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

In the matter of the application of WELLS FARGO BANK, NATIONAL ASSOCIATION, U.S. BANK NATIONAL ASSOCIATION, THE BANK OF NEW YORK MELLON, THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., WILMINGTON TRUST, NATIONAL ASSOCIATION, HSBC BANK USA, N.A. and DEUTSCHE BANK NATIONAL TRUST COMPANY (as Trustees, Indenture Trustees, Securities Administrators, Paying Agents, and/or Calculation Agents of Certain Residential Mortgage-Backed Securitization Trusts), Petitioners, For Judicial Instructions under CPLR Article 77 on the Administration and Distribution of a Settlement Payment.	Index No. 657387/2017 Honorable Marcy S. Friedman IAS Part 60 Motion Seq. No. 1 **REPLY SUBMISSION OF NOVER VENTURES, LLC AND THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., AS TRUSTEE UNDER THE DUKE IX INDENTURE**

Nover Ventures, LLC ("Nover") and The Bank of New York Mellon Trust Company, N.A. ("BNYMTC"), solely in its capacity as the Duke IX Trustee, and acting pursuant to a direction from the Duke IX Controlling Class,[1] submit this Joint Merits Reply pursuant to the December 19, 2017 Order to Show Cause and the August 15, 2018 Stipulation Regarding Merits Briefing Schedule and Trustee Substitutions.

PRELIMINARY STATEMENT

This memorandum of law replies to the myriad of conflicting arguments before the Court. A number of Interested Persons argue for distribution methodologies directly contrary to the express language of the Governing Agreements. For example, Tilden Park, Ellington, and DW

[1] All capitalized terms not defined herein shall have the meaning prescribed in Nover's and the Duke IX Trustee's September 14, 2018 and September 28, 2018 submissions (along with the papers filed in support thereof, the "Prior Submissions"). BNYMTC's position as set forth herein is limited to its role as the Duke IX Trustee acting pursuant to a direction from the Controlling Class, as delineated in the Prior Submissions.

Partners (hereinafter, the "Tilden Park Aligned Investors") argue that the thousands of pages of detailed write-up provisions in the Governing Agreements should be disregarded in favor of a "one size fits all" methodology subsumed in a few lines of the Settlement Agreement. Other Interested Persons at times embrace, and at other times disregard, provisions of the Governing Agreements as needed to support their positions. After twenty briefs and arguments by dozens of investors, Nover and the Duke IX Trustee stand alone as the only Interested Persons who have steadfastly maintained a consistent, impartial, and rational position across all six issues before the Court: the Court should apply the Governing Agreements when instructing Petitioners how to distribute the Allocable Shares.

Given that Nover and the Duke IX Trustee have already addressed most of the Interested Persons' arguments in the Prior Submissions, this memorandum of law focuses on the few arguments not previously addressed.

ARGUMENT

I. Where the Write-Up Provision Specifies Subordinate Bonds, Petitioners Should Not Write-Up Senior Bonds (Exhibit E).

Petitioners and all Interested Persons except the Tilden Park Aligned Investors[2] agree that the Governing Agreements apply if there is a conflict between the Governing Agreements and the Settlement Agreement. Rather than follow the Governing Agreements, the Tilden Park Aligned Investors argue that the Court should pick and choose between the Governing Agreements and Settlement Agreement, picking the Governing Agreements for distribution and the Settlement Agreement for write-up. This "hybrid" approach is not only self-serving, but it

[2] Ellington and DW Partners wrongly assert, without support, that "the Court must look first to the [Settlement Agreement] to determine which certificates are eligible to be written up on account of the Settlement Payment . . . ." (Opposition of DW Partners LP and Ellington Management Group, L.L.C. at 2.)

also blatantly disregards the express terms of the Settlement Agreement and the Governing Agreements.

A. The Governing Agreements Apply To Both Distribution and Write-Up.

The Tilden Park Aligned Investors first argue that the Settlement Agreement trumps the Governing Agreements' write-up provisions because the Settlement Agreement, although in substance an amendment to the Governing Agreements, is not labeled as such so as to insulate it from legal challenge. This argument is nonsense. First, such a tortured interpretation is directly contrary to Section 7.05, which expressly states that the Settlement Agreement is ***not an amendment***. (Settlement Agreement at §7.05.) Second, this position requires turning a blind eye to the fact that the Petitioners and the Institutional Investors—actual signatories to the Settlement Agreement—agree that the Settlement Agreement is not intended to, and does not, amend the Governing Agreements. And, finally, the Tilden Park Aligned Investors' argument is not factually or legally correct given that the Governing Agreements explicitly state that consent of more than 50% of certain certificateholders is required for an amendment. (*See*, *e.g.*, BSABS 2005-HE3 PSA, at §11.01, Schiefelbein Aff., Ex. C, NYSCEF Dkt. No. 702; BALTA 2006-2 PSA at §11.02, Klein Aff. Ex. B, NYSCEF Dkt. No. 603.)

