
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),

**Appellate
Case No.:
2020-02716**

Petitioners,

For Judicial Instructions under CPLR Article 77
on the Distribution of a Settlement Payment

(For Continuation of Caption See Inside Cover)

OPENING BRIEF FOR AMBAC ASSURANCE CORPORATION

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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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PRELIMINARY STATEMENT

This CPLR Article 77 proceeding concerns the proper distribution of a settlement payment being made to hundreds of residential mortgage-backed securities (“RMBS”) trusts (the “Settlement Trusts”). In 2014, JPMorgan Chase & Co. and its affiliates (collectively, “JPMorgan”) agreed to pay \$4.5 billion to the Settlement Trusts pursuant to a settlement agreement with certain RMBS investors (the “Settlement Agreement”). Based on a formula set forth in the Settlement Agreement, an allocable portion of the settlement payment (“Allocable Share”) was required to be transferred to each Settlement Trust for further distribution in accordance with the terms of each Settlement Trust’s governing agreement (the “Governing Agreements”).

In this Article 77 proceeding, the Petitioner Trustees and Payment Administrators of the Settlement Trusts seek further judicial instruction concerning the proper distribution of the Allocable Share for each trust. The Petitioners raise a number of contractual issues relevant to the Settlement Trusts’ distribution methodologies for which they claim that the Settlement Agreement and Governing Agreements do not provide clear guidance. Ambac Assurance Corporation (“Ambac”) insured certain classes of certificates issued by three of the Settlement

Trusts (the “Ambac Trusts”)¹ and has made *over \$200 million* in claims payments to those trusts. In 2018, Ambac appeared in this proceeding to provide its views concerning the proper interpretation of the relevant contracts.

In its February 13, 2020 decision concerning the issues raised by the Petition, the IAS Court erred in two key respects. First, with respect to the 2006 Trusts, the IAS Court failed to give effect to a contractual provision which specifically grants Ambac a priority right to receive Subsequent Recoveries before they are paid to investors as a means to compensate Ambac for claims payments that it made to those trusts pursuant to its insurance policies. Because Ambac has made *over \$150 million* in claims payments to the 2006 Trusts—well in excess of the \$31 million Allocable Shares due to those trusts under the Settlement Agreement—Ambac is entitled to receive the entire Allocable Shares for the 2006 Trusts. Second, with respect to the 2005 Trust, the IAS Court failed to recognize that the relevant contract requires the balances of *all* classes of certificates to be written up to account for the settlement payment, including “senior” certificates. This Court should reverse the IAS Court’s ruling in these two narrow respects.

STATEMENT OF THE QUESTIONS PRESENTED

1. Where Ambac has a contractual right to receive certain funds “first,” can other interested parties receive those funds ahead of Ambac?

¹ The Ambac Trusts include GPMF 2005-AR5 (the “2005 Trust”), and GPMF 2006-AR2 and GPMF 2006-AR3 (the “2006 Trusts”).

2. Where the trusts' contract language and structure indicate that the balances of "senior" certificates must be written up to account for trust recoveries, should the Court require the balances of such certificates to be written up to account for the Allocable Shares?

BACKGROUND

A. Ambac's Role as Certificate Insurer

Ambac serves as the "Certificate Insurer" for certain classes of certificates issued by the three Ambac Trusts: the Class I-A-2 and II-A-2 certificates in the GPMF 2006-AR2 Trust, the Class II-A-2 certificates in the GPMF 2006-AR3 Trust, and the Class II-A-2 and III-A-2 certificates in the GPMF 2005-AR5 Trust (the "Insured Certificates"). As the Certificate Insurer, Ambac issued financial guaranty insurance policies (the "Policies")² that protect holders of Insured Certificates in two ways. First, Ambac compensates holders for shortfalls in scheduled interest payments. Second, when the balances of the Insured Certificates are written down to account for losses realized on the mortgage loans held by the trust ("Realized Losses"),³ Ambac pays holders the amount of those

² (R.4607-4647.)

