SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

In the Matter of the Application of U.S. BANK N.A., WELLS FARGO BANK, N.A., WILMINGTON TRUST, N.A., WILMINGTON TRUST COMPANY, and CITIBANK, N.A. (as Trustees, Indenture Trustees, Securities Administrators, Paying Agents, and/or Calculation Agents of Certain Residential Mortgage-Backed Securitization Trusts), Petitioners, For Judicial Instructions under C.P.L.R. Article 77 on the Administration and Distribution of a Settlement Payment.	Index No. 651625/2018 IAS Part 60 Mot. Seq. #001 Hon. Marcy Friedman

MERITS BRIEF OF TILDEN PARK

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INTRODUCTION

The first question asked in the Petition is whether each trust should distribute Settlement funds using the Pay First Method, the Write-Up First Method, or a different method (each, a different "Order of Operations"). For the trusts held here by Tilden Park Capital Management LP, its affiliates, and advisory clients ("Tilden Park") – the LMT 2007-2 and LMT 2007-4 trusts (the "Tilden Park Trusts") – this question has a simple answer. Each trust should distribute Settlement funds using the Order of Operations set forth in such trust's Governing Agreement. And the Governing Agreements for the Tilden Park Trusts unequivocally provide, and therefore require, that the Trustees use the Pay First Method.

The Settlement Agreement repeatedly and unambiguously mandates that each trust's Governing Agreement controls distributions of Settlement funds, including the Order of Operations. In stark opposition to any creative theory that may be presented in this proceeding, the Settlement Agreement plainly states that distributions within each trust must occur "in accordance with the . . . Governing Agreements," Dkt. 3 § 3.06(a), "pursuant to the terms of the Governing Agreements," *id.* § 3.06(b), and "in conformance with the terms of the Governing Agreement for a particular Trust," *id.* § 3.06(c). The Settlement Agreement leaves no doubt that each trust's Governing Agreement determines the Order of Operations the Trustees should use in distributing Settlement funds to investors. The Court should enter the relief sought in Tilden Park's corrected answer.[1]

[1] Tilden Park filed a notice correcting its answer on October 15, 2018. *See* Dkt. 139. Although Tilden Park's initial answer requested broader relief, *see* Dkt. 65, later agreements among stakeholders have obviated the need to address issues not discussed in this brief. Finally, while Tilden Park believes the undercollateralization provisions of the Governing Agreements have no material impact on the distribution for the Tilden Park Trusts, Tilden Park respectfully requests that, if those provisions are found material, then the Court should enforce them as written.

STATEMENT OF FACTS

I. THE SETTLEMENT AGREEMENT

On November 30, 2016, Lehman Brothers Holdings Inc., together with its subsidiaries and affiliates (collectively, "Lehman Brothers"), entered into the Settlement Agreement to resolve claims involving billions of dollars of mortgage-backed securities. Dkt. 3 ("Settlement Agmt."). The Settlement Agreement resulted from "years of extensive, good faith and arms' length negotiations." *In re Lehman Bros. Holdings, Inc.*, No. 08-13555, 2017 WL 2889658, at *5 (Bankr. S.D.N.Y. July 6, 2017).

The Settlement Agreement provides a two-step process for making payments to investors. Settlement Agmt. § 3.06(a). First, the bankruptcy plan's administrator makes payments to each trust according to the percentage of the total recovery allocated to that trust (each trust's "Allocable Share"). *Id.* Second, once each trust has received its Allocable Share, the Trustee "further distribut[es]" the money to the trust's investors "in accordance with the distribution provisions of the Governing Agreements." *Id.* Thus, at step one, each trust receives a payment according to its Allocable Share under the Settlement Agreement, and, at step two, each investor receives a distribution under the relevant trust's Governing Agreement.

The Settlement Agreement also provides that, "to the extent permitted under each trust's Governing Agreement," the Trustee for each trust would increase, or "write up," the balances of the trust's certificates. Settlement Agmt. § 3.06(b). To accomplish the write-up, each Trustee applies "the amount of the Plan Payment for that trust to increase the balance of securities within that Trust (other than any class of REMIC residual interests) in reverse order of previously allocated losses, as though such Plan Payment was a subsequent recovery." *Id.* As noted above, Section 3.06(b) dictates that the write-up occur "to the extent permitted under each Trust's Governing Agreement." *Id.*

> The final sentence of § 3.06(b) states:
>
> > For 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 Plan Payments on the Net Allowed Claim provided for in Subsection 3.06(a).

Settlement Agmt. § 3.06(b). Because Section 3.06(a) provides for distribution to investors "in accordance with the distribution provisions of the Governing Agreements," Section 3.06(b)'s prohibition on affecting that distribution underscores that the Trustees must adhere to the payment rules in each trust's Governing Agreement, and not misuse the priorities mandated for the write-up in Section 3.06(b) in applying the payment operations set forth in the Governing Agreements, as mandated in Section 3.06(a).

