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

In the Matter of the Application of WELLS FARGO BANK, NATIONAL ASSOCIATION, U.S. BANK NATIONAL ASSOCIATION, THE BANK OF NEW YORK MELLON, THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., WILMINGTON TRUST, NATIONAL ASSOCIATION, HSBC BANK USA, N.A., and DEUTSCHE BANK NATIONAL TRUST COMPANY (as Trustees, Indenture Trustees, Securities Administrators, Paying Agents, and/or Calculation Agents of Certain Residential Mortgage-Backed Securitization Trusts), Petitioner, For Judicial Instructions under CPLR Article 77 on the Distribution of a Settlement Payment.	Index No. 657387/2017 IAS Part 60 Hon. Marcy S. Friedman

REPLY BRIEF OF TILDEN PARK

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TABLE OF CONTENTS

ARGUMENT[1]

I. The Settlement Agreement Controls in the Event of Conflict With the Governing Agreements

A. *Res Judicata*

The parties' Responses reflect widespread confusion concerning the application of *res judicata* to this case. Nover contends that *res judicata* does not apply. Nover Response 20-23. Other parties contend that *res judicata* not only applies but compels a particular interpretation of the Settlement Agreement. *See* II/AIG Response 9-10 & II/AIG Br. 6-9 (*res judicata* requires Pay First); GMO Response 6 (*res judicata* precludes interpreting Settlement Agreement to supersede PSAs).

Neither of these positions is correct. *Res judicata* applies here, but it does not extend to disputes over interpretation of the Settlement Agreement. Rather, as we explained in our opening brief, what *res judicata* bars is any objection to the Settlement Agreement's terms – including any claim that the Settlement Agreement *cannot* supersede the Governing Agreements because that would constitute an unlawful amendment of those agreements. *See* Tilden Br. 5-7. If (as we have shown) the Settlement Agreement by its terms overrides the PSAs in some respects, it is now too late to argue that this result is impermissible.

This follows from the established rule that *res judicata* bars all "issues . . . that could

[1] Four other respondents have adopted and incorporated by reference arguments made in this brief. Strategos Capital Management, LLC has adopted Point I, and DW Partners LP and Ellington Management Group, LLC have adopted Point I.A. In addition, D.E. Shaw Refraction Portfolios L.L.C. has authorized us to say that it joins in the arguments made in Tilden Park's previously-filed memoranda and in this Reply, as those arguments relate to the four trusts as to which D.E. Shaw has appeared (SACO 2005-9, GPMF 2005-AR2, SAMI 2006-AR7 and SAMI 2007-AR1).

Opening briefs and response briefs filed by respondents are referred to as "_____ Br." and "_____ Response," respectively. Specifically, we refer to (a) the following opening briefs: Dkt. No. 515 ("Tilden Br."), Dkt. No. 545 ("Olifant Br."), Dkt. No. 576 ("II/AIG Br."), Dkt. No. 599 ("GMO Br."); Dkt. No. 573 ("HBK Br."), and (b) the following response briefs: Dkt. No. 668 ("Tilden Response"), Dkt. No. 663 ("II/AIG Response"), Dkt. No. 675 ("GMO Response"), Dkt. No. 687 ("HBK Response"), Dkt. No. 698 ("Nover Response"), Dkt. No. 708 ("DW/Ellington Response").

have been raised" in "a prior action between the same parties involving the same subject matter." *In re Hunter*, 4 N.Y.3d 260, 269-70 (2005). The Petition in the first Article 77 proceeding ("*JPM I*") sought judicial approval of the Trustees' acceptance of the Settlement Agreement, but it did not request the Court's assistance in construing that agreement. *See* Affirmation of Anna Vinogradov in Support of Reply Brief of Tilden Park ("Vinogradov Reply Aff."), Ex. A (*JPM I* Petition) ¶ 75 (requesting "declaration that [the Trustees'] acceptance of the Settlement on behalf of each of the Accepting Trusts comports with all applicable duties under the Governing Agreements and any other applicable law . . ."). Consequently, *res judicata* bars any objections to the Settlement Agreement's terms, but not disputes over interpretive issues.[2]

B. Section 7.05

As in their opening briefs, a number of parties continue to argue that Section 7.05 of the Settlement Agreement somehow nullifies that agreement's multiple substantive rules. As before, most of these parties simply ignore the obvious deficiencies of this interpretation. *See* Tilden Response 2-5.

