To be Argued by:
DANIELLE L. ROSE
(Time Requested: 15 Minutes)

New York Supreme Court

Appellate Division—First Department

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, NA, 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

(For Continuation of Caption See Inside Cover)

Appellate Case No.: 2020-02716

REPLY BRIEF FOR HBK PARTIES

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New York County Clerk's Index No. 657387/17

Appellants-Respondents

AEGON USA INVESTMENT MANAGEMENT, LLC, BLACKROCK FINANCIAL MANAGEMENT, INC., CASCADE INVESTMENT, LLC, FEDERAL HOME LOAN BANK OF ATLANTA, FEDERAL HOME LOAN MORTGAGE CORP., FEDERAL NATIONAL MORTGAGE ASSOCIATION, GOLDMAN SACHS ASSET MGMT L.P., VOYA INVESTMENT MGMT LLC, INVESCO ADVISERS, INC., KORE ADVISORS, L.P., METROPOLITAN LIFE INS. CO., PACIFIC INVESTMENT MGMT COMPANY LLC, TEACHERS INS. AND ANNUITY ASSOC. OF AMERICA, TCW GROUP, INC., THRIVENT FINANCIAL FOR LUTHERANS and WESTERN ASSET MGMT. CO.
(the "Institutional Investors")

– and –

Appellants-Respondents

AMERICAN GENERAL LIFE INSURANCE COMPANY, AMERICAN HOME ASSURANCE COMPANY, LEXINGTON INSURANCE COMPANY, NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA., THE UNITED STATES LIFE INSURANCE COMPANY IN THE CITY OF NEW YORK and THE VARIABLE ANNUITY LIFE INSURANCE COMPANY
(the "AIG Parties")

– and –

Appellants-Respondents

ELLINGTON MANAGEMENT GROUP, L.L.C. and DW PARTNERS LP
(the "Ellington and DW Parties")

– and –

Appellants-Respondents

TILDEN PARK INVESTMENT MASTER FUND LP on behalf of itself and its advisory clients, TILDEN PARK MANAGEMENT I LLC on behalf of itself and its advisory clients and TILDEN PARK CAPITAL MANAGEMENT LP on behalf of itself and its advisory clients
(the "Tilden Park Parties")

– and –

Appellants-Respondents

PROPHET MORTGAGE OPPORTUNITIES LP, POETIC HOLDINGS VI LLC, POETIC HOLDINGS VII LLC and U.S. BANK NATIONAL ASSOCIATION, solely in its capacity as Indenture Trustee for the Prophet and Poetic Trusts
(the "Prophet and Poetic Parties")

– and –

Appellant-Respondent

AMBAC ASSURANCE CORPORATION
("Ambac")

– and –

Appellants-Respondents

U.S. BANK NATIONAL ASSOCIATION, as NIM Trustee, U.S. Bank, solely in its capacity as Indenture Trustee for the HBK Trusts
(the "HBK Parties")

– against –

Respondent

NOVER VENTURES, LLC
("Nover")

– and –

Respondent

D.E. SHAW REFRACTION PORTFOLIOS, L.L.C.
("D.E. Shaw")

– and –

Respondent

STRATEGOS CAPITAL MANAGEMENT, LLC
("Strategos")

– and –

Respondents

OLIFANT FUND, LTD., FFI FUND LTD. and FYI LTD.
(the "Olifant Parties")

– and –

Respondents

GMO OPPORTUNISTIC INCOME FUND
and GMO GLOBAL REAL RETURN
(the "GMO Parties")

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CASES

U.S. Bank, solely in its capacity as Indenture Trustee for certain NIM Trusts holding direct interests in the HBK Trusts and solely at the direction of HBK, by its undersigned counsel, respectfully submits this reply brief in further support of the HBK Parties' Opening Brief (NYSCEF #59) ("HBK Opening Br.") appealing from the Decision and Order of Supreme Court, entered February 13, 2020.[1]

PRELIMINARY STATEMENT

In the Decision, Supreme Court issued three rulings affecting the HBK Trusts, which this Court reviews *de novo*. These rulings, as a matter of long-standing New York law, constitute clear error, notwithstanding Respondents' voluminous briefs to

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[1] All capitalized terms not defined herein shall have the meaning set forth in the HBK Opening Brief. As explained in footnote 1 of the HBK Opening Brief (which footnote the HBK Parties incorporate here by reference), U.S. Bank, solely in its capacity as Indenture Trustee of the HBK NIM Trusts (the "NIM Trustee"), and solely at the direction of HBK, submits this memorandum reflecting the positions of HBK. Further, 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 RMBS trusts at issue in the underlying settlement.

