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

In the matter of the application of

WELLS FARGO BANK, NATIONAL ASSOCIATION, et al.,

Petitioners,

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

Index No. 657387/2017

Friedman, J.

REPLY BRIEF OF THE INSTITUTIONAL INVESTORS AND AIG PARTIES CONCERNING THE PETITION

TABLE OF CONTENTS

INTRODUCTION... 1

I. The Settlement Agreement Requires Pay First. 3

A. Paragraphs 3.06(a) and 3.06(b) Unambiguously Require Pay First. 3

B. The Settlement Agreements Did Not “Evolve” Away from Pay First. 4

II. The Governing Agreements for Exhibit D Trusts Do Not Specify the Order of Operations. 5

III. The Definition of Overcollateralization Amount Precludes Temporary Overcollateralization. 7

IV. The Countrywide Decision as to Fourteen “Principal Cap” Trusts is Completely Irrelevant to the Issues Facing the Court Here.. 9

TABLE OF AUTHORITIES

Page(s)

Cases

Barnhart v. Peabody Coal Co.,
537 U.S. 149 (2003) 6

Cruz v. TD Bank, N.A.,
855 F.Supp. 2d 157 (S.D.N.Y. 2012), aff'd and remanded, 742 F.3d 520 (2d. Cir. 2013) 6

Frank G. v. Bd. of Educ. of Hyde Park,
459 F.3d 356 (2d. Cir. 2006) 6

Pursuant to the August 15, 2018 Stipulation Regarding Merits Briefing Schedule and Trustee Substitutions (Dkt. No. 486), the Institutional Investors and the AIG Parties submit this Reply to the Response Briefs submitted by other investors.

INTRODUCTION

The Opening and Response Briefs make four things clear:

First, investors arguing for Write Up First do not have a plausible argument that the Settlement Agreement requires Write Up First. The Pay First sequence is set out in two paragraphs of Section 3.06. The first requires distribution of the Settlement Payment "to Investors" as though it were a subsequent recovery. The second requires that the certificate write-up (i) must occur "*[a]fter*" the distribution set forth in the first paragraph; and (ii) cannot "*affect"* the distribution set forth in the first paragraph. That Pay First sequence was employed in each one of the five global RMBS settlement agreements. Because the Governing Agreements for the Exhibit D trusts are silent as to the order of operations, the clear terms of the Settlement Agreement control.

Second, as to the Governing Agreements, investors arguing for Write-Up First rely nearly exclusively on the definition of "Certificate Principal Balance." But rather than argue from words in the definition, they focus on words missing from the definition, from which they divine apparent meaning. Although these investors attempt to invoke the interpretive canon of *expressio unius*, that canon plainly does not apply here, and certainly not in light of the gap-filling provisions of the Settlement Agreement, which unambiguously require Pay First. Nor do these investors offer any reason why Write Up First makes practical or economic sense under the Governing Agreements. In this case, the silence on which these investors rely is merely silence. The Settlement Agreement fills the silence by requiring Pay First.

Third, HBK's NIM trustee and Tilden Park argue for Pay First *with* temporary overcollateralization for 26 trusts but cannot overcome the definition of "Overcollateralization Amount," which requires the Trustees to "*tak[e] into account*" the write-down and write-up of certificate balances associated with the "payment" of subsequent recoveries—two operations that appear in the section of the Governing Agreements called "*Distributions*." The write-up is necessary, as an *accounting* matter, to keep the trusts' assets and liabilities in balance. The write-up and the write-down are thus two sides of the same coin. In this way, the Governing Agreements preclude the creation of temporary overcollateralization at some point *during* the distribution.

Fourth, some investors seek to analogize the issues here to those facing Justice Scarpulla in the previous Countrywide distribution dispute concerning fourteen "Principal Cap" trusts. That dispute has nothing to do with the issues here. There, the question was whether the trustee should apply the mechanical calculation of the defined term "Principal Distribution Amount," which was essentially defined as A *minus* B *plus* C. Tilden Park urged the calculation to be enforced literally, while AIG and two of the Institutional Investors objected that doing so would be inconsistent with other terms of the Governing Agreements and the overall intent of the senior-subordinate structure. ***That is not at all the situation here.*** Here, both the literal text and the intent of the Settlement Agreement and Governing Agreements require Pay First, *without* temporary overcollateralization. Amazingly, as to the issues *here* – concerning how to measure the Overcollateralization Amount – Tilden Park *joined* AIG and the Institutional Investors in an undisputed judgment as to 512 Countrywide trusts, which clarified that the "Overcollateralization Amount" was not to be measured *between* the write down and write up steps.

