

**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.)

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**REPLY 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 Reply Memorandum of Law, along with the Reply Affirmation of Seth D. Allen, and the exhibits attached thereto (“Allen Reply 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<sup>1</sup> regarding the issues raised in paragraphs 21 through 48 of the Petition (the “Order of Payment Issue”).<sup>2</sup>

### **PRELIMINARY STATEMENT**

Notwithstanding the submission of ten separate opposition briefs, totaling more than 130 pages, no Respondent gives the Court reason to diverge from the simple rule that HBK has proposed for the distribution of funds to the HBK Settlement Trusts: apply the plain terms of the HBK Settlement Trust PSAs and decline to rewrite them. Instead, Respondents’ various opposition briefs, to the extent they diverge from HBK’s proposed distribution, present self-serving conceptions of fairness, reasonableness or intent, to persuade the Court to apply—or not apply—provisions of the PSAs as best suits them. The Court should decline all such invitations to re-write the HBK Settlement Trust PSAs and should instead enforce them according to their plain terms, which require that each HBK Settlement Trust’s Allocable Share be distributed

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<sup>1</sup> U.S. Bank incorporates by reference Footnote 1 of its opening and opposition briefs, submitted at the direction of Respondent HBK, solely in U.S. Bank’s capacity as Indenture Trustee under the NIM Trusts referenced on Exhibit 10 to the Allen Affirmation, and submits this Reply Memorandum of Law with the same conditions stated therein.

<sup>2</sup> All capitalized terms in this Memorandum of Law have the meaning given to them in the Petition, unless otherwise specified.

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

### ARGUMENT

#### I. THE GOVERNING AGREEMENTS CONTROL THE ORDER OF DISTRIBUTION AND PAYMENT

There are many things on which most Respondents agree. Most Respondents agree with HBK that the Governing Agreements control the question of how Petitioners should distribute each trust's Allocable Share. (Ambac Opp'n Br. at 2 – 3 (but not with respect to HBK Settlement Trusts); DW Partners and Ellington Opp'n Br. at 5, 23 – 24 (while arguing that the Settlement Agreement governs the write-up, conceding that the Governing Agreements govern distributions); GMO Opp'n Br. at 2 – 4, 6 (but not with respect to the HBK Settlement Trusts); Nover Opp'n Br. at 3, 9 – 10, 13 – 14; Olifant Opp'n Br. at 3; Poetic and Prophet Opp'n Br. at 2 – 3 (but not with respect to the HBK Settlement Trusts); Tilden Opp'n Br. at 5 – 7, 10 (arguing for a “hybrid” approach but conceding that that distribution is governed by the PSAs).)

The Institutional Investors and AIG argue that the Settlement Agreement governs the distribution issue, but on the questions of whether to pay first (Petitioners should) and whether to enforce the retired class provisions (Petitioners should), they nonetheless come to the same conclusions as HBK. (Institutional Investors and AIG Opp'n Br. at 5 – 14.) Even if the Settlement Agreement controlled the order of distribution and write-up of the HBK Settlement Trusts—it does not—as the Institutional Investors observe, the Settlement Agreement would nevertheless require a trustee to distribute funds first, before writing-up. (*See* HBK Opp'n Br. at 9.) Thus, the few Respondents who argue that the Settlement Agreement controls the sequence of distribution and that that sequence is write-up first (*see* DW Partners and Ellington Opp'n Br. at 17 – 20; *see also* Tilden Opp'n Br. at 2 – 5 (arguing for a “hybrid” approach that shifts back

and forth between the Settlement Agreement and the Governing Agreements)), are wrong for the reasons already set forth by HBK, the Institutional Investors and AIG. (Institutional Investors and AIG Opp'n Br. at 5 – 14 and HBK Opp'n Br. at 7 – 18.)

**II. READING EACH RELEVANT AGREEMENT AS AN INTEGRATED WHOLE SHOWS THAT THE SEQUENCE OF OPERATIONS IN ALL OF THOSE AGREEMENTS IS PAY FIRST, WRITE-UP SECOND**

**A. The HBK Settlement Trust PSAs.**

The fact that the Settlement Agreement's distribution provisions in Section 3.06(a) are before the write-up provisions in Section 3.06(b) demonstrates the Settlement Agreement's pay first requirement. (Institutional Investors and AIG Opp'n Br. at 7.) The same is true for the HBK Settlement Trust PSAs, which provide distribution provisions in Section 5.04(a) of the HBK Settlement Trust PSAs before the write-up provisions in Section 5.04(b), again demonstrating the sequence of payment before write-up.