GMO is the only party that attempts to address these deficiencies, and it fails. GMO claims Tilden Park "fails to identify any provision in the underlying Governing Agreements that is purportedly contrary to, and amended by," the Settlement Agreement's substantive rules. GMO Response 2. But GMO itself has admitted – correctly – that multiple "sections of the Settlement Agreement *provide clear indication that they intend to supersede conflicting provisions of Governing Agreements* . . . ." GMO Br. 4 n.7 (emphasis added)*; see also* Settlement Agreement § 3.06(a) (overriding PSA distribution provisions to extent they permit

[2] Justice Scarpulla applied *res judicata* in precisely this fashion in the second Countrywide Article 77 proceeding. She considered all interpretative issues raised by the parties, but she held that *res judicata* barred TIG's objection to particular settlement agreement provisions because "TIG had a full and fair opportunity to raise its objection to the settlement agreement's terms in the prior proceeding . . . ." Tilden Br. 6-7 (quoting *In re Bank of N.Y. Mellon*, 56 Misc. 3d 210, 217 (Sup. Ct. N.Y. Cty. 2017)).

REMIC residual interests to share in Settlement Payment); Tilden Br. 3-4 (discussing Settlement Agreement §§ 3.03, 3.06(b) & (c), 3.07).

GMO's claim that the Settlement Agreement's substantive rules are mere "gap-fillers," applicable only to the extent particular PSAs are silent on these issues (GMO Response 3-4), is equally false. Each of the Settlement Agreement rules noted above applies to *all* settlement trusts, not just to the small minority whose PSAs are silent. *See* Settlement Agreement §§ 3.03, 3.06(a)-(c), 3.07. In the few instances where a particular rule merely fills a gap, the Settlement Agreement says so explicitly. *See, e.g.,* Settlement Agreement § 3.06(a) ("[I]f the Governing Agreement for a particular Settlement Trust does not include the concept of 'subsequent recovery,' the Allocable Share of such Settlement Trust shall be distributed as though it was unscheduled principal . . . .").

GMO attempts to bolster its misreading of the Settlement Agreement by repeatedly quoting a passing statement in the *JPM I* Petition that the Settlement Payment would be "paid out to Certificateholders in accordance with the [Governing Agreements'] contractual payment provisions." GMO Response 4, 6. In fact, this one-sentence summary was as accurate as any such abbreviated description could be. It precisely described the Settlement Agreement's distribution provision, which incorporates the PSAs' distribution waterfalls by providing that the Settlement Payment is to be "distribut[ed] to Investors in accordance with the distribution provisions of the Governing Agreements." Settlement Agreement § 3.06(a). For investors who wished to understand the Settlement Agreement's write-up mechanics as well as its payment priorities in their full detail, the Petition annexed a copy of that agreement. *JPM I* Petition ¶ 15.

II. The Governing Agreements Control the Order of Operations

As explained in our prior briefs, the mandate of Settlement Agreement § 3.06(a) that the Trustees distribute the Settlement Payment "in accordance with the [Governing Agreements']

distribution provisions" can only be implemented by applying each PSA's Certificate Principal Balance ("CPB") definition. Tilden Br. 10-11; Tilden Response 7. That definition, together with other PSA provisions, determines whether the CPB on any given distribution date includes or does not include the write-up of the amount of subsequent recoveries received by the trust for distribution on that date – that is, whether distributions are made on a Write-Up First or a Pay First basis. *See* Tilden Br. 14-18; Tilden Response 7, 11.[3]

A. Each Governing Agreement Requires Either Write-Up First or Pay First

The Institutional Investors and AIG (together, the "Institutional Investors") claim the Governing Agreements are "silent" as to the order of operations. This is not true.

The Institutional Investors argue, first, that the Governing Agreements are "silent as to . . . *which* subsequent recoveries are used to increase the Certificate Principal Balance" – that is, whether the increase includes "subsequent recoveries from the *current* distribution period, [or merely those] from *prior* distribution periods." II/AIG Response 11-12 (emphasis in original). This ignores that the CPB definition in PSAs with typical Write-Up First features (the "Write-Up First PSAs") specifically states that the CPB includes "any Subsequent Recoveries *added to the Certificate Principal Balance of such Certificate pursuant to Section 5.04(b).*" *See* Affirmation of Anna Vinogradov, Dkt. No. 518 ("Vinogradov Aff."), Ex. A (BSABS 2005-AQ2 PSA, Art. I) (Definition of CPB) (emphasis added). Section 5.04(b) makes clear that the subsequent recoveries newly added to the CPB are those received during the current distribution period. *See* Point II.B below.