³ Realized Losses in a trust principally occur when a deficiency balance remains after the liquidation of an underlying mortgage loan, *e.g.*, when the proceeds from a foreclosure are less than the outstanding loan balance owed by the borrower. The PSA specifies how and when Realized Losses are allocated to particular classes of certificates, resulting in "write downs" of those certificates' balances (*i.e.*, reductions in the maximum amounts that holders of those certificates can receive).

Realized Losses. As part of the bargain, the pooling and servicing agreement (“PSA”) that governs each Ambac Trust gives Ambac certain rights to recover its claims payments from the securitization trust.

Ambac’s core obligation under its Policies is to pay the “Deficiency Amount” on each Distribution Date (typically the 25th of each month). (R.4610 (GPMF 2006-AR2 Certificate Insurance Policy (Definitions of “Insured Amounts” and “Insured Payments”))).) The Deficiency Amount is the sum of interest shortfalls for and Realized Losses allocable to the Insured Certificates on a given Distribution Date. (R.4609 (definition of “Deficiency Amount”).) At the time these issues were addressed below, Ambac had paid more than \$200 million in claims payments due to Realized Losses in the three Ambac Trusts,⁴ but had received less than \$500,000 in reimbursements for those trusts.

B. The Settlement Agreement

As explained more fully in the opening brief of the Institutional Investors, AIG, DW, and Ellington,⁵ the Settlement Agreement provides that the

⁴ Specifically, at the time this matter was briefed below, Ambac had made over \$68 million in claims payments due to Realized Losses to the insured classes of the GPMF 2005-AR5 Trust, over \$44 million in such claims payments to the insured classes of the GPMF 2006-AR2 Trust, and over \$105 million in such claims payments to the insured classes of the GPMF 2006-AR3 Trust. (R.3634-3635.)

⁵ The “Institutional Investors” include 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

Allocable Share of the \$4.5 billion settlement payment for each Settlement Trust must be treated as though it is a “Subsequent Recovery” under each trust’s Governing Agreement. (R.418 (Settlement Agreement § 3.06(a)).) In general terms, Subsequent Recoveries function as reversals of previous Realized Losses. In the ordinary course, the trusts might receive Subsequent Recoveries through additional collections on mortgage loans that previously experienced losses. In the Settlement Agreement, the parties agreed that the extraordinary, one-time settlement payment from JPMorgan would be treated as a Subsequent Recovery and distributed in accordance with the requirements of each Settlement Trust’s PSA.

C. The Article 77 Proceeding

After the Settlement Agreement was approved by the New York Supreme Court in August 2016,⁶ the Petitioners initiated this Article 77 proceeding seeking judicial instruction concerning the proper method by which to distribute the settlement funds in 270 of the Settlement Trusts. Petitioners sought instructions on several issues relevant to the distribution methodology, the

Assoc. of America, TCW Group, Inc., Thrivent Financial for Lutherans, and Western Asset Mgmt. Co. “AIG” includes 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. “DW” refers to DW Partners LP. “Ellington” refers to Ellington Management Group, L.L.C.

⁶ See *Matter of U.S. Bank N.A. v. Federal Home Loan Bank of Boston*, No. 652382/2014, 2016 WL 9110399 (Sup. Ct., N.Y. Cty., Aug. 12, 2016).

resolution of which would determine which holders of different classes of certificates would receive the Allocable Shares paid to each trust. Ambac and a number of other interested parties responded to the Petition, appearing with respect to the particular Settlement Trusts in which they held interests and advocating for particular distribution methodologies for those trusts.