For purposes of resolving the HBK Parties' appeal, the Court generally need not wade into NYSCEF #74 ("Ellington/DW Br.") or #73 ("D.E. Shaw Br."), which address settlement trusts other than the HBK Trusts or adopt arguments set forth by other parties. There are also separate appeals at NYSCEF #60 (Ambac) and #58 ("Tilden Park Opening Br.") that need not be addressed to resolve this appeal. This brief thus focuses on NYSCEF #72 ("Olifant Br."), #75 ("Nover Br."), and #76 ("II/AIG Br."). To the extent other parties filed briefs making further arguments in support of Supreme Court's decision, they are addressed in substance herein.

the contrary. In trying to sustain these rulings, Respondents add words to or excise them from the contracts, fail to harmonize all terms, or seek to imply contractual provisions that are not part of those agreements. The Decision—which erroneously embraced those interpretations—should be reversed as to the HBK Trusts.

First, the Retired Class Provision, on its face, precludes both the write up of, and future payments to, the Zero Balance Classes. The Retired Class Provision contains three requirements: (i) it applies "on any Distribution Date after" the Certificate Principal Balances of certain classes of certificates have been reduced to zero; and on such Distribution Dates, the affected classes (ii) "will be retired" and (iii) "will no longer be entitled to distributions." (R. 3536 (PSA § 5.04(a)).) These commands are unambiguous and unqualified, and the provision does not allow for retired classes to be resuscitated. Respondents' reading of the provision—which interprets the term "retirement" to mean a temporary ineligibility for payments only so long as a class has a zero balance—improperly ignores these plain terms.

Second, Supreme Court erred by finding that the HBK Trust PSAs require the application of the Write-Up First Method. The HBK Trust PSAs do not address whether the RMBS trustees should distribute funds to classes of certificates before or after class Certificate Principal Balances are increased (or "written up") to reflect Subsequent Recoveries. Supreme Court erred by finding that a separate defined term mandates the Write-Up First Method. As Supreme Court and all Respondents agree,

Section 5.04(b)—the actual Subsequent Recovery Provision—does not say whether the RMBS trustees should apply the Pay First or Write-Up First Method. And the Certificate Principal Balance definition does not resolve the order of operations for Subsequent Recoveries. Rather, it just refers back to the Subsequent Recovery Provision (Section 5.04(b)), which itself does not address the order of operations. The HBK Trusts are thus silent on the order of operations. Because the Settlement Agreement requires the Pay First Method be applied to each trust's Allocable Share where the governing agreements are silent, the Court should order that the Pay First Method governs the distribution of each HBK Trust's Allocable Share.

Third, this Court should reverse Supreme Court's decision regarding overcollateralization. Its holding erroneously assumed that the defined term "Overcollateralization Amount" includes both payment of principal and write-up for Subsequent Recoveries. But the actual HBK Trust PSAs' text requires the Overcollateralization Amount to be calculated only "after taking into account the payment of principal." (R. 5292 (PSA § 1.01).) Given that payments of principal (governed by 5.04(a)(2)) and write-ups for Subsequent Recoveries (5.04(b)) are different procedures, set forth in different provisions, which may occur in a different sequence, there is no basis to presume that one necessarily includes the other.

ARGUMENT

I. SUPREME COURT ERRED BY PERMITTING BOTH DISTRIBUTIONS TO, AND WRITE UPS OF, ZERO BALANCE CLASSES

The Retired Class Provision gives three distinct commands as to Zero Balance Classes. (R. 3536 (PSA § 5.04(a)).) First, it applies on "any Distribution Date" after the class's Certificate Principal Balance "has been reduced to zero." Second, on any such Distribution Date, the class "will be retired." Third, on any such Distribution Date, the class "will no longer be entitled" to future distributions.

Supreme Court's ruling disregarded these requirements. Respondents offer no legitimate interpretation, grounded in the contract, to support that ruling. The Retired Class Provision's requirement that Zero Balance Classes "will be retired" *and* "will no longer be entitled to distributions" describes their ongoing, permanent status, not—as Respondents wrongly suggest—a temporary condition or a mere precondition to another action. (*See* Nover Br. at 44; Olifant Br. at 12.) The ruling on this issue below should be reversed.

A. The Retired Class Provision Prohibits Any Future Distributions to Zero Balance Classes.

Supreme Court erred by finding that payments of principal may be distributed to Zero Balance Classes. (R. 63-64 (Order at 38-39).) The Retired Class Provision prohibits distribution to Zero Balance Classes on "any Distribution Date after the Certificate Principal Balance of a Class of Class A Certificates or Class M

Certificates has been reduced to zero." (R. 3536 (PSA § 5.04(a)).) On all Distribution Dates after such an occurrence, those classes "will no longer be entitled to distributions." (*Id*.) This prohibition is unconditional and self-executing. Indeed, it does not require any action by any other party. The Retired Class Provision does not say that Zero Balance classes will be retired "*while* the Certificate Principal Balance has been reduced to zero," or that they will be retired "*until* the Certificate Principal Balance has been written up to an amount greater than zero." (*See* HBK Opening Br. at 28-29.) Supreme Court's decision should be reversed on this ground alone.