A few Respondents ask the Court to overlook the overall structure of the HBK Settlement Trust PSAs (DW Partners and Ellington Opp'n Br. at 17; Tilden Opp'n at 11, 13), but in so doing, they ignore that the Court must read the HBK Settlement Trust PSAs as “a harmonious and integrated whole” rather than “distort[ing]” the meaning so that “undue force is given to single words or phrases.” *Westmoreland Coal Co. v. Entech, Inc.*, 100 N.Y.2d 352, 358 (2003).<sup>3</sup>

Tilden argues that the overall structure of the HBK Settlement Trust PSAs supports its argument for writing-up under Section 5.04(b) before distributing under Section 5.04(a), noting

that at least some of the actions directed by Section 5.04(b) occur prior to those required by Section 5.04(a): Section 5.04(b) requires the Master Servicer to deposit Subsequent Recoveries into the Protected Account **pursuant to Section 4.01(b)(iii), and Section 4.01(b)** in turn requires such deposits to be made “on a

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<sup>3</sup> The HBK Settlement Trusts are not affected by the issue of whether senior bonds should be written-up (*see, e.g.*, Institutional Investors and AIG Opp'n Br. at 16 – 17; Nover Opp'n Br. at 4 – 13); therefore, this Memorandum of Law does not express an opinion on that issue.

daily basis within one Business Day of receipt” of all Subsequent Recoveries – *i.e.*, prior to the distributions required by Section 5.04(a).

(Tilden Opp’n Br. at 13 (emphasis added).) Tilden’s argument proves HBK’s point. It is not Section 5.04(b) that requires a trustee to “deposit Subsequent Recoveries into the Protected Account,” it is Section 4.01, which **precedes** Section 5.04. Thus, the sequence is maintained: deposit (Section 4.01), pay (Section 5.04(a)), write-up (Section 5.04(b)) and then write-down for Realized Losses (Section 5.05).

A closer look at Article 5 of the HBK Settlement Trust PSAs reinforces this point. **First**, under Section 5.01, there are Advances, which the Master Servicer must pay “no later than 10:00 a.m. Eastern time on the Distribution Account Deposit Date.” (Allen Reply Affirm. Ex. 1.) The Distribution Account Deposit Date is either “**The** Business Day prior to each Distribution Date,” or “**Two** Business Days prior to each Distribution Date.” (Allen Reply Affirm. Ex. 2 (emphasis added).) **Second**, under Section 5.02, there are “Compensating Interest Payments,” which must be made “no later than the close of business on the Business Day immediately preceding such Distribution Date”; that is, the day **after** the Advances must be paid by the Master Servicer. (Allen Reply Affirm. Ex. 3.)

**Third**, the next day, **on** the Distribution Date, the trustee must first make “REMIC Distributions” under Section 5.03 and then make distributions to certificateholders under Section 5.04(a), in the following order: Interest Funds under Section 5.04(a)(1), then the Principal Distribution Amount under Section 5.04(a)(2), and finally Excess Cashflow under Section 5.04(a)(4). (Allen Affirm. Ex. 5 (Section 5.04); Allen Reply Affirm. Ex. 4 (Section 5.03).) After the distributions are made (or, as Section 5.04(b) puts it, “[i]n addition to the foregoing distributions,”) a trustee must write-up for Subsequent Recoveries under Section 5.04(b). (Allen

Affirm. Ex. 5.) And, of course, the trustee then must send wire transfers or checks to certificateholders so that they can receive their distributions. (*Id.* Section 5.04(c).)

**Fourth**, after all distributions have been made and write-ups for Subsequent Recoveries allocated, a trustee must allocate Realized Losses. (Allen Opp. Affirm. Ex. 8 (Section 5.05).) Section 5.05 is explicit in providing that this allocation is made last on the Distribution Date, “**after** the actual distributions to be made on such date as provided above.” (*Id.*) After Realized Losses are allocated, a trustee must “prepare and make available to” certificateholders the “Monthly Statements to Certificateholders,” under Section 5.06. (Allen Reply Affirm. Ex. 5 (Section 5.06).) Reading the HBK Settlement Trust PSAs as “a harmonious and integrated whole,” the order of operations is self-evident. *Westmoreland Coal Co.*, 100 N.Y.2d at 358.

**B. The Settlement Agreement.**

For the same reasons, the Court should look to the overall structure of Section 3 of the Settlement Agreement to see that, to the extent the Court relies upon it in determining the order of payment and write-up, the language and structure of Section 3 support the requirement to pay distributions first, before writing-up bonds, as discussed by the Institutional Investors and AIG. (Institutional Investors and AIG Opp’n Br. at 5 – 10.) Thus, DW Partners and Ellington (DW Partners Opp’n Br. at 17) are wrong in asking the Court to ignore the structure of Section 3 of the Settlement Agreement when interpreting it.