As relevant to Ambac’s appeal, two key issues were disputed:

(i) whether Ambac has a priority right to receive the Allocable Shares for the 2006 Trusts as partial reimbursement for the claims payments it has made to those trusts, and (ii) whether the “senior” certificates issued by the 2005 Trust are eligible to have their balances written up to account for the Allocable Share received by that trust.⁷

First, Ambac argued that it is entitled to receive the Allocable Shares for the 2006 Trusts pursuant to the clear terms of the trusts’ PSAs. In particular, the PSAs for the two 2006 Trusts have a special provision that governs the distribution of Subsequent Recoveries—as opposed to principal payments collected in the normal course—and provides that “Subsequent Recoveries will be allocated *first* to the Certificate Insurer” as compensation for claims payments it

⁷ This second contractual interpretation issue applies equally to the 2006 Trusts; however, Ambac argued that the IAS Court need not reach this issue with respect to the 2006 Trusts because a separate contractual provision (Section 6.02) grants Ambac a priority right to receive the *entire* Allocable Shares for those trusts. (R.3628.) Ambac argued in the alternative that the senior certificates for the 2006 Trusts should likewise be written up to account for the Allocable Shares. (R.989.)

previously made. (R.3625-3628 (citing GPMF 2006-AR2 PSA §§ 6.02(b), (c)).) It is only *after* the Certificate Insurer has received the Subsequent Recoveries to which it is entitled that any remaining funds may be distributed to investors through the “waterfall” provision controlling the distribution of principal funds. (R.13728-13730 (citing PSA § 6.01).) Because the \$31 million Allocable Shares due to the 2006 Trusts under the Settlement Agreement are dwarfed by the over \$150 million in claims payments Ambac has made to those two trusts, Ambac argued it is entitled to receive the entire Allocable Shares for the 2006 Trusts. (R.3623.)

Second, Ambac argued that the Allocable Share for the 2005 Trust should be applied to write up the balances of *all classes* of certificates that were written down due to Realized Losses, including senior certificates. (R.3629-3630.) Ambac acknowledged that it did not have a priority right to receive the entire Allocable Share for the 2005 Trust; rather, Ambac relied upon its subrogation right to stand in the shoes of the holders of Insured Certificates and receive the settlement distributions otherwise due to those holders. (R.3629.)

D. The IAS Court’s Decision

On February 13, 2020, the IAS Court issued a lengthy ruling addressing all the issues raised by parties appearing in this proceeding. (R.25-71.) As relevant here, the court rejected Ambac’s argument that it has a priority right to

receive the entire Allocable Shares for the 2006 Trusts pursuant to PSA Section 6.02, holding instead that the Allocable Share must be distributed through Section 6.01, which is the trusts’ general principal distribution waterfall. (R.67-68.) The court attempted to “reconcile” Sections 6.01 and 6.02 by holding that Ambac is entitled to “receive the pro rata payment designated for the [insured] A2 certificates” under the waterfall, “as reimbursement for the claim payments Ambac made to the A2 certificateholders.” (R.67-68.) In other words, the IAS Court held that Ambac is entitled to receive any portion of the settlement payment that would otherwise be due to the insured certificates.

With respect to the 2005 Trust, the IAS Court “reject[ed] Ambac’s claim that the PSA authorizes the write-up of senior certificates.” (R.68.) Rather, the court held that only the “subordinate” classes of certificates are eligible to be written up. (R.60; R.68.) The combined effect of the IAS Court’s rulings is that Ambac stands to receive *nothing* from the Settlement Agreement—despite its over \$200 million in claims payments to the 2005 Trust and the 2006 Trusts.

Ambac timely appealed the IAS Court’s decision. (R.15-16.)

STANDARD OF REVIEW

The questions presented are legal issues subject to *de novo* review by this Court. *See In re Part 60 RMBS Put-Back Litig.*, 155 A.D.3d 482, 483 (1st Dep’t 2017); *Gulf Ins. Co. v. Transatlantic Reinsurance Co.*, 13 A.D.3d 278, 279

(1st Dep’t 2004) (“a de novo standard of review applies because the IAS court interpreted a contract provision . . . as a matter of law”) (citation omitted).