Finally, Section 3.06(c) of the Settlement Agreement again emphasizes that the Governing Agreements control how the Trustees should distribute Plan Payments to investors. Settlement Agmt. § 3.06(c). It provides that if "the payment procedure described in Sections 3.06(a) and 3.06(b) may not conform to the terms of the Governing Agreement for a particular Accepting Trust," that procedure "shall be modified" to ensure "conformance with the terms of the Governing Agreement for a particular Trust." *Id.* Thus, Section 3.06(c) makes clear that the "payment procedure" described in Sections 3.06(a) and (b), rather than superseding the Governing Agreements, instead must be made to "conform" to them. *Id.* That clarification reinforces the dictate of Sections 3.06(a) and (b) that distributions to investors occur "in accordance with the distribution provisions of the Governing Agreements," *id.* § 3.06(a), and that write-ups occur "to the extent permitted under each Trust's Governing Agreement," *id.* § 3.06(b). It further causes the write-up provision of each Governing Agreement, to the extent it is present and applicable to that trust's Allocable Share, to govern in the event of any conflict with the write-up procedure mandated in Section 3.06(b). Ultimately, the write-up terms of the Settlement Agree-

ment exist solely as a gap-filling device to provide necessary instructions for trusts whose Governing Agreements lack their own write-up provisions.

II. THE TILDEN PARK TRUSTS

As relevant here, the LMT 2007-2 and LMT 2007-4 Trusts have identical distribution provisions. Both provide in Section 5.01(b) of each trust's Trust Agreement, among other terms, that "[a]ll distributions or allocations made with respect to Certificateholders within each Class on each Distribution Date shall be allocated among the outstanding Certificates in such Class equally in proportion to their respective initial Certificate Principal Amounts (or initial Notional Amounts)." Ellis Decl. Ex. A (LMT 2007-2 Trust Agmt.) § 5.01(b); *id.* Ex. B (LMT 2007-4 Trust Agmt.) § 5.01(b) The definition of Certificate Principal Amount in each Governing Agreement provides that, "[f]or purposes of Article V hereof," including § 5.01(b), "Certificate Principal Amounts shall be determined as of the close of business ***of the immediately preceding Distribution Date***, after giving effect to all distributions made ***on such date***." LMT 2007-2 Trust Agmt. at 12 (emphasis added); *see also* LMT 2007-4 Trust Agmt. at 14. Thus, the Governing Agreements provide that the Trustees must determine the Certificate Principal Amounts as of the prior Distribution Date, after giving effect to distributions made on that prior date.

III. THE BANKRUPTCY PROCEEDING

The United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") approved the Settlement Agreement as "reasonable, fair and equitable and supported by adequate consideration." *In re Lehman Bros.*, 2017 WL 2889658, at *1. "Certificateholders, noteholders, and any other parties claiming rights in any Accepting Trust," the Bankruptcy Court found, had received "reasonable" and "adequate" notice of the Settlement Agreement and were "given the opportunity to be heard in opposition" to it. *Id.* at *2. One group of claimants objected to the Settlement Agreement because it did not specify "what

portion of the Net Allowed Claim, if any, will be allocated" to Lehman Brothers. *Id.* at *4. The Bankruptcy Court overruled that objection. *Id.* And it held that all other objections, as well as any that "could have been raised," were "overruled and/or waived." *Id.* at *2.

After approval, the Bankruptcy Court set the amount of the Allowed Claim payable under the Settlement Agreement at $2.375 billion. Dkt. 6. It also ordered that the "allocation and distribution of the Allowed Claim shall be conducted in accordance with the terms of the . . . Settlement Agreement." *Id.*

IV. THIS PROCEEDING

The Trustees then filed this Petition. Dkt. 1 (Pet.) at 1. As relevant here, the Petition asks the Court to determine which of the two operations envisioned by Section 3.06 should occur first: (1) the distribution to investors described in Section 3.06(a); or (2) the write-up of certificate balances set forth in Section 3.06(b). Pet. ¶34. The Trustees state that the Governing Agreements control whether to pay or write up first, stating that "[f]or trusts with Governing Agreements that clearly specify a particular order of operations," they will "follow the provisions of the Governing Agreements." *Id.* ¶36. Thus, the Trustees raise this issue only for Trusts that, they allege, "do not clearly specify . . . the Pay First Method or the Write-Up First Method." *Id.*

ARGUMENT

The Court should instruct the Trustees to follow the order of operations specified in each trust's Governing Agreement. For the Tilden Park Trusts, those Governing Agreements unambiguously require paying first. Following the Governing Agreements' Order of Operations, where applicable, is the consensus of the parties to the Tilden Park Trusts. And the Settlement Agreement's terms, which are *res judicata*, require payment to investors "in accordance with the distribution provisions of the Governing Agreement," including each Governing Agreement's Order of Operations. Settlement Agmt. §3.06(a). None of the respondents' arguments for

disregarding the Governing Agreements have merit. The Court should instruct the Trustees to follow the Pay First Method for the LMT 2007-2 and LMT 2007-4 Trusts.