The Institutional Investors' further contention – that the Governing Agreements are

[3] Our prior briefs rebutted the arguments of a number of parties that Settlement Agreement Section 3.06 requires the Trustees to use either the Pay First Method or the Write-Up First Method for all trusts. *See* Tilden Br. 12-14; Tilden Response 5-7. The parties' Responses advance no arguments on this issue that we have not already fully addressed.

Other issues too – such as the treatment of overcollateralization release provisions and zero-balance bonds – are not addressed in this Reply because our prior briefs fully addressed these issues.

"silent as to . . . whether the Certificate Principal Balance should be increased by subsequent recoveries *before* or *after* the subsequent recoveries are distributed" (II/AIG Response 12; emphasis in original) – is equally without basis:

- As we and others have explained, the CPB definition in Write-Up First PSAs requires several *other* elements of the certificate balance calculation (distribution amounts and Applied Realized Loss Amounts) to be applied on a delayed basis. The addition of subsequent recoveries is not subject to any such limitation, making clear that subsequent recoveries are added *before* the distribution, in contrast to distribution amounts and Applied Realized Loss Amounts, which are subtracted *after* the distribution. *See* Tilden Br. 15-16.

- Section 5.05(a) reinforces this conclusion, stating expressly that "All Realized Losses to be allocated to the Certificate Principal Balances of all Classes on any Distribution Date shall be so allocated *after* the actual distributions to be made on such date as provided above." *See id.* 16 (emphasis added).[4]

The Institutional Investors give great weight to the Trustees' exclusion of a number of Pay First trusts from Exhibit D. II/AIG Response 11-12. But the Trustees' treatment of these trusts just underscores the specific differences between Write-Up First and Pay First PSAs that we highlighted in our opening brief. As we explained, the definition of Certificate Principal Amount in the PSAs for these particular Pay First trusts differs crucially from that in the Write-Up First PSAs: It states that "Certificate Principal Amounts shall be determined as of the close of business of *the immediately preceding Distribution Date*, after giving effect to all distributions made on such date" (emphasis added) – an express Pay First directive, absent from the Write-Up First PSAs and requiring the opposite result. *See* Tilden Br. 17-18 & n.10 (construing four of these Pay First trusts); *compare* II/AIG Response 11 n.6 & Ex. 22 to Supplemental Sheeren

[4] HBK claims Section 5.05(a) actually supports a Pay First reading of the Write-Up First PSAs (HBK Response 17-18), but its convoluted contention makes little sense. At bottom, HBK's argument rests on a misreading of the word "above" in the last sentence of Section 5.05(a) to refer to the preceding portions of that section. In fact, when the last sentence of Section 5.05(a) is read together with the penultimate sentence (quoted in the second bullet point above), it is clear that the word "above" in *both* of these sentences refers to the preceding section, Section 5.04, concerning distributions. Both sentences confirm that Realized Losses are allocated to the CPB after distributions are made (in contrast to subsequent recoveries, which are allocated prior to distributions). Furthermore, it is the entirety of Section 5.04, which in HBK's PSAs includes both the write-up and the distribution, that begins with the CPB prior to the distribution date referenced in the last sentence of Section 5.05(a).

Affidavit (all six trusts have the language just quoted).[5] The different CPB language employed in these trusts' PSAs makes clear that, when the PSAs' drafters wanted to vary the order of operations, they knew exactly how to do so. *See* Tilden Br. 16-18 (describing four versions of PSA language used for Pay First trusts).

B. Section 5.04(b) Confirms the Order of Operations Required by Each Governing Agreement's CPB Definition

HBK, unlike the Institutional Investors, focuses on the CPB definition's reference to Section 5.04(b) – that is, its statement that the CPB includes "any Subsequent Recoveries added to the Certificate Principal Balance of such Certificate pursuant to Section 5.04(b)." *See* HBK Response 9-13.

HBK is correct that Section 5.04(b) determines which subsequent recoveries are added to the CPB on a distribution date. However, HBK fails to recognize that Section 5.04(b) does not alter the order of operations dictated by each PSA's CPB definition; rather, it leaves that order of operations (whether Write-Up First or Pay First) in place.