ARGUMENT

I. THE IAS COURT ERRED BY FAILING TO GIVE EFFECT TO CONTRACTUAL PROVISIONS THAT PROVIDE AMBAC WITH A PRIORITY RIGHT TO RECEIVE “SUBSEQUENT RECOVERIES”

Under New York law, it is a cardinal rule of contract interpretation that a contract must be construed “in a way that affords a fair meaning to all of the language employed by the parties” and “leaves no provision without force and effect.” *Consol. Edison Co. of N.Y. v. Allstate Ins. Co.*, 98 N.Y.2d 208, 221-22 (2002) (citation omitted). The IAS Court’s ruling ran afoul of these principles because it failed to give effect to contractual provisions that grant Ambac a priority right to receive Subsequent Recoveries obtained by the 2006 Trusts. Specifically, PSA Section 6.02 provides that Subsequent Recoveries are deposited into the Custodial Account, where they are “*first*” used to compensate Ambac for any claims payments it has made on account of prior losses. (R.3708 (GPMF 2006-AR2 PSA §§ 6.02(b), (c)).) Only after that obligation has been satisfied are any remaining Subsequent Recoveries distributed to investors under the general principal distribution “waterfall.” (R.3705-3708 (PSA § 6.01).)

The IAS Court failed to give effect to Section 6.02. Instead of attributing to the word “first” its ordinary meaning, *i.e.*, before all others, the IAS

Court construed it to mean: ahead of the holders of insured certificates, but at the same time as the holders of certain uninsured certificates. This was error. The court should have interpreted Section 6.02 in accordance with its plain meaning. This Court should reverse the IAS Court’s ruling and give effect to Ambac’s bargained-for contractual rights.

A. PSA Section 6.02 Requires Subsequent Recoveries To Be Paid “First” To Ambac Directly From the Custodial Account

The plain text of PSAs for the 2006 Trusts requires that Subsequent Recoveries are paid to Ambac *before* these funds are distributed to certificateholders through the general principal distribution waterfall. The PSAs for the 2006 Trusts contain new language in Section 6.02 that was not present in the 2005 Trust, and that specifically addresses the distribution of Subsequent Recoveries. (R.3708 (PSA § 6.02 (titled “Allocation of Losses and Subsequent Recoveries”))).) At the outset, Section 6.02(b) provides that Subsequent Recoveries are deposited into the trust’s “Custodial Account.” (*Id.* (PSA § 6.02(b) (“[I]n the event that the Servicer receives any Subsequent Recoveries, the Servicer shall deposit such funds into the Custodial Account . . .”))).) The Custodial Account holds certain funds before they are transferred once per month to the Distribution Account, from which they are distributed to the holders of certificates. (R.3690-3691 (PSA § 4.01).)

Once deposited into the Custodial Account, Section 6.02(b) provides that Subsequent Recoveries are “*first* used to pay any amounts owed to the Certificate Insurer as set for[th] in Section 6.02(c).” (R.3708 (PSA § 6.02(b)) (emphasis added).) Section 6.02(c), in turn, provides:

*Subsequent Recoveries will be allocated first to the Certificate Insurer for payment on any Reimbursement Amounts for such Distribution Date in respect of any Deficiency Amount described in clauses (a)(2) or (b)(y) of such definition, but only to the extent of the portion of Subsequent Recoveries that were paid by the Certificate Insurer for Realized Losses that were allocated to Class I-A-2 Certificates or II-A-2 Certificates, as applicable.*⁸

(*Id.* (PSA § 6.02(c)) (emphasis added).) Thus, Ambac is entitled to be reimbursed “to the extent of” the amounts it has paid to the trust “for Realized Losses.” (*Id.*) In other words, if Ambac has previously made claims payments to the trust due to Realized Losses, it is entitled to be reimbursed for those claims payments from any

⁸ The “Reimbursement Amount” is defined in Ambac’s Policies as “the sum of (i) all Insured Payments paid by the Certificate Insurer, but for which the Certificate Insurer has not been reimbursed prior to such Distribution Date pursuant to Section 6.01 of the Agreement, plus (ii) interest accrued thereon” (R.4611 (GPMF 2006-AR2 Certificate Insurance Policy).)