As to the Exhibit E, F, G, and H issues, the Institutional Investors and AIG Parties stand on the arguments made in their Opening and Response Briefs.

As to the dispute concerning Ambac's allegation that it is entitled to the entire $30 million+ Settlement Payment for GPMF 2006-AR2 and GPMF 2006-AR3, the Institutional Investors and AIG Parties likewise stand on the arguments made in their Response Brief, given that Ambac's Response Brief (i) still fails to explain why it is entitled to *any* instruction concerning its purported reimbursement rights; and (ii) still does not even cite the principal distribution waterfall, much less attempt to explain how it permits Ambac to leapfrog the uninsured, super-senior certificates.

I. The Settlement Agreement Requires Pay First.

Several investors continue to take the position that the Settlement Agreement actually requires Write Up First. This is flat-out wrong.

A. Paragraphs 3.06(a) and 3.06(b) Unambiguously Require Pay First.

Each of the investors arguing the Settlement Agreement requires Write Up First focuses nearly exclusively on the first sentence of Paragraph 3.06(b)—the write-up paragraph—which states that "[a]fter the distribution of the Allocable Share to a Settlement Trust pursuant to Subsection 3.06(a)," the Trustees are required to write up certificate balances by the amount of the Settlement Payment. They focus selectively on the phrase "*to a Settlement Trust*" and argue that because it does not say "*to Investors*," it necessarily refers to the point in time after the deposit of the Settlement Payment into the trust, but before the distribution to investors.[1] It says no such thing.[2] Instead, it says the write-up is to occur "after the distribution . . . to a Settlement Trust pursuant to Subsection 3.06(a)." The investors arguing for Write Up First completely ignore that final qualifier—"*pursuant to Subsection 3.06(a)*."

[1] *See* Response Brief of DW Partners LP and Ellington Management Group, L.L.C., at 18-19.

[2] Some investors point to Paragraph 21 of the Petition, in which the Trustees allege that the Settlement Agreement "left unaddressed" the order of operations. Respectfully, this should be understood as reflecting the Trustees' desire to avoid potential liability, rather than signaling actual doubt by the Trustees about what these provisions clearly mean.

Paragraph 3.06(a) in turn is crystal clear that it governs the distribution to investors. There are three sentences in Paragraph 3.06(a), and each one of them governs distributions to investors. In fact, some form of the word "distribution" is used ***sixteen separate times*** in those three sentences, and each such reference is clearly and necessarily a "distribution" to investors. Thus, read in context, the first sentence of Paragraph 3.06(b) describes a write-up process that follows a distribution of the Allocable Shares to investors.[3]

Finally, to the extent there were any doubt that the payment to investors precedes the write-up, the last sentence of Paragraph 3.06(b) removes that doubt by stating that "[f]or the avoidance of doubt, this Subsection 3.06(b) is intended only to increase the balances of the related classes of securities, as provided for herein, and shall not affect the distribution of the Settlement Payment provided for in Subsection 3.06(a)." The only way to understand this sentence is that payment must precede write-up, since the reverse approach *would* "affect the distribution of the Settlement Payment provided for in Subsection 3.06(a)." Accordingly, this sentence confirms Pay First.

B. The Settlement Agreements Did Not "Evolve" Away from Pay First.

Some investors assert that the Institutional Investors' practice has "evolved" over time, speculating that "after requiring Pay First in the first global RMBS settlement agreement (Countrywide), the Institutional Investors and Trustees subsequently abandoned that approach in favor of a trust-by-trust approach."[4] This claim is not only wrong; it is bizarre. The Institutional Investors are *here* and take the opposite view of the agreement they signed.

Beyond that point, the plain text of each global settlement agreement requires Pay First. The only "evolution" that occurred is the manner in which they deal with a potential conflict

---

[3] In contrast, the single reference in Paragraph 3.06(a) to the disbursement of the Settlement Payment into the Settlement Trusts' distribution or collection accounts is called a "*deposit*"—not a "*distribution*."