Respondents offer no reasoned explanation why Zero Balance Classes can receive future distributions, such as through the Settlement Payment. The plain language of the Retired Class Provision is absolute. Further, its inclusion after the payment waterfalls emphasizes that Zero Balance Classes cannot receive any further distributions: the Retired Class Provision applies "notwithstanding the foregoing" Section 5.04 waterfalls, and such waterfalls set forth the only method by which funds

are distributed to classes of certificates. (R. 3536 (PSA § 5.04(a)).) Thus, payments cannot be made to a Zero Balance Class certificate regardless of any write ups.[2]

Respondents' only response is circular and unpersuasive. Like Supreme Court, Respondents say if the Zero Balance Classes are written up, they are eligible as a natural consequence to receive subsequent distributions. (*See* R. 63 (Order at 38).) But it is not a natural consequence to receive distributions that the Retired Class Provision explicitly prohibits.

Further, Respondents' interpretation not only ignores the Retired Class Provision's plain terms, it renders its bar on future distributions superfluous. Section 5.04's plain terms already bar distributions to Class A and Class M certificates when the Certificate Principal Balance "is reduced to zero." R. 3533-3535 (PSA § 5.04(a) (providing for distributions "until the Certificate Principal Balance is reduced to zero").) By simple operation of the waterfall provisions, such classes will not receive funds when they have zero balances; no Retired Class Provision is needed to accomplish that outcome.

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[2] Respondents correctly note that the "notwithstanding" provision comes before, and does not refer to, the Subsequent Recovery Provision. But that is irrelevant. As explained in Point I.B below, the Retired Class Provision's retirement command strips Zero Balance Classes of their rights, including any right to be written up under Section 5.04(b).

In short, Respondents' interpretation of the Retired Class Provision contravenes New York law by "caus[ing] it . . . to have no consequence." *Matter of Dex Media, Inc. v. Tax Appeals Trib. of the Dep't of Taxation & Fin. of the State of N.Y.*, 180 A.D.3d 1281, 1283 (3d Dep't 2020) (a contract should be interpreted so that "every word and every provision is to be given effect" (quoting *Nielsen v. Preap*, 139 S. Ct. 954, 969 (2019))). This interpretation should be rejected.

B. The Subsequent Recovery Provision Does Not Override the Retired Class Provision.

The Subsequent Recovery Provision, Section 5.04(b), cannot help Respondents overcome the Retired Class Provision's prohibition on distributions to Zero Balance Classes. Supreme Court erred by improperly interpreting this provision in isolation rather than in harmony with all terms of the agreement. *See Natixis Real Estate Capital Tr. 2007-HE2 v. Natixis Real Estate Holdings, L.L.C.*, 149 A.D.3d 127, 134 (1st Dep't 2017) (applying the well-established principle that "contract provisions should be harmonized, if reasonably possible, so as not to leave any provision without force and effect" in interpreting RMBS PSA (citation and internal quotation marks omitted)).

Supreme Court's ruling—which Respondents defend here—was predicated on one critical point: that the Subsequent Recovery Provision, on its face, applies to all classes of certificates, without qualification. (R. 63 (Order at 38).) It then

reasoned that because that provision does not distinguish among classes of certificates, the Zero Balance Classes may be written up upon the trusts' receipt of Subsequent Recoveries and, thereafter, would be eligible for waterfall payments. (R. 63-64 (Order at 38-39).)

This is wrong under the contracts' terms and New York law. While, as Supreme Court found, "the write-up provisions do not limit the classes that may be written up on account of subsequent recoveries," (R. 63 (Order at 38)), other provisions limit its application. Contrary to Respondents' assertions and Supreme Court's Decision, the Subsequent Recovery Provision does not actually apply to all classes. (Olifant Br. at 9 (quoting R. 63) ("[T]he PSAs expressly 'provide for the balances of *all* classes of certificates to be written up by subsequent recoveries . . . .'") (emphasis added by Olifant Br.); *see also* Nover Br. at 36.)

First, the Certificate Principal Balance definition limits the application of Subsequent Recoveries solely to Classes A and M. It provides that Subsequent Recoveries are added to the Certificate Principal Balance "of such Certificate pursuant to Section 5.04(b)" only "in the case of a Class A Certificate or a Class M Certificate." (R. 3530 (PSA § 1.01).) Subsequent Recoveries are not applied to any other classes.

Second, as to Class A and Class M Certificates, the Retired Class Provision further limits the application of Subsequent Recoveries. The Retired Class Provision

unambiguously requires that on "any Distribution Date" after a class's certificate principal balance "has been reduced to zero," such class "will be retired and will no longer be entitled to distributions." (R. 3536 (PSA § 5.04(a)).) Once a class Certificate Principal Balance has been reduced to zero, by definition, it is retired and cannot be written up, as shown further below.