The Tilden Park Aligned Investors also misconstrue Section 7.13's statement that the Settlement Agreement contains the entire agreement among the "Parties" to mean that the Settlement Agreement supersedes the Governing Agreements. Not so. The section simply says that the Settlement Agreement signed by the "Parties," which only include JPMorgan, the Institutional Investors, and the Accepting Trustees, supersedes "all prior agreements and understandings between the Parties." The only rational reading of Section 7.13 is that the "prior agreements and understandings" refers to prior discussions and agreements between JPMorgan, the Institutional Investors, and the Accepting Trustees—*i.e.*, settlement talks—not the Governing

Agreements. This must be so because the Governing Agreements were not agreements or understandings negotiated between the "Parties." Indeed, Section 7.13 explicitly states that it is subject to Section 7.05, which provides that the Settlement Agreement does not amend the Governing Agreements.

Furthermore, had the drafters intended for the Settlement Agreement to prevail over the Governing Agreements—which we know they did not—they would have expressly said so. The Tilden Park Aligned Investors do not (and cannot) explain why, if they are correct, the drafters would include Sections 3.06(a), 7.05, and 7.13 expressly deferring to the Governing Agreements ***and not include*** language unequivocally establishing that the Settlement Agreement's distribution terms supersede the Governing Agreements distribution terms in all material respects when it comes to the distribution of the Settlement Funds. It is axiomatic that any change to the waterfall provisions contained in the Governing Agreements could have significant economic ramifications and, were it the intent of the drafters to make such a change, they would have done so expressly. At bottom, the absence of any such provision is as telling as the presence of Sections 3.06, 7.05, and 7.13.

B. The Allocable Shares Are Subsequent Recoveries For All Purposes.

The Tilden Park Aligned Investors also claim that, although the Allocable Shares are "Subsequent Recoveries" for purposes of distribution, they are not for purposes of write-up because: (i) the Allocable Shares are not received by the master servicer or servicer; and (ii) they do not relate to a specific mortgage loan. Again, this Court confirmed that the Allocable Shares are "subsequent recoveries" pursuant to the Governing Agreements' write-up provisions in the prior Article 77 proceeding. *In re U.S. Bank Nat'l Ass'n*, No. 652382/2014, 2016 WL 9110399 (Sup. Ct. N.Y. Cnty. Aug. 12, 2016). Moreover, who receives the Allocable Shares is beside the point. All subsequent recoveries, whether collected by a servicer or paid pursuant to the

Settlement Agreement, are paid into the ***same*** trust collection or distribution accounts. (Settlement Agreement at §3.06(a) ("Each Trust's Allocable Share shall be deposited into the related Trust's collection or distribution account pursuant to the terms of the Governing Agreements . . . as though such Allocable Share was a 'subsequent recovery . . . .'").) It makes zero sense to distinguish among who collected certain funds for purposes of write-ups, but not distributions, particularly considering that, once received, the cash is fungible.

The Tilden Park Aligned Investors' argument regarding the application of subsequent recoveries as to a particular mortgage loan is similarly without merit. As a condition of becoming effective, Section 2.09 of the Settlement Agreement requires the Internal Revenue Service to issue a private letter ruling that the Settlement Agreement will not cause a Settlement Trust to lose its REMIC (favorable tax) status or "the receipt of the Allocable Shares of the Settlement Payment by the Settlement Trusts will not cause, or result in, the imposition of any taxes on the Settlement Trusts or on any portion of a Settlement Trust for which a REMIC election has been made in accordance with the terms of the applicable Governing Agreement." (Settlement Agreement at §2.09.)