[4] Tilden Park Response Brief (Dkt. No. 668) at 8.

between the Settlement Agreement and the Governing Agreements. In all cases, they provide that the Governing Agreements control in the event of conflicts. But they do so in different ways. The earlier agreements accomplish this through provisions like Section 7.05 of the JPMorgan Settlement Agreement, which states that nothing in the agreement is intended to, or does, modify the Governing Agreements. The Lehman agreement takes a somewhat different approach by stating explicitly that if the distribution methodology conflicts with that in the Governing Agreements, the distribution methodology can be modified by the Trustees or a court to "conform[] with the Governing Agreements."[5] But those are two paths to the same place.[6] In any event, the Trustees themselves have already conceded (1) that they are "required and intend to follow the provisions of the Governing Agreements" that "clearly specify" the order of operations, and (2) that the trusts in Exhibit D do *not* specify an order of operations.[7]

II. The Governing Agreements for Exhibit D Trusts Do Not Specify the Order of Operations.

Investors arguing that the Governing Agreements require Write Up First focus nearly exclusively on the definition of "Certificate Principal Balance," asserting that the definition *implicitly* embeds the Write Up First methodology. But their interpretation depends entirely on words <u>missing</u> from the text. Misusing the interpretive canon of *expressio unius*, they argue that subsequent recoveries for the current period *must* be added to the certificate balances at the beginning of a distribution because the definition of "Certificate Principal Balance" does not limit the addition of subsequent recoveries to subsequent recoveries "on previous distributions"—a qualifier this is expressly applied to principal receipts and realized losses.[8]

---

[5] *Compare* Section 7.05 of JPMorgan Agreement (Ex. 6) *with* Section 3.06(c) of Lehman Agreement (Ex. 8).

[6] *Id.*

[7] Petition ¶ 23.

[8] *See, e.g.*, Tilden Park Response Brief (Dkt. No. 668) at 16.

Grasping for meaning in the silence, however, investors arguing for Write Up First grossly misapply the *expressio unius* canon. That canon applies to a "series of two or more terms or things that should be understood to go hand in hand, thus raising the inference that a similar unlisted term was deliberately excluded."[9] It "has force ***only*** when the items expressed are members of an associated group or series, justifying the inference that items not mentioned were excluded by deliberate choice, not inadvertence."[10] "Properly invoked, *expressio unius* prevents expanding an enumerated list of items or exceptions."[11]

Here, subsequent recoveries were not *excluded* from a series, they do not go "hand in hand" with principal receipts and realized losses on *completely different* loans, and the canon as invoked does not "prevent expanding an enumerated list of items or exceptions."[12] The definition of Certificate Principal Balance simply leaves open *which* subsequent recoveries are to be included in the definition of Certificate Principal Balance, and *when* they are to be added. Further, these investors invoke the canon without offering any theory as to why the result they urge would make sense in the context of these Governing Agreements. They do not, in other words, offer an explanation as to how or why it makes sense economically, practically or otherwise to mandate that the Certificate Principal Balances be calculated using *one* temporal rule for principal receipts and realized losses but a *different* rule for subsequent recoveries. That is because there is not one.

In contrast, as noted in the Institutional Investors' and AIG Parties' Response Brief, the ***Pay First*** JPALT trusts *excluded* from Exhibit D include the same language cited by these investors in the definition of Certificate Principal Balance, but *also* include a provision that clearly

---

[9] *Frank G. v. Bd. of Educ. of Hyde Park*, 459 F.3d 356, 370 (2d. Cir. 2006).

[10] *Barnhart v. Peabody Coal Co.*, 537 U.S. 149, 168 (2003) (emphasis added) (internal quotation omitted).

[11] *Cruz v. TD Bank, N.A.*, 855 F.Supp. 2d 157, 171 (S.D.N.Y. 2012), aff'd and remanded, 742 F.3d 520 (2d. Cir. 2013).