In short, Supreme Court erred by finding that the Subsequent Recovery Provision applies to all classes and at all times. It does not. Under the plain terms of the HBK Trust PSAs, it applies solely to Class A and Class M classes and solely before those class Certificate Principal Balances have been reduced to zero. New York law requires that the more specific terms of the Retired Class Provision and the Certificate Principal Balance definition control over the more generally applicable Subsequent Recovery provision. *Muzak Corp. v. Hotel Taft Corp.*, 1 N.Y.2d 42, 46 (1956) ("Even if there is an inconsistency between a specific provision and a general provision of a contract (we find none), the specific provision controls.")

C. Section 10.02 Does Not Modify or Override the Retired Class Provision.

Nor is there any contractual basis to "read" the Retired Class Provision "in conjunction with Section 10.02" such that retirement only becomes final and permanent when the Section 10.02 procedures are followed, as Respondents argue.

(*See* Olifant Br. at 13; *id.* at 17 ("'retirement' does not occur until the Trustee has taken the steps described in Section 10.02"); Nover Br. at 44-45).)[3]

First, retirement denotes finality, as Respondents concede. (*See* Olifant Br. at 7 (describing Section 10.02).) The term "retired" in both the Retired Class Provision and Section 10.02 has the same meaning: the final, permanent termination of such classes' rights. As this Court has held, the same term used in multiple parts of the same agreement "should presumptively be given the same meaning." *State v. R.J. Reynolds Tobacco Co.*, 304 A.D.2d 379, 380 (1st Dep't 2003) (internal citation omitted).

Second, the fact that there are two separate retirement provisions in the HBK Trust PSAs does not render "retirement" a temporary condition when used in the Retired Class Provision. The Retired Class Provision (unlike Section 10.02) is self-executing. It specifies that certain classes of certificates "will be retired" on "any Distribution Date after" the Certificate Principal Balance "has been reduced to zero." (R. 3536 (PSA § 5.04(a)).)[4] This applies whether the Certificate Principal Balance

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[3] All citations to "Section 10.02" are to Olifant's proposed Supplemental Record on Appeal, NYSCEF #69, in which Section 10.02 for the BSABS 2005-AQ2 PSA can be found at SR-2 to SR-3.

[4] Contrary to Respondent's argument (Nover Br. at 45), the fact that certificates "will be retired" reflects the inexorable consequence of an event that may or may not occur—the reduction of certain Certificate Principal Balances to zero—not a requirement of future action.

has been reduced to zero by payment of principal or allocation of realized losses. The fact that a certificate retired under the Retired Class Provision is "outstanding" just means that it has not been cancelled; it does not imply that it carries any further rights.[5]

Third, the Section 10.02 retirement conditions do not need to be satisfied for the Retired Class Provision to be enforced. (*Contra* Olifant Br. at 17 (arguing that in every trust, following Section 10.02's procedure is a prerequisite to "retirement").) There is no legitimate basis to read the HBK Trust PSAs that way. Section 10.02 and the Retired Class Provision do not even reference each other, and the HBK Trust PSAs' other provisions make clear that, had the parties intended to require Section 10.02's terms to govern the Retired Class Provision, they would have said so.

The HBK Trust PSAs expressly apply Section 5.04(c)—which is found in the same section as the Retired Class Provision—subject to Section 10.02. Section 5.04 refers to Section 10.02 *twice*, and it only applies "[s]ubject to Section 10.02 [t]hereof respecting the final distribution." (R. 3537 (PSA § 5.04(c)).) By contrast, the

[5] Nor does the fact that the "retired" certificates are still traded matter here. This is extrinsic evidence not before the Court. In any event, it just means some investors are betting on one interpretation of the contract. Class CE certificates are also still trading, reflecting other investors' beliefs in another interpretation.

Retired Class Provision does not invoke Section 10.02. As Section 5.04(c) demonstrates, where the HBK Trust PSAs require that the Section 10.02 procedure be followed, the agreements explicitly say so.[6]

Further, Section 10.02 is not the exclusive method by which a certificate is retired and its rights eliminated. Rather, it provides one mechanism for retirement that applies in specific situations. (*See* SR-2 (PSA § 10.02).) Respondents mistake a sufficient condition for retirement (Section 10.02) for a necessary one. (*See* Nover Br. at 46; Olifant Br. at 13.) In fact, Respondents concede that there is at least one other provision under which a certificate "no longer has any rights": Section 6.03, which applies "to cancel lost or mutilated certificates." (R. 14427 (BSABS 2006-HE1 PSA § 6.03).) There is no basis to find that these provisions are the exclusive mechanisms by which a class of certificates loses its rights.