The IRS private letter ruling was necessary because Section 1.860G-2(g)(1)(ii) of the Internal Revenue Code requires a REMIC trust's cash flow investments to be "payments received on qualified mortgages." 26 C.F.R. § 1.860G-2(g)(1)(ii) (2018). If the Allocable Shares do not themselves constitute "payments received on qualified mortgages," then the Settlement Trusts could either forfeit their REMIC status or, at the very least, forfeit their favorable REMIC tax treatment. Accordingly, the Petitioners sought and received the necessary

IRS rulings by September 19, 2017.[3] (*See* October 5, 2017 Notice to Investors, Affirmation of David Schiefelbein ("Schiefelbein Aff."), Ex. A.)[4]

Indeed, the IRS's private letter rulings make clear that the Tilden Park Aligned Investors' position that the Allocable Shares do not relate to a specific mortgage loan is factually wrong. Instead, the IRS specifically found:

> Each Taxpayer's right to the Allocable Share under the Settlement Agreement is akin to a payment received by such Taxpayer from a sponsor or prior owner in lieu of the sponsor or prior owner's repurchase of such a defective obligation. Therefore, pursuant to Section 1.860G-2(g)(1)(ii), the Allocable Share ***will be considered a payment received on a qualified mortgage*** pursuant to Section 1.860G- 2(g)(1)(ii).

I.R.S. Priv. Ltr. Rul. 102765-17 (Apr. 27, 2017) (emphasis added), Schiefelbein Aff., Ex. B.) The Allocable Shares reflect payments relating to a particular mortgage such that they qualify as "subsequent recoveries" for all purposes.[5]

C. Writing-Up Only Subordinate Certificates Is Commercially Reasonable.

The Tilden Park Aligned Parties next suggest, without proof, that writing-up subordinate certificates instead of senior certificates will not result in a commercial outcome merely because of the tenet that RMBS structures are ***generally*** senior-subordinated structures. First and foremost, RMBS structures are not always senior-subordinated structures where the senior most

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[3] Although an unredacted version of the IRS private letter ruling is not publicly available, Nover believes that a redacted version is publicly available at https://www.irs.gov/pub/irs-wd/201730006.pdf. (*See* I.R.S. Priv. Ltr. Rul. 102765-17 (Apr. 27, 2017), Schiefelbein Aff., Ex. B.) Regardless whether the foregoing relates to the JPMorgan settlement, it is wholly consistent with prior IRS private letter rulings issued in other global RMBS settlements. (*See* I.R.S. Priv. Ltr. Rul. 113051-15 (Oct. 5, 2015), Schiefelbein Aff., Ex. C).

[4] The notice is also publicly available at http://www.rmbstrusteesettlement.com/docs/JPM%20Settlement%20--%20Effective%20Date%20Notice.pdf.

[5] Nor does it matter whether the payment relates to a performing or liquidated loan for purposes of the language of some Governing Agreements. That a loan was liquidated with a loss is highly indicative that there was a breach of a representation and warranty such that the Allocable Shares would go to settle that loss.

certificates receive priority for every payment and write-up. Were this so, all Governing Agreements would be identical and this proceeding would be moot. The Governing Agreements were drafted with differences and, absent evidence to the contrary, the Court must assume that the drafters intended for the Exhibit E trusts to write-up only subordinated certificates. Indeed, as Nover and the Duke IX Trustee point out, the prospectus supplements evidence that the drafters intended this outcome by endorsing the write-up of subordinate certificates only. Notably, no Interested Person refuted this argument in their responsive papers.

In any event, writing-up only subordinate certificates ***does*** result in a commercially reasonable outcome (albeit the outcome the Tilden Park Aligned Parties do not prefer). Senior certificates will still receive distributions ahead of subordinate certificates, and subordinate certificates will still take realized losses ahead of senior certificates. If anything, the position argued for by the Tilden Park Aligned Parties—that senior certificates can be written-up—would result in the ***commercially unreasonable*** outcome that certain junior tranches otherwise not entitled to any of the settlement funds, would nonetheless receive money. As such, the only commercially reasonable outcome results from following the Governing Agreements.

D. There Is No Proof of a Scrivener's Error.

Having failed to prove that their position is otherwise correct, Ellington and DW Partners make a last-ditch effort to pin the omission of any discussion of writing-up senior certificates in the Governing Agreements as a "likely" scrivener's error. This argument is pure conjecture and without any proof. "Reformation based upon a scrivener's error requires proof of a prior agreement between [the] parties, which when subsequently reduced to writing fails to accurately reflect the prior agreement." *Warberg Opportunistic Trading Fund L.P. v. GeoResources, Inc.*, 58 N.Y.S.3d 1, 6 (1st Dep't 2017) (quoting *U.S. Bank. N.A. v. Lierberman*, 950 N.Y.S.2d 127 (1st Dep't 2012)) (alteration in original). Indeed:

> There is a heavy presumption that a deliberately prepared and executed written instrument accurately reflects the true intention of the parties. . . . The party seeking reformation bears the burden of proving by clear and convincing evidence that the instrument is not correct due to an error in the reduction of the agreement to writing, or that it was executed under mutual mistake or unilateral mistake coupled with fraud. This means that the plaintiff must show, in no uncertain terms, not only that mistake or fraud exists, but also exactly what the parties agreed upon, particularly if the negotiations were conducted by sophisticated, counseled people.