Section 6.02(c) limits the portion of the total Reimbursement Amount that is payable to Ambac under this provision to that made “in respect of any Deficiency Amount described in clauses (a)(2) or (b)(y) of such definition.” (R.3708 (GPMF 2006-AR2 PSA § 6.02(c)).) This clause has the effect of limiting the payment of Reimbursement Amounts to those attributable to claims payments Ambac made *due to Realized Losses*, as opposed to claims payments made due to interest shortfalls. (R.3648 (definition of “Deficiency Amount”).)

It is undisputed that Ambac has paid over \$150 million in claims payments to the insured classes of the 2006 Trusts which satisfy this definition. (R.3634-3635.)

Subsequent Recoveries “first”—*before* the Subsequent Recoveries are distributed to any other parties. (*Id.*)

There were sound reasons for giving Ambac priority in receiving Subsequent Recoveries in the 2006 Trusts. As explained above, Subsequent Recoveries generally “reverse” Realized Losses. When the 2006 Trusts experienced such Realized Losses, Ambac was required to make claims payments to the Trustee for the benefit of the holders of Insured Certificates, pursuant to its Policies. As a corollary, when the trusts later obtain Subsequent Recoveries that reverse the prior losses, the PSA provides that those recoveries are given special treatment. Subsequent Recoveries are *not* distributed through the principal distribution waterfall in the normal course; rather, they are first used to compensate Ambac for the amounts it has paid out to the trusts for Realized Losses.

Nevertheless, the IAS Court held that the Allocable Shares for the 2006 Trusts must be paid through the principal distribution waterfall set forth in Section 6.01, effectively giving Section 6.01 precedence over Section 6.02. (R.67-68.) In so holding, the IAS Court apparently credited the position of the Institutional Investors, which had argued that Subsequent Recoveries are included in the definition of the “Principal Funds” that are distributed through the waterfall. (R.10859-10862.) Specifically, the term “Principal Funds” is defined to include certain “Liquidation Proceeds,” which is, in turn, defined to include Subsequent

Recoveries. (R.3658-3659.) Such Principal Funds are indeed subject to Section 6.01’s waterfall provisions. (R.3705-3708.)

However, this reasoning overlooks an important qualification in the definition of Principal Funds that supports Ambac’s position. The definition of Principal Funds does not include Subsequent Recoveries that have been withdrawn directly from the Custodial Account *before* any such funds reach the Distribution Account:

Principal Funds: With respect to each Loan Group and each Distribution Date . . . (g) all Liquidation Proceeds collected during the related Prepayment Period (or, in the case of *Subsequent Recoveries*, during the related Due Period) on the Mortgage Loans in the related Loan Group, to the extent such Liquidation Proceeds relate to principal, *in each case to the extent remitted by the Servicer to the Distribution Account pursuant to this Agreement . . .*⁹

(R.3658-3659 (emphasis added).) This definition contemplates that there are some Subsequent Recoveries that are *not* “remitted . . . to the Distribution Account” from the Custodial Account and, thus, never become Principal Funds subject to Section 6.01’s waterfall—namely, the Subsequent Recoveries that are paid directly to Ambac pursuant to Section 6.02. It is only *after* Ambac has been reimbursed “first” for its claims payments pursuant to Section 6.02 that any remaining

⁹ None of the other components of Principal Funds contains a similar carve-out.

Subsequent Recoveries would flow from the Custodial Account to the Distribution Account for eventual distribution through the waterfall.

The IAS Court failed to construe these contractual provisions together in a way that gives effect to each of them. Because the definition of Principal Funds makes clear that Subsequent Recoveries are distributed under Section 6.01 *only* to the extent they are transferred from the Custodial Account to the Distribution Account, the correct way to give full effect to the special treatment of Subsequent Recoveries provided by PSA Sections 6.02(b) and (c) is to pay Ambac its share of the Subsequent Recoveries *directly from the Custodial Account* before any such funds flow into the Distribution Account and become Principal Funds that are distributed under Section 6.01. This construction honors the command that “Subsequent Recoveries will be allocated *first* to the Certificate Insurer.” (R.3708 (PSA § 6.02(c)) (emphasis added).) *See Greenfield v. Philles Records*, 98 N.Y.2d 562, 569 (2002) (“[A] written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms.”).