**C. Isolated Contract Terms Cannot Be Used to Ignore the Pay First Rule of the HBK Settlement Trust PSAs.**

Respondents’ approach of cherry-picking terms in the HBK Settlement Trust PSAs rather than reading the PSAs “a harmonious and integrated whole,” is the opposite of how a contract should be interpreted. *Westmoreland Coal Co.*, 100 N.Y.2d at 358.



**First**, a number of Respondents—despite agreeing with HBK that the Governing Agreements govern the order of distribution and write-up—point to the definition of Certificate Principal Balance to argue that a trustee must write-up first. (Ambac Opp’n Br. at 3 (but not with respect to HBK Settlement Trusts); Olifant Opp’n Br. at 2 – 3 (but not with respect to HBK Settlement Trusts); Tilden Opp’n Br. at 11 – 12.) But as HBK demonstrated in its opposition, the definition of Certificate Principal Balance does not carry the weight these Respondents would place upon it. (HBK Opp’n Br. at 11 – 17; *see also* Institutional Investors and AIG Opp’n Br. at 11 – 13.) Indeed, as the Institutional Investors and AIG point out, even trusts that the Petitioners agree are pay first define Certificate Principal Balance in the same way as the HBK Settlement Trust PSAs. (Institutional Investors and AIG Opp’n Br. at 11 – 12.)

**Second**, as HBK, the Institutional Investors and AIG explained in their oppositions, the Realized Losses provision (Allen Opp. Affirm. Ex. 8) does not support an argument for writing-up trusts before making distributions. Indeed, as discussed in HBK’s opposition and above, the structure and operation of Realized Loss allocation under Section 5.05 demonstrates why write-ups are processed after distributions, but before Section 5.05 write-downs. (HBK Opp’n Br. at 17 – 18; *see also* Institutional Investors and AIG Opp’n Br. at 13.) The Institutional Investors and AIG correctly note that “[s]ubsequent recoveries allocated in a particular distribution month are associated with entirely different loans than the realized losses allocated in that period.” (Institutional Investors and AIG Opp’n Br. at 13 (arguing that no inference can be drawn from the process for allocating Realized Losses).) And in any event, the sequence and logic of distributing, then writing-up to account for Subsequent Recoveries, and then writing-down to account for Realized Losses is dispositive of the pay first issue. (HBK Opp’n Br. at 17 – 18; *see also* Institutional Investors and AIG Opp’n Br. at 13 – 14.)

**Third**, as HBK, the Institutional Investors and AIG explained in their oppositions, neither the definition of Current Interest nor the final sentences of Section 5.04(b) relating to Current Interest can be read to override the pay first, write-up second structure of the HBK Settlement Trust PSAs. (HBK Opp'n Br. at 13 – 17; *see also* Institutional Investors and AIG Opp'n Br. at 13 – 14.) As the Institutional Investors and AIG explain regarding the final sentences of Section 5.04(b), those sentences only “clarif[y] that certificates are not entitled to interest for the period of time between (i) the distribution date on which such certificate suffered a realized loss on a particular loan and (ii) the distribution date on which such certificate received the subsequent recovery writeup with respect to such loan, which reverses the prior realized loss.” (Institutional Investors and AIG Opp'n Br. at 13 – 14.)

**III. PRIOR SETTLEMENT AGREEMENTS AND CONSENT ORDERS ARE IRRELEVANT**

A major point of contention in opposition briefing was the effect of other RMBS trustee settlements and consent orders on the Court's decision here. (*See* DW Partners and Ellington Opp'n Br. at 18 – 22; GMO Opp'n Br. at 4 – 5; Institutional Investors and AIG Opp'n Br. at 8 – 11, 14 – 15; Nover Opp'n Br. at 20 – 22; Olifant Opp'n Br. at 2 – 3, 6 – 16; Tilden Opp'n Br. at 8 – 10, 18 – 20.) However, the Court must look to the HBK Settlement Trust PSAs to resolve this dispute rather than relying on unrelated documents or appeals to extrinsic evidence such as commercial reasonableness or unevicenced intent. Court orders arising by consent or where the specific issues raised in this proceeding—such as whether a trustee should ignore PSA provisions relating to overcollateralization—were not litigated and are irrelevant to the interpretation of the unambiguous distribution provisions. (*See* HBK Opp'n Br. at 4 – 7, 20 – 21.)

**IV. TRUSTEES MAY NOT IGNORE OR REWRITE PSA PROVISIONS RELATING TO OVERCOLLATERALIZATION AND EXCESS CASHFLOW**

**A. Trustees Must Calculate Overcollateralization Release Amount and Distribute it as Part of Excess Spread.**

The Institutional Investors and AIG repeatedly assert that “the Pay First method” cannot “create overcollateralization.” (Institutional Investors and AIG Opp’n Br. at 15 – 16.) However, the Institutional Investors and AIG provide no new arguments in support of their position that the Court should ignore the unambiguous provisions of the HBK Settlement Trust PSAs relating to overcollateralization and Excess Cashflow; the arguments in their opening brief are thoroughly rebutted in HBK’s opposition. (See HBK Opp’n Br. at 19 – 25.)