Section 5.04(b) provides that subsequent recoveries are added to the CPB as of the distribution date for which the amount of a Realized Loss is reduced. The definition of Realized Loss, in turn, provides that a mortgage loan's Realized Loss is reduced by subsequent recoveries that are received by the Master Servicer with respect to that loan – and the reduction is effective on the date, and to the extent, those subsequent recoveries are distributed to investors or applied to increase Excess Spread.[6] The combined effect of these two provisions is that, on any given

[5] The Institutional Investors emphasize that some *other* parts of the CPB definition in these Pay First PSAs have "the same textual features" as those in the Write-Up First PSAs. II/AIG Response 12. But this is of no moment, since the operative language quoted above overrides those similarities, compelling a Pay First reading. Nor is the absence of such operative language in the Write-Up First PSAs an indication of "silence" on the matter, because the common CPB language, *when unmodified,* requires Write-Up First.

[6] *See* Vinogradov Aff., Ex. A (BSABS 2005-AQ2 PSA) at § 5.04(b) ("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

distribution date, subsequent recoveries write up the CPB to the extent they are included in the distribution to investors. Subsequent recoveries received at the specific times associated with the current distribution period (*i.e.*, by the end of the prior calendar month or, for some trusts, by the 15th of the current month) are thus both added to the CPB write-up and distributed to investors on that distribution date.[7] For Write-Up First trusts, this write-up occurs prior to that day's distribution, per the CPB definition. For Pay First trusts, by contrast, the PSAs instruct that the CPB is "determined as of the close of business of the immediately preceding Distribution Date," thus excluding current-period subsequent recoveries from the CPB used for the current distribution and leaving the Section 5.04(b) write-up to occur after the distribution is made.

HBK makes little attempt to parse the interplay of these provisions. Instead, it simply reiterates its two prior arguments why Section 5.04(b) supposedly requires Pay First for all trusts: that a Trustee cannot "tak[e] into account" subsequent recoveries and determine whether the amount of a Realized Loss is reduced without first making the required distribution to investors; and that, because Section 5.04(b) comes after Section 5.04(a) in each PSA, it somehow follows that write-ups should be made after distributions. *See* HBK Response 11. As explained in our Response, neither argument holds water. *See* Tilden Response 12-13.[8]

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increase the Certificate Principal Balance . . ."); Affirmation of Anna Vinogradov in Support of Response Brief of Tilden Park, Dkt. No. 669 ("Vinogradav Opp. Aff."), Ex. E (BSABS 2005-AQ2 PSA, Art. I) (Definition of Realized Loss: "to the extent the Master Servicer receives Subsequent Recoveries with respect to any Mortgage Loan, the amount of the Realized Loss with respect to that Mortgage Loan will be reduced to the extent such recoveries are distributed to any Class of Certificates or applied to increase Excess Spread on any Distribution Date").

[7] *See* Vinogradov Aff., Ex. A (BSABS 2005-AQ2 PSA) at § 5.04(a) ("On each Distribution Date, an amount equal to the . . . Principal Funds for such Distribution Date shall be . . . distributed" to investors); Vinogradov Reply Aff., Ex. B (BSABS 2005-AQ2 PSA, Art. I) (defining Principal Funds as "all . . . Subsequent Recoveries collected during the related Prepayment Period (to the extent such . . . Subsequent Recoveries relate to principal)"); *id.* (Art. I) (definition of Prepayment Period: "As to any Distribution Date, the period commencing on the 16th day of the month prior to the month in which the related Distribution Date occurs and ending on the 15th day of the month in which such Distribution Date occurs").

[8] HBK further argues that the omission of "on previous Distribution Dates" as a modifier of Subsequent Recoveries in the CPB definition is not a matter for *espressio unius* but arises instead from the inclusion of earlier subsequent recoveries in the definition of Applied Realized Loss Amounts. *See* HBK Response 15-16. But under that reading,

C. The Governing Agreements' Interest Provisions Do Not Affect the Order of Operations

HBK's convoluted argument that the PSA interest provisions require Pay First (HBK Response 13-17) is plainly wrong. HBK's protracted discussion obscures the simple point that interest is not calculated, or paid, on subsequent recoveries until certificate balances are written up to account for them. This unsurprising result is dictated by the write-up instructions in the PSAs. *See* Vinogradov Aff., Ex. A (BSABS 2005-AQ2 PSA) § 5.04(b) ("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.").[9]

Other respondents have argued, conversely, that PSA interest provisions are without effect for Pay First trusts, thereby supposedly supporting a Write-Up First reading for all settlement trusts. This argument also fails. As just noted, the interest provisions refer to "*any* Interest Accrual Period preceding the distribution date" (emphasis added), meaning that written-up classes are not entitled to compensation for any interest forgone throughout the entire time they remained written down. This provision has no bearing on the order of operations.