In short, if the HBK Trust PSAs meant to instruct that the Zero Balance Classes "will be retired until the class is written up" or be "subject to Section 10.02 [t]hereof respecting the final distribution" (as Section 5.04(c) provides), the

[6] And, in contrast to Section 5.04(c), it would not make sense for the Retired Class Provision to refer to Section 10.02, which addresses the mechanics of "a final distribution." The application of the self-executing Retired Class Provision at issue here concerns Zero Balance Classes that have been retired due to the allocation of realized losses, i.e., the lack of a distribution.

contracts would so state. The contracts unambiguously contain no such instructions, and it is error to imply those terms.[7]

D. Respondents' Economic Interests Cannot Supplant the Retired Class Provision's Plain Language.

Respondents' arguments based on their own views of the HBK Trusts' economic structure merely reflect their individual interests and cannot displace the basic canon of New York contract law: that contracts among "sophisticated, counseled" parties will be enforced according to their terms. *See 2138747 Ontario, Inc. v. Samsung C & T Corp*., 31 N.Y.3d 372, 381 (2018) (quoting *Vermont Teddy Bear Co. v. 538 Madison Realty Co.*, 1 N.Y.3d 470, 472 (2004)).

Respondents maintain that it would be illogical for classes of certificates with very low balances to be eligible to be written up while Zero Balance Classes are permanently retired. (*See* Olifant Br. at 12; Nover Br. at 44.) But New York courts do not look behind the four corners of a written agreement among sophisticated parties to determine whether it is commercially sensible. *See Vigilant Ins. Co. v.*

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[7] Contrary to Respondents' arguments, interpreting "retired" to mean "having no further rights" does not render the second provision ("no longer entitled to receive distributions") superfluous. The Retired Class Provision appears at the end of the payment waterfalls in Section 5.04(a), and it applies "notwithstanding the foregoing" provisions. The inclusion of the general provision (no further rights) and the specific provision (no further distributions) makes clear that the Retired Class Provision not only limits the rights of the Zero Balance Classes to receive distributions but also applies more broadly.

Bear Stearns Companies, Inc., 10 N.Y.3d 170, 177 (2008) ("[U]nambiguous provisions of a[] . . . contract must be given their plain and ordinary meaning."). Instead, New York courts uniformly enforce unambiguous contractual provisions by their terms. Here, the Retired Class Provision unambiguously mandates that, without any further action by any party, the certificates (i) "will no longer be entitled to distributions," and thus cannot receive payments; and (ii) "will be retired," and thus cannot be written up. Supreme Court's ruling did not give effect to these terms and should therefore be reversed.

II. SUPREME COURT ERRED BY FINDING THE WRITE-UP FIRST METHOD GOVERNS THE APPLICATION OF HBK TRUST SUBSEQUENT RECOVERIES

Supreme Court erred in finding that the HBK Trust PSAs mandate the Write-Up First Method. Like Supreme Court, Respondents strain to find a term in the HBK Trust PSAs that does not exist. The HBK Trust PSAs are silent as to the order of

operations and, consequently, the Settlement Agreement's Pay First Method applies to each HBK Trust's Allocable Share.[8]

A. The HBK Trust PSAs Are Silent on the Order of Operations for Subsequent Recoveries.

Supreme Court erred in finding that the HBK Trust PSAs specify the Write-Up First Method. (R. 38-39 (Order at 13-14) (rejecting the arguments raised below that the HBK Trust PSAs are silent on the issue).) The HBK Trust PSAs contain no terms explicitly mandating the Write-Up First Method. They indisputably do not address the order of operations in the Subsequent Recovery Provision. (*See* R. 3537 (PSA § 5.04(b)).) And contrary to the Decision and Respondents' briefs, the Certificate Principal Balance does not resolve the order of operations either. Under New York law, courts should not "interpret an agreement as impliedly stating something which the parties have neglected to specifically include." *Global*

[8] No party disputes on appeal that the Settlement Agreement requires the Pay First Method, nor does any party dispute that the Settlement Agreement serves—at a minimum—as a gap filler. While Tilden Park contends that the Settlement Agreement goes even further and overrides any governing agreements' write-up method (Tilden Park Opening Br. at 18-21), this argument should be rejected as it impermissibly amends the governing agreements. (*See generally* NYSCEF #78 (GMO Br. opposing Tilden Park Opening Br.).) However, if the Court nonetheless finds that the Settlement Agreement dictates the order of operations, then the HBK Trusts must follow the Pay First Method regardless of the HBK Trust PSAs, and Supreme Court's decision on this issue should be reversed for that reason.

Reinsurance Corp. of Am. v. Century Indemnity Co., 30 N.Y.3d 508, 519 (2017) (internal citation and quotation marks omitted).

First, Supreme Court's interpretation of the Certificate Principal Balance definition elides the text of the agreement. Supreme Court held that "any" Subsequent Recoveries in the Certificate Principal Balance definition necessarily means all Subsequent Recoveries to be added "as of any Distribution Date," which it then held meant that those recoveries must be applied before payment. (R. 36-38 (Order at 11-13).) But the full text of the definition does not support this interpretation. The actual definition provides that "any Subsequent Recoveries pursuant to Section 5.04(b)" be added. (R. 3530 (PSA § 1.01) ("Certificate Principal Balance").) "Any" does not refer to the timing of the Subsequent Recoveries but rather those Subsequent Recoveries determined by Section 5.04(b), without reference to the timing thereof. Because Section 5.04(b) does not specify the order of operations in the HBK Trust PSAs, the Certificate Principal Balance definition cannot resolve whether Certificate Principal Balances are increased (or written up) before or after payment of principal.