Spivak v. Bertrand, No. 653712/20015, 2016 WL 469639 at *5 (Sup. Ct. N.Y. Cnty. Feb. 8, 2016). Here neither Ellington nor DW Partners come close to meeting this burden or otherwise credibly claiming that the exclusion of senior certificates from certain of the Subsequent Recovery write-up provisions is somehow a mistake. Ellington and DW Partners have presented no evidence, and given that they did not participate in the drafting, there is no credible basis to suppose drafting error.

II. Petitioners Should Write-Up Zero Balance Certificates Regardless of the So-Called "Retired Class Provision" (Exhibit G).

Only Poetic and Prophet, the NIM Trustee at the direction of HBK (collectively, the "Prophet Parties"), and the Institutional Investors contend that the so-called "Retired Class Provision" precludes the write-up of zero balance bonds. They are wrong. The Retired Class Provision requires certificates to be affirmatively retired and the provision similarly makes clear that reducing a certificate principal balance to zero ***does not equate to*** retirement.

The Prophet Parties' main argument is premised on their conflating a "zero-balance bond" with the Retired Class Provision. The two are not synonymous. Despite the Prophet Parties' argument to the contrary, the Retired Class Provision is clear that, once the Certificate Principal Balance of a class of certificates has been reduced to zero, the certificates are ***not automatically*** retired and that class of certificates is ***not automatically*** precluded from distributions. Indeed, as the Prophet Parties' authority acknowledges, retirement does not occur

just because of a reduction in value caused by massive, unanticipated losses. (*See* Prophet Parties' Opening Brief at 5-6.)

Nor do the Governing Agreements require that a Certificate Principal Balance permanently remain zero. The provisions the Prophet Parties cite stand for the basic principle that a bond with a zero balance on any particular distribution date should not receive distributions. That is an obvious proposition, but one which does not imply that a balance must always be zero. To the contrary, the Definition of Certificate Principal Balance in the Governing Agreements expressly allows writing-up of zero balance bonds from sufficient subsequent recovery.

Finally, the Prophet Parties admit that the certificates were not retired pursuant to the Final Distribution sections of the Governing Agreements. (*See* Reply Memorandum of Law of Prophet Parties at 10.) Instead, the Prophet Parties claim that there are two types of retirement anticipated by the Governing Agreements, one where the certificate principal balance is reduced to zero as a result of losses and one where the balance is reduced as a result of a final distribution. Even if there were two separate retirement provisions, once a certificate is retired, it ceases having economic value because it cannot be freely traded. Here, the certificates are still being freely traded and therefore cannot be said to be retired. The Prophet Parties do not address that argument, presumably because they cannot. Nor do the Prophet Parties address Nover and the Duke IX Trustee's argument that the language of the Retired Class Provision requires an action in futurity—that something must happen for the certificates to be retired. Instead, the Prophet Parties change the Retired Class Provision's language that a class of certificates "will be retired" to "such classes are retired." (Prophet Parties' Response at 4.) Irrespective of which

provision is used, because no certificates at issue were "retired," the Exhibit G Trust certificates must be written-up.

III. Allocable Shares Should Flow to Investors, not the Certificate Insurer.

Finally, Ambac alleges that it is entitled to the full Allocable Shares for insured loan groups in certain trusts. Nover disagrees and adopts the position of the Institutional Investors and AIG. (*See* Institutional Investors' Response at 18-22.)

CONCLUSION

For the foregoing reasons, as well as those that may be presented in additional briefing and at oral argument before the Court, Nover and the Duke IX Trustee (acting solely at the direction of the Duke IX Controlling Class) respectfully request that the Court instruct Petitioners to distribute the Allocable Shares for the Settlement Trusts in a manner that is consistent with the terms, meaning, and intent of the Governing Agreements by following the language of those Agreements, including without limitation, by using the Write-Up First Method (Exhibit D), not writing-up senior certificates because to do so would be contrary to the Governing Agreements (Exhibit E), following the Governing Agreements where it differs from the Settlement Agreement (Exhibit F), writing-up zero balance certificates (Exhibit G), and treating subsequent recoveries as principal (Exhibit H). Nover and the Duke IX Trustee also request all other relief, at law or in equity, to which they may be justly entitled.

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Respectfully submitted,

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