The Institutional Investors and AIG stand alone in their argument that the HBK Settlement Trust PSAs allow the trustee to rewrite the definition of Overcollateralization Release Amount. Indeed, Nover and Olifant have urged the Court to adopt an unjustified write-up first rule because paying first may require some portion of the Allocable Share to be included in Overcollateralization Release Amount. (See Nover Opening Br. at 20 – 21; see also DW Partners and Ellington Opp’n Br. at 14 (arguing against enforcement); Olifant (but not with respect to HBK Settlement Trusts) Opening Br. at 11 – 13; Olifant Opp’n Br. at 16 – 17 (arguing that the Institutional Investors’ and AIG’s argument to “redefine” trust’s overcollateralization provisions “is not a reasonable reading of the Governing” Agreements).) Although HBK and Tilden disagree on which trusts are pay first, HBK agrees with Tilden that where distributions must be made before write-up, those distributions must include “overcollateralization, resulting in the distribution of a portion of the settlement proceeds the excess cashflow waterfall. . . .” (Tilden Opp’n Br. at 13 – 15.) As Tilden notes, “[n]o legal basis exists to deviate from the PSA’s unambiguous terms, which are dispositive and must be followed.” (*Id.* at 15.)

**B. Precedent Suggests That The Court Should Apply the Overcollateralization and Excess Cashflow Provisions of the HBK Settlement Trust PSAs.**

HBK joins in Tilden’s thorough rebuttal (*id.* at 15 – 20), of the Institutional Investors’ and AIG’s arguments in favor of writing the provisions relating to overcollateralization and Excess Cashflow out of the HBK Settlement Trust PSAs (or, alternatively, reading provisions that do not exist into them).

As discussed in HBK’s opposition, Justice Scarpulla’s decision in *In re Bank of New York Mellon*, 56 Misc. 3d 210, 223 – 225 (Sup. Ct. N.Y. Cty. 2017), (the “BoNYM Article 77 Proceeding”) is instructive here. The BoNYM Article 77 Proceeding court rejected almost identical arguments by the Institutional Investors and AIG—framed there as concerns about “leakage.” *Id.* at 223 – 225. Specifically, it rejected the argument that PSAs should be rewritten to avoid distributions going to any class other than senior investors, finding that “the parties plainly understood when they negotiated the Settlement Agreement that there could be instances where the Governing Agreements’ general subordination scheme may not apply.” (Tilden Opp’n Br. at 18 (quoting *In re Bank of New York Mellon*, 56 Misc. 3d at 222).) As Nover notes in a different context (Nover Opp’n Br. at 9), if the parties to the HBK Settlement Trust PSAs had wanted to prioritize senior classes so that no part of the Allocable Share was to be paid to subordinate classes until the senior classes had been paid in full, they could have done so. They did not.

That the PSA language litigated in the BoNYM Article 77 Proceeding differs from the PSA language at issue here does not make that decision any less relevant. The decision is directly on point regarding the question of whether the Court should ignore or rewrite the overcollateralization provisions of the HBK Settlement Trust PSA based on commercial reasonableness or the parties’ unevicenced intentions. That is exactly what the Institutional

Investors, AIG and others argued in BoNYM Article 77 Proceeding and exactly what Justice Scarpulla rejected (*see* HBK Opp'n Br. at 4 – 7, 20 – 21). This Court should do the same.

Olifant looks to the BoNYM Article 77 Proceeding as support for writing-up the HBK Settlement Trusts before distributing the trusts' Allocable Shares, even though the result of the analysis in the BoNYM Article 77 Proceeding was that the Allocable Share should be paid first. (Olifant Opp'n Br. at 11.) To the extent Olifant is urging the Court to apply the unambiguous terms of the relevant PSAs, HBK agrees (but of course such an analysis leads to a different result than the one Olifant seeks). To the extent Olifant is arguing that the definition of Principal Distribution Amount in BoNYM Article 77 Proceeding trusts is "equivalent to the definition of "Certificate Principal Balance in the" HBK Settlement Trusts and that somehow supports writing-up those trusts (*id.*), Olifant is mistaken. Principal Distribution Amount defines what is to be distributed, while Certificate Principal Balance is an accounting term (and the balance of a class fluctuates as distributions, write-up and write-downs are applied). For the HBK Settlement Trusts, neither term defines the order of distribution and write-up.

### 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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