Second, the HBK Trust PSAs' express provision addressing the order of operations for realized losses reinforces that the agreements are silent on the order of operations for Subsequent Recoveries. (*See* R. 3540 (PSA § 5.05(a)) (applying realized losses "after the actual distributions to be made on such date").) Realized

losses and Subsequent Recoveries are essentially mirror images of one another; indeed, they sit almost back to back in the HBK Trust PSAs. (R. 3537 (containing PSA §§ 5.04(b), 5.05).) The inclusion of explicit order of operations language in one provision, and the omission of such language in the other, reflects that the HBK Trust PSAs are silent as to the order of operations for Subsequent Recoveries. Contrary to Respondents' assertions, this is significant: it shows that the parties to the contracts knew how to prescribe the order of operations but did not do so for Subsequent Recoveries. Thus, the HBK Trust PSAs can only be reasonably interpreted as silent on the order of operations for Subsequent Recoveries.

Third, other parts of the Certificate Principal Balance definition—which specify timing for other actions—do not resolve the order of operations for Subsequent Recoveries. Respondents argue that, because certain other calculations include only amounts from previous Distribution Dates, the absence of a similar timing element for Subsequent Recoveries means that the Certificate Principal Balance must include current Subsequent Recoveries prior to distributions. The better reading of that silence, however, is silence. The Certificate Principal Balance is reduced for distributions and "Applied Realized Losses" on "previous" Distribution Dates. (R. 3530 (PSA § 1.01).) But assigning one order of operations for these calculations does not mean that the omission of the same order of

operations for Subsequent Recoveries requires the opposite treatment. Rather, it reflects silence as to the order of operations.[9]

Respondents' remaining arguments are unavailing. Implying an order of operations is not necessary to effectuate the parties' intent, as Supreme Court correctly recognized in finding that some governing agreements are silent as to the order of operations. (*See* R. 43 (Order at 18) (holding that "in the absence of a controlling provision in the Governing Agreements, that the group four Trusts are governed by the Settlement Agreement").) Because the order of operations is not necessary "to effectuate the intention of the parties," *Sacramento Nav. Co. v. Salz*, 273 U.S. 326, 329 (1927), New York courts should not interpret the "agreement as impliedly stating something which the parties have neglected to specifically include." *Global Reinsurance Corp.*, 30 N.Y.3d at 519 (internal citation and quotation marks omitted).

[9] To the extent Respondents rely on a recent Minnesota state-court decision, the order-of-operations issue in that case was undisputed. *See In the Matter of the MASTR Adjustable Rate Mortgages Trust 2007-1*, No. 62-TR-CV-18-46, Dkt. 177 at 4 (Minn. Dist. Ramsey Cty. Oct. 27, 2020) ("All parties taking a position on the issue, including Petitioner, are of the opinion that the PSAs support using the 'write up first' over the 'pay first' method."). That decision stands for the unremarkable proposition that different courts, confronted with different contracts, may reach different conclusions as to the order of operations.

And, contrary to Respondents' assertions that the Write-Up First Method must apply in order to facilitate distributions, that is simply not the case. RMBS trusts can and do operate without first writing up for Subsequent Recoveries. As Supreme Court correctly recognized, some trusts apply a Write-Up First Method; some apply a Pay First Method; and others do not specify any method at all. (*See* R. 41-43 (Order at 16-18).) In asserting that the Write-Up First Method must apply, Respondents are essentially just saying that their economic interests should prevail. There is no one "right" method; rather, the contractual terms determine the treatment of Subsequent Recoveries. As to the HBK Trust PSAs, those terms are silent about the order of operations.[10]

B. Because the HBK Trust PSAs Are Silent as to the Order of Operations, the Settlement Agreement's Pay First Method Governs Each HBK Trust's Allocable Share.

Despite Respondents' feigned surprise, written agreements often do not address every term or contingency. Under well-settled principles of contract interpretation, where a fully integrated agreement is silent, the issue may be resolved by the parties to the contract. *See Trs. of Freeholders & Commonalty of Town of*

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[10] This argument was preserved for appeal. While a party cannot "argu[e] on appeal a theory not advanced before the court of original instance" *Admiral Ins. Co. v. Marriott Int'l, Inc.*, 79 A.D. 3d 572, 572 (1st Dep't 2010), the Institutional Investors advanced this argument before Supreme Court, and Supreme Court ruled on it. (*See* Nover Br. at 48 n.16; R. 35 (Order at 10) ("The Institutional Investors argue that the Governing Agreements are silent as to the order of operations").)