[12] *See supra* notes 9-11.

provides for Pay First.[13] Similarly, the Governing Agreements for twenty-seven settlement trusts that were *excluded* from this Article 77, and which received their settlement funds in January 2018, include the very same textual features, but *also* include a provision requiring subsequent recoveries to be added to certificate balances "***prior*** to giving effect to distributions" on the Distribution Date on which subsequent recoveries are received.[14] These two sets of Governing Agreements show that the mere fact that the Governing Agreements for certain Exhibit D trusts reference "*prior*" principal receipts and realized losses while also referencing "*any*" subsequent recoveries, cannot be understood as compelling Write-Up First. The Governing Agreements for the Exhibit D trusts are simply silent, and the Settlement Agreement's Pay First sequence fills that silence.[15]

III. The Definition of Overcollateralization Amount Precludes Temporary Overcollateralization.

Tilden Park and HBK's NIM Trustee now concede, as they must, that the issue of temporary overcollateralization for 26 trusts turns entirely on the definition of Overcollateralization Amount.[16] They further concede that the definition requires the trustees to measure Overcollateralization Amount in a manner that "takes into account" the "payment of principal" like subsequent recoveries.[17] They also now explicitly argue that "taking into account" the "payment" of subsequent recoveries is a *one-way* street, such that the Trustees should only take into account the write-down, but not the write-up.[18] That is not a plausible reading of the contract.

---

[13] *See* Response Brief of Institutional Investors and AIG Parties at 11 and Ex. 22.

[14] *See* Ex. 25 to Second Supplemental Sheeren Affidavit (excerpting Governing Agreements for 27 excluded trusts).

[15] The Olifant Funds again point to a variety of uncontested Minnesota proceedings, including one in which Wells Fargo has *sought judicial instructions* concerning the order of operations. Those cases are irrelevant. Wells Fargo argues *here* that the trusts in Exhibit D "do not clearly specify whether the Petitioners should use the Pay First Method or the Write-Up First Method." Petition ¶ 23. Moreover, as noted above, the language on which Olifant relies is present in JPMorgan trusts unquestionably requiring Pay First.

[16] Tilden Park Response Brief (Dkt. No. 668) at 14-15.

[17] *Id.*

[18] Tilden Response Brief at 14; HBK NIM Trustee Response Brief at 23.

Subsequent recoveries are like ordinary principal payments in some ways, but not in others. An ordinary principal payment reduces both the outstanding balance of a trust's assets (i.e., the mortgage loan balances) and its liabilities (i.e., the certificate balances). Not so for subsequent recoveries, which by definition are received on liquidated loans whose mortgage loan balances have already been written down to zero and are not reduced by subsequent recoveries. In order to keep the trusts' assets and liabilities in balance, however, each of the Governing Agreements account for this in the section entitled "*Distributions*." A provision at the end of that section states that the certificate balances must be written up in the same amount they are written down, ensuring that subsequent recoveries do not cause the trusts to appear falsely overcollateralized (i.e. its assets exceeding its liabilities), even though they are not. As a matter of *accounting*, then, the Governing Agreements state that when subsequent recoveries are distributed, certificate balances are written down and up by equal and offsetting amounts—keeping the trusts' assets and liabilities in balance.

Taking into "account" the payment of subsequent recoveries necessarily requires the Trustees to "account" for both sides of the subsequent recovery coin. To do otherwise would be entirely unreasonable and would lead to absurd results not intended by the Governing Agreements. As the Trustees concede, "many of the OC Trusts have little or no current overcollateralization amount."[19] Tilden Park and HBK's preferred result would require the Trustees to embrace a counter-factual and absurd *fiction* that the trusts *are* overcollateralized—even though everyone knows they are not. The absurdity of Tilden Park and HBK's preferred result is highlighted by other investors, including the Olifant Funds, Nover and its CDO trustee, and GMO.[20]

[19] Petition ¶ 27.

[20] Opening Briefs of Olifant Funds at 11; Nover and its CDO trustee at 20; GMO at 4.

IV. The Countrywide Decision as to Fourteen "Principal Cap" Trusts is Completely Irrelevant to the Issues Facing the Court Here.