III. Senior Bonds With Losses Should Be Written Up

In our opening and response briefs, we demonstrated that (1) the Settlement Agreement requires that "each" class of certificates be written up on account of the Settlement Payment; and (2) the Governing Agreements' write-up provisions do not conflict with this uniform write-up

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subsequent recoveries are added to the CPB pursuant to Section 5.04(b) on the *current* distribution date. Recognizing, rather than ignoring, that current write-up compels Write-Up First, the opposite of what HBK argues.

[9] The Settlement Agreement includes a similar provision. *See* Settlement Agreement § 3.06(b) ("Investors shall not be entitled to payment in respect of interest on the amount of such increases for any interest accrual period relating to the distribution date on which such increase occurs or any prior distribution date.").

instruction, because they do not apply to the Settlement Payment. *See* Tilden Br. 19-22; Tilden Response 20-22.

In its response, Nover – the only party contending that Settlement Payment write-ups should be limited to subordinate certificates – claims that the Governing Agreements' write-up provisions *do* apply to the Settlement Payment. Nover Response 11-13. Nover is wrong.

Crucially, Nover does not even attempt to rebut our showing that (a) the Governing Agreement write-up instructions apply only to subsequent recoveries that are *received by the Master Servicer and reduce the Realized Loss for a specific loan*; and (b) the Settlement Payment fails to satisfy these requirements, because it was not received by the Master Servicer and will not reduce the Realized Loss for any loan. *See* Tilden Br. 20-21. The Governing Agreements' write-up instructions simply do not apply to the Settlement Payment, which is why the Settlement Agreement supplies a write-up instruction of its own, in Section 3.06(b).

Unable to rebut this showing, Nover points instead to the Settlement Agreement's treatment of the Settlement Payment "as though [it] was a 'subsequent recovery'" for distribution purposes. *See* Nover Response 12-13. Nover's argument appears to be that, by treating the Settlement Payment in this fashion, the Settlement Agreement implicitly directed the Trustees to apply not only the PSAs' distribution provisions, but their write-up provisions as well.

This interpretation is defeated by the Settlement Agreement's plain terms. Most obviously, the interpretation would nullify the Settlement Agreement's own write-up instruction, which by its terms applies to all settling trusts. *See* Section 3.06(b).

In addition, this interpretation – apparently predicated on the notion that subsequent recoveries reduce Realized Losses for specific mortgage loans and thereby trigger the PSAs' write-up instructions (*see* Nover Response 11-12) – ignores that the Settlement Agreement *does*

not reduce individual loan losses on account of the Settlement Payment.[10] The Settlement Agreement's write-up instruction, Section 3.06(b), applies only to classes of certificates, not to individual loans. Moreover, Section 3.06(c) provides that the Settlement Payment will not reduce the aggregate loan losses suffered by each trust. *See* Tilden Br. 21-22 & n.16. Consequently, it is clear that the Settlement Payment does not reduce Realized Losses and is not treated under the Settlement Agreement as though it does so.[11]

CONCLUSION

For the foregoing reasons, as well as those set forth in Tilden Park's opening and responsive briefs, the Court should grant the relief requested in Tilden Park's Answer.

October 10, 2018
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[10] Realized Loss, as used in the PSAs, is a concept applicable to *individual* loans. *See, e.g.*, Vinogradov Aff., Ex. F (BALTA 2006-8 PSA, Art. I) (defining "Realized Loss" "as to any Liquidated Mortgage Loan"); *id.* (Art. I) (defining "Subsequent Recoveries" as "amounts received . . . by the Master Servicer . . . specifically related to a Liquidated Mortgage Loan . . . that resulted in a Realized Loss").

[11] Consistent with the Settlement Agreement's provisions, trustees implementing the Settlement Agreement for trusts not included in the Petition have written up class certificate balances to account for the settlement payments but have *not* reduced Realized Losses. *See* Tilden Br. 22 n. 17; *see also* Vinogradov Aff. Ex. H.

It is also worth noting that no provision of the PSAs requires Applied Realized Loss Amounts to comprise all Realized Losses. For examples of trusts where Realized Losses are never applied to senior classes and the trusts routinely have become undercollateralized, *see* DW/Ellington Response 9.