terms of HBK Settlement Trust PSAs. And particularly so, because as Nover recognizes, the Settlement Agreement requires a trustee to follow the distribution provisions of a Settlement Trust's governing documents.

Sixth, the argument that following the terms of the HBK Settlement Trust PSAs in calculating an Overcollateralization Release Amount will leave the trusts undercollateralized fails for at least two reasons. The HBK Settlement Trust PSAs state unambiguously that the Overcollateralization Release Amount must be computed and, if applicable, distributed. Respondents cannot erase provisions from the PSAs because they do not like their effect, particularly where there is nothing in the PSAs establishing an overarching rule that a trust can never be over- or under-collateralized at the end of a Distribution Date. *See Marin*, 128 A.D.3d at 515.

Moreover, the HBK Settlement Trust PSAs provide a mechanism to address under-collateralization (which shows both that it is not forbidden and that its likelihood is

contemplated). The calculations of Excess Spread include the Extra Principal Distribution Amount, which addresses under-collateralization on prior Distribution Dates, providing:

> With respect to any Distribution Date, the lesser of (i) the excess, if any, of the Overcollateralization Target Amount for such Distribution Date, over the Overcollateralization Amount for such Distribution Date (after giving effect to distributions of principal on the Certificates other than any Extra Principal Distribution Amount) and (ii) the Excess Spread for such Distribution Date.

(Allen Opp. Affirm. Ex. 7.)

Indeed, the HBK Settlement Trust PSAs also allow for overcollateralization, too (up to the amount of the Overcollateralization Target Amount.) (*See* § 5.04(a)(1).)

CONCLUSION

For the foregoing reasons, the Court should direct the trustees of the HBK Settlement Trusts to make distributions as provided by Section 5.04(a) of the HBK Settlement Trust PSAs with the distribution of Overcollateralization Release Amount before writing up certificate balances as provided by Section 5.04(b) of the HBK Settlement Trust PSAs (*i.e.,* Pay First, Write-Up Second).

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