Critically, the Custodial Account is *not* the same account that feeds the principal distribution waterfall; rather, funds flow into the waterfall from the *Distribution Account*. (R.3705 (PSA § 6.01).) The Custodial Account is located “upstream” from the Distribution Account (R.3690-3692 (PSA §§ 4.01, 4.02, 4.03)); any funds in the Custodial Account are then transferred to the Distribution

Account on a specified date each month. (R.3691 (PSA § 4.02(d)).) It is only the funds that actually reach the Distribution Account that are subject to the waterfall provisions set forth in Section 6.01. (R.3705 (PSA § 6.01) (“On each Distribution Date, an amount equal to the Interest Funds and Principal Funds for such Distribution Date shall be withdrawn by the Trustee *from the Distribution Account to the extent of funds on deposit therein* and distributed for such Distribution Date”) (emphasis added); *see also* R.3693 (PSA § 4.04(c)).)

Instead of adopting the reasoning set forth above, the IAS Court attempted to “reconcile” PSA Sections 6.01 and 6.02 by reading the latter as merely allowing Ambac to receive Subsequent Recoveries before the holders of insured certificateholders under the waterfall. (R.67-68.) But there was no conflict between those two provisions that needed to be reconciled. Read together, the relevant PSA provisions provide a clear sequencing of events relating to the payout of Subsequent Recoveries. The IAS Court should have given effect to the plain meaning of Section 6.02 and enforced Ambac’s right to receive Subsequent Recoveries “first”—before all other interested parties. *See Greenfield*, 98 N.Y.2d at 569.

Indeed, the IAS Court’s interpretation of Section 6.02 would leave Ambac with no greater rights in the 2006 Trusts than it has in the 2005 Trust, where the PSA *lacks* the special priority provision that was added in Section 6.02

for the 2006 Trusts. The very different reimbursement provision for which Ambac bargained with respect to the 2006 Trusts must be given force and effect. *See Consol. Edison Co.*, 98 N.Y.2d at 221-22.

B. Ambac Does Not Seek a Windfall

Before the IAS Court, the Institutional Investors argued that paying Ambac the entire Allocable Shares for the 2006 Trusts would result in a “windfall” to Ambac. (R.10845.) Nothing could be further from the truth. It is perfectly reasonable that the PSA requires those funds to be used “first” to reimburse Ambac, given that it was *Ambac* that suffered severe financial consequences as a result of the trusts’ losses. It is undisputed that Ambac has paid *over \$150 million* in claims payments to compensate the 2006 Trusts for Realized Losses. Under the Settlement Agreement, the 2006 Trusts are due to receive Allocable Shares that represent a small fraction of Ambac’s claims payments—approximately \$10 million for the GPMF 2006-AR2 Trust, and approximately \$21 million for the GPMF 2006-AR3 Trust. Even after receiving those amounts, Ambac will still have made over \$100 million in unreimbursed claims payments, with no significant recoveries on the horizon.¹⁰ There is nothing unfair about Ambac obtaining this partial and entirely inadequate recovery.

¹⁰ In contrast, the holders of the most senior certificates (like the Institutional Investors) had suffered minimal, if any, losses. In the GPMF 2006-AR2 Trust, the Class I-A-1 and II-A-1 certificates had no Realized Losses *at all*. (R.10870-10878 (GPMF 2006-AR2 Remittance Report).) In the GPMF 2006-AR3 Trust, the Class II-A-1 certificates, with an original face value

Accordingly, this Court should reverse the IAS Court's ruling with respect to the 2006 Trusts and direct the payment of the relevant Allocable Shares to Ambac, consistent with PSA Section 6.02.