Southampton v. Jessup, 173 N.Y. 84, 89-91 (1903) (where construction contract did not specify the material to be used, contracting party could select it); *see also* HBK Opening Br. at 26-27 (collecting cases). Here that resolution came in the form of the Settlement Agreement, and Supreme Court properly applied the Settlement Agreement's Pay First Method as a gap filler where the underlying contracts are silent. Indeed, no party disputes that, if the HBK Trust PSAs are silent, then the Settlement Agreement governs the order of operations. (*See* R. 35 (Order at 10).) Nor does any party dispute that the Settlement Agreement requires that the Pay First Method be applied. (*Id.*) Accordingly, Supreme Court's ruling on the HBK Trusts' order of operations should be reversed, and the Court should order that the Settlement Agreement's Pay First Method applies to the HBK Trusts.

III. SUPREME COURT ERRED BY NOT GIVING EFFECT TO THE HBK TRUSTS' OVERCOLLATERALIZATION PROVISIONS

The Petition recognized that, where the Pay First Method is applied to trusts with an overcollateralization feature, application of the governing agreements' plain language would result in some settlement funds being distributed through the excess cashflow waterfall. (R. 375 (Petition ¶ 34).) Supreme Court erred in interpreting the HBK Trust PSAs to avoid such outcome.

Respondents' arguments supporting this ruling improperly require either adding words to or disregarding terms of the agreements. Respondents contend that

distributions may be made under the excess cashflow waterfall only "[i]f the HBK Trusts had performed well, and the Overcollateralization Amount exceeded the Overcollateralization Target Amounts over time." (II/AIG Br. at 12.) But "[c]ourts may not, through their interpretation of a contract, add or excise terms or distort the meaning of any particular words or phrases, thereby creating a new contract under the guise of interpreting the parties' own agreements." *Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc.*, 30 N.Y.3d 572, 581 (2017). Here, Respondents' general description as to how they think the HBK Trust PSAs should work does not correspond to how the HBK Trust PSAs' text directs that the Overcollateralization Amount be determined.

A. Overcollateralization Must Be Calculated after Taking into Account Only the "Payment of Principal."

The HBK Trust PSAs require that the Overcollateralization Amount be calculated after taking into account "the payment of principal." R. 5292 (PSA § 1.01 ("Overcollateralization Amount").) Supreme Court erred by interpreting "payment of principal" to mean both payment of principal and the write-up for Subsequent Recoveries. While Supreme Court correctly notes that both accounting functions "take place upon distribution of Subsequent Recoveries," (R. 49 (Order at 24)), that is irrelevant because the HBK Trust PSAs do not actually calculate the Overcollateralization Amount after factoring in application of Subsequent

Recoveries. Instead, the Overcollateralization Amount is calculated "after taking into account" solely the payment of principal. (*See* R. 5292 (PSA § 1.01).) Because Supreme Court's interpretation modifies the HBK Trust PSAs, it should be reversed. *Nomura*, 30 N.Y.3d at 581 ("Courts may not, through their interpretation of a contract, add or excise terms or distort the meaning of any particular words or phrases . . . ."); *2138747 Ontario, Inc.*, 31 N.Y.3d at 381 (agreement among sophisticated, counseled parties must be applied as written); *Greenfield v. Philles Records*, 98 N.Y.2d 562, 570-71 (2002) ("if 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").[11]

In support of Supreme Court's interpretation, Respondents try to collapse two distinct parts of the HBK Trust PSAs, arguing that the payment of principal must necessarily include write-ups for Subsequent Recoveries. They say that applying the overcollateralization provision as written relies on a "fictitious moment" between the payment of principal and the write-up for Subsequent Recoveries. (*See* II/AIG Br. at 18.) But, as shown by the long-running order of operations dispute, payments

[11] As previously explained (*see* HBK Opening Br. at 36-37), trusts that follow the Write-Up First Method will not distribute settlement proceeds as excess cashflow, but if a trust follows the Pay First Method and includes an overcollateralization feature, then some portions of the settlement payment may be distributed as excess cashflow.

of principal and write-ups for Subsequent Recoveries are different actions, set forth in different provisions ((5.04(a) vs. 5.04(b)), that can take place in different sequences depending on a trust's governing agreements. While these actions must both eventually take place to address changes to a trust's assets and liabilities (*see* R. 49 (Order at 24)), that does not mean they occur simultaneously. As Supreme Court found, some RMBS trusts apply the Write-Up First Method, others apply the Pay First Method, and others are silent. (*See* R. 41-43 (Order at 16-18).) This variation leaves no doubt that payments and write-ups are different procedures that can take place at different times.