Certain investors go to great lengths to analogize the issues here to those before Justice Scarpulla as to the fourteen "Principal Cap" Countrywide trusts.[21] There, in fourteen of the 530 Countrywide trusts, the term "Principal Distribution Amount" was mechanically defined as "A" (certificate balances), *minus* "B" (mortgage loan balances) *plus* "C" (overcollateralization target amount).[22] Tilden Park noticed that unique calculation in those fourteen trusts and urged the Court to apply it literally—which would effectively "cap" the settlement funds distributed to super-senior certificates in an amount equal to "C" (the overcollateralization target amount), with the excess settlement funds distributed to the junior certificates purchased by Tilden Park. AIG and two of the Institutional Investors argued that (i) the literal application of the Principal Distribution Amount formula for a large, one-time settlement would be inconsistent with other provisions of the PSAs and their overall purpose, and (2) the Court should make a one-time adjustment to permit the entirety of the settlement to be included in the Principal Distribution Amount.[23] Based on the unique language of those fourteen trusts—language that even Tilden concedes is *different* than is at issue for the JPMorgan trusts[24]—Justice Scarpulla agreed with Tilden's interpretation.[25]

Here, in contrast, the Pay First vs. Write-Up First dispute is resolved by *both* the literal terms *and* the overall intent of the Settlement Agreement and Governing Agreements. As to the order of operations, Paragraphs 3.06(a)-(b) of the Settlement Agreement plainly require Pay First.

---

[21] *See, e.g.*, Tilden Park Response Brief at 19.

[22] *See* Ex. 11 at p. 12 of 18 (Countrywide Decision on Fourteen Principal Cap Trusts).

[23] *See* Tilden Park Answer (Dkt. No. 32) at 15 (noting "cap" in Principal Distribution Amount) & merits brief (Dkt. No. 122) at 11 (same); *see also* the Institutional Investors' and AIG's Answer (Dkt. No. 34) & merits brief (Dkt. No. 96), in Index No. 150973/2016.

[24] *See* Response Brief of Tilden Park at 16 n.17

[25] It is notable that Justice Scarpulla's interpretation was challenged on appeal, but the parties settled the matter prior to the First Department ruling on the merits of her decision.

As to temporary overcollateralization, the dispute is resolved by the definition of Overcollateralization Amount in the Governing Agreements, the plain meaning of which requires the Trustees to "take into account" both the certificate write-down and write-up associated with the payment of subsequent recoveries. After all, the subsequent recovery write-up is an *accounting mechanism* to keep the trust's assets and liabilities in balance. To ignore the write-up would be to ignore one-half of the payment of subsequent recoveries.

Remarkably, in the Countrywide case, Tilden Park *joined* the Institutional Investors and AIG in entering into an undisputed judgment for 512 trusts that did not have the "cap" in the Principal Distribution Amount. For those 512 trusts, the issue was whether to account for both the write-down and the write-up in calculating the Overcollateralization Amount. The definition of "Overcollateralization Amount" in the Countrywide trusts required that overcollateralization be measured "*after giving effect to*" distributions, which, like the JPMorgan definitions, require the trustee to account for *both* the write-down and the write-up.[26] Tilden Park ***agreed*** and signed onto a judgment directing the trustee "not [to] measure [the] Overcollateralization Amount during the distribution between the pay down and write up steps described in . . . the Verified Petition."[27] For these reasons, the dispute over the fourteen Principal Cap Countrywide trusts is completely inapt.

In sum, the Court should enforce the plain text of the Settlement Agreement and Governing Agreements – and their intent – by directing the Trustees to distribute the settlement on a Pay First basis, *without* temporary overcollateralization.

---

[26] *See* Supporting Affidavit to the Institutional Investors' Answer (Dkt. No. 36) in Index No. 150973/2016.
[27] Ex. 9.

Dated: New York, New York
October 10, 2018

WARNER PARTNERS, P.C.

By: /s/ Kenneth E. Warner
Kenneth E. Warner
950 Third Avenue, 32nd Floor
New York, New York 10022
(212) 593-8000

GIBBS & BRUNS LLP
Kathy D. Patrick (*pro hac vice*)
David M. Sheeren (*pro hac vice*)
1100 Louisiana, Suite 5300
Houston, Texas 77002
(713) 650-8805

Attorneys for the Institutional Investors

QUINN EMANUEL URQUHART
& SULLIVAN, LLP

By: /s/ Kevin S. Reed
Kevin S. Reed
51 Madison Avenue
New York, NY 10010
Tel.: (212) 849-7000
Fax.: (212) 849-7100
Email: kevinreed@quinnemanuel.com

Attorneys for the AIG Parties