II. THE IAS COURT ERRED BY HOLDING THAT SENIOR CERTIFICATES MAY NOT BE WRITTEN UP

The IAS Court also erred with respect to the 2005 Trust in holding that the balances of the "senior" certificates may not be written up on account of the trust's receipt of its Allocable Share of the settlement proceeds. The 2005 Trust's contractual language and structure require the balances of *all* classes of certificates to be written up to account for Subsequent Recoveries, including the trust's Allocable Share.

In contrast to the 2006 Trusts, Ambac does not contend that it has a priority right with respect to the 2005 Trust. Rather, Ambac relies on its subrogation rights, which entitle it to receive the Subsequent Recoveries that would otherwise be paid to holders of the insured senior certificates. (R.4389 (GPMF 2005-AR5 PSA § 4.10(d)).) Ambac's claims payments with respect to the 2005 Trust far exceed the Allocable Shares for the insured loan groups, so Ambac effectively stands in the shoes of the holders of the insured senior certificates. (R.3635.)

of approximately \$492 million, have been allocated approximately \$6.6 million in Realized Losses. (R.10879-10886 (GPMF 2006-AR3 Remittance Report).) These losses pale in comparison to Ambac's over \$150 million in claims payments.

The IAS Court erred in ruling that the 2005 Trust’s senior certificates are ineligible to be written up to account for the trust’s Allocable Share of the settlement payment. In order to avoid duplicative briefing, Ambac respectfully refers the Court to the following arguments set forth in more detail in the brief submitted by the Institutional Investors, AIG, DW, and Ellington:

- First, the terms of the 2005 Trust’s PSA require the balances of senior certificates to be written up to account for any Subsequent Recoveries. The provision cited by the IAS Court, Section 6.02(h), does not speak to the write-up of senior certificates and certainly does not prohibit it. (R.4409-4410 (PSA Section 6.02(h)).) Moreover, such write-ups are *required* by the definition of “Realized Loss,” which refers to the reduction of Realized Losses to the extent Subsequent Recoveries are applied to reduce the Current Principal Amount of “*any* Class of Certificates.” (R.4349 (emphasis added).)
- Second, limiting write-ups to subordinate certificates would be contrary to the structure of the transaction, as set forth in the PSA. It would also create absurd consequences without clear contractual language providing for such a result: the more junior certificates would receive the Allocable Share, instead of the senior certificates.

Accordingly, this Court should reverse the IAS Court's ruling with respect to the eligibility of the 2005 Trust's senior certificates for write-ups.¹¹

CONCLUSION

For the reasons stated above, this Court should reverse the IAS Court's ruling insofar as it held (1) that Ambac was not entitled to receive the entire Allocable Shares for the 2006 Trusts, and (2) that the balances of the senior certificates issued by the 2005 Trust may not be written up on account of its Allocable Share.

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Respectfully submitted,



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¹¹ As explained above, these arguments also apply to the 2006 Trusts. However, if the Court accepts Ambac's argument in Section I, *supra*, that Ambac is entitled to the entire Allocable Shares for the 2006 Trusts, it need not reach the write-up issue with respect to those trusts.

PRINTING SPECIFICATIONS STATEMENT

I hereby certify pursuant to 22 N.Y.C.R.R. § 1250.8(j) that the foregoing brief was prepared on a computer using Microsoft Word.

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STATEMENT PURSUANT TO CPLR 5531

1. The Index Number in the IAS Court was 657387/2017.
2. The full names of the parties are set forth above. There have been no changes.
3. The action was commenced in the Supreme Court, New York County (Commercial Division).
4. This proceeding was commenced on December 15, 2017. The Petition was served on December 15, 2017.
5. This CPLR Article 77 proceeding concerns the proper distribution of a settlement payment being made to hundreds of residential mortgage-backed securities trusts, pursuant to relevant contracts.
6. The appeal is from a decision and order of the Commercial Division (Friedman, J.), dated February 13, 2020, and entered February 13, 2020.
7. The appeal is being perfected on the full record.