Even if the write-up process were "integral to the payment of Subsequent Recoveries" (*see* II/AIG Br. at 15), that does not mean that it must take place concurrently with payments of principal. Respondents argue that both the write-up provision and the payment provision appear in the same "Distributions" section of the HBK Trust PSAs. But the Subsequent Recovery provision (5.04(b)) is separate from the contractual terms governing payment of principal (5.04(a)(2)), and the Overcollateralization Amount expressly does not refer to the whole "Distributions" section; it refers to a sub-part thereof. The HBK Trust PSAs do not instruct the RMBS trustees to calculate the Overcollateralization Amount "after taking into account distributions pursuant to Section 5.04," which includes payments of principal, write ups for subsequent recoveries, as well as payments under the interest

and excess cashflow waterfalls. Instead, it includes one component alone: "the payment of principal." (*See* R. 5292 (PSA § 1.01).) If the HBK Trust PSAs intended that the Overcollateralization Amount include both payments of principal and write ups for Subsequent Recoveries, it would include both.

Under New York law, "[t]he best evidence of [parties'] intent is the parties' writing." *Marin v. Constitution Realty, LLC*, 28 N.Y.3d 666, 673 (2017); *see also CNH Diversified Opportunities Master Account, L.P. v. Cleveland Unlimited, Inc., No. 42*, -- N.E.3d --, 2020 WL 6163305, at *5 (N.Y. Oct. 22, 2020) (a contract "must be enforced according to the plain meaning of its terms" (internal citation and quotation marks omitted)). Here, there is no legitimate basis to infer that the term "payment of principal" encompasses more than what it says.

B. The HBK Trust PSAs' Written Terms Control.

Unable to find support for Supreme Court's interpretation in the text of the HBK Trust PSAs, Respondents argue that the HBK Trusts do not, as a general matter, have more assets than liabilities and thus payments under the excess cashflow waterfall would be improper. (R. 50 (Order at 25).) Essentially, they argue that it makes more sense to ignore the overcollateralization terms because the trust and waterfall structure was "intended to insulate senior classes from realized losses." (*Id.*).

But the HBK Trust PSAs provide a specific, unambiguous formula for calculating overcollateralization that must be applied as written. Overcollateralization must be assessed on each monthly "Distribution Date," (*see* R. 5292 (PSA § 1.01) ("Overcollateralization Release Amount")), not as a general matter. Respondents' insistence that the plain language of the HBK Trust PSAs ought to be ignored in favor of a hypothetical, generalized evaluation of the trust's assets and liabilities over time contravenes New York law requiring the agreements to be applied as written. *In re Bank of N.Y. Mellon*, 56 Misc. 3d 210, 222, 225 (Sup. Ct. N.Y. Cty. 2017) ("the general intent of the [g]overning [a]greements to protect senior certificateholders over junior certificateholders does not operate to override the plain and unambiguous terms of the [s]ettlement [a]greement").[12]

Respondents' sky-is-falling arguments about the supposedly dreadful consequences of applying the agreement as written are not persuasive. Parties with interests in the HBK Trusts' distributions should have anticipated that the overcollateralization terms would be applied as written because the HBK Trust PSAs

[12] Indeed, as shown by the dispute concerning the write-up of senior certificates (Nover Br. at 24-25), not all "senior" certificates get paid first, and not all excess cashflow payments exclusively go to the "junior" certificates (HBK Opening Br. at 40 & n.5). As Nover acknowledges, each RMBS trust "has its own idiosyncrasies and unique features and . . . it is improper to assume that these idiosyncratic differences are anything but intention." (Nover Br. at 32.)

are governed by New York law, and New York courts are emphatic that unambiguous agreements between sophisticated, counseled parties must be enforced as written. *2138747 Ontario, Inc.*, 31 N.Y.3d at 381. Indeed, another Article 77 court that adjudicated the administration and distribution of an RMBS settlement payment likewise enforced the overcollateralization terms as written, finding that any general structure designed to "create a cushion of excess mortgage loans that will insulate the trust's certificateholders from losses" did not supersede the actual agreements' overcollateralization terms. *In re Bank of N.Y. Mellon*, 56 Misc. 3d at 213, 222, 225. And Petitioners here did not even seek instruction on this issue. They sought instruction on five other issues, covering numerous aspects of the administration and distribution of the settlement funds, but not on this one. (*See* R. 365 (Petition ¶ 8).)

In short, applying the overcollateralization provisions as written does not upend any reasonable expectations of the parties; rather, it gives effect to them.

CONCLUSION

For the reasons set forth above, the HBK Parties respectfully request that this Court reverse Supreme Court's decision as it relates to the HBK Trusts and direct the RMBS trustees: (i) to enforce the Retired Class Provision by its plain terms and not increase (or "write up") the class Certificate Principal Balances of, or make distributions to, Zero Balance Classes upon each HBK Trust's receipt of Subsequent

Recoveries; (ii) to apply the Pay First Method to each HBK Trust's Allocable Share; and (iii) to give effect to the overcollateralization provisions and, where an HBK Trust's Allocable Share results in Overcollateralization Release Amounts, distribute excess cashflow as directed by the HBK Trust PSAs.

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