I. THE TILDEN PARK TRUSTS' GOVERNING AGREEMENTS REQUIRE THE PAY FIRST METHOD

All parties involved with the Tilden Park Trusts agree that the Governing Agreements control the Order of Operations to the extent they apply. The Trustees state that "[f]or trusts with Governing Agreements that clearly specify a particular order of operations," they "intend to follow the provisions of the Governing Agreements." Pet. ¶36. And both respondents that have appeared for the Tilden Park Trusts other than Tilden Park – Nover and the Institutional Investors – agree with that approach. Nover argues that the Order of Operations should follow a method "consistent with the plain language of the Governing Agreements and the trusts' structures." Dkt. 73 at 2. And the Institutional Investors acknowledge that the Settlement Agreements only control the Order of Operations to the extent "the trust instruments do not require otherwise." Dkt. 70 at 2.

The Trustees erroneously include the Tilden Park Trusts among those that "do not clearly specify whether [they] should use the Pay First Method or the Write-Up First Method." Pet. ¶14. But the Governing Agreements for both the LMT 2007-2 and LMT 2007-4 Trusts unambiguously require the Pay First Method. The Governing Agreements reach that result through their definition of the term "Certificate Principal Amount." LMT 2007-2 Trust Agmt. at 12; LMT 2007-4 Trust Agmt. at 14. For both trusts, the "Certificate Principal Amount" directs the Trustee, "***on*** any Distribution Date on which a Subsequent Recovery is distributed," to write up the certificate balances of certificates with outstanding applied realized losses. LMT 2007-2 Trust Agmt. at 12; LMT 2007-4 Trust Agmt. at 14 (emphasis added). But for purposes of distribution, "Certificate Principal Amounts shall be determined as of the close of business of the

immediately preceding Distribution Date, ***after*** giving effect to all distributions made on such date." LMT 2007-2 Trust Agmt. at 12 (emphasis added); LMT 2007-4 Trust Agmt. at 14.

That distinction between "determining" the Certificate Principal Amount and "giving effect to all distributions" requires paying first. Because the Trustee must use the ***prior*** distribution date's certificate balances, no write-up occurring ***on*** the current Distribution Date can be considered. The write-up for the current Distribution Date will be considered only for the next month's distribution. Thus, on each distribution date, the Trustee must first make distributions and then write up balances "after giving effect to all distributions."

II. THE SETTLEMENT AGREEMENT REQUIRES FOLLOWING THE GOVERNING AGREEMENTS' ORDER OF OPERATIONS

The plain text of the Settlement Agreement reinforces the consensus among the parties to the Tilden Park Trusts: The Governing Agreements control the Order of Operations. All attempts to overrule those agreements fail.

A. The Settlement Agreement Is *Res Judicata*

The doctrine of *res judicata* bars any challenge to the Settlement Agreement's rules for paying Settlement funds. Under well-known preclusion principles, a "party may not litigate a claim where a judgment on the merits exists from a prior action between the same parties involving the same subject matter." *In re Hunter*, 4 N.Y.3d 260, 269 (2005). "The doctrine applies with full force to Bankruptcy Court determinations." *Evergreen Bank N.A. v. Dashnaw*, 246 A.D.2d 814, 815 (3d Dep't 1998); *see also Ins. Co. of Pa. v. HSBC Bank USA*, 10 N.Y.3d 32, 38 (2008) ("Res judicata 'applies with full force to matters decided by the bankruptcy courts . . . .'"). *Res judicata* applies "not only [to] issues actually litigated, but also to 'issues that . . . could have been raised' in the prior action." *HSBC Bank*, 10 N.Y.3d at 39 (quoting *Federated Dep't Stores, Inc. v. Moitie*, 452 U.S. 394, 398 (1981)). Simply put, "a party who has

been given a full and fair opportunity to litigate a claim should not be allowed to do so again." *Hunter*, 4 N.Y.3d at 269.

These principles preclude any objection to the Settlement Agreement's payment terms. The Bankruptcy Court gave all certificateholders notice and "the opportunity to be heard in opposition" to the Settlement Agreement. *In re Lehman Bros.*, 2017 WL 2889658, at *2. It then overruled the objections it received and found that any objection that "could have been raised" was "overruled and/or waived." *Id.* at *2. Thus, the Bankruptcy Court has already rejected any objection to the Settlement Agreement's payment procedures, and *res judicata* bars any party from raising such a challenge now. *HSBC Bank USA*, 10 N.Y.3d at 39. Neither can any party challenge the Settlement Agreement as commercially unreasonable, since the Bankruptcy Court has found those terms "reasonable, fair and equitable and supported by adequate consideration." *In re Lehman Bros.*, 2017 WL 2889658, at *1; *HSBC Bank USA*, 10 N.Y.3d at 40.

B. The Settlement Agreement Adopts the Governing Agreements' Order of Operations

Because the Bankruptcy Court's approval of the Settlement Agreement has preclusive effect, the unambiguous text of the Settlement Agreement controls how the Trustees must make payments to investors. Where, as here, "a contract is complete, clear and unambiguous, it must be enforced according to its plain meaning." *Littleton Constr. Ltd. v. Huber Constr., Inc.*, 27 N.Y.3d 1081, 1083 (2016). This rule "applies with even greater force in commercial contracts negotiated at arm's length by sophisticated, counseled businesspeople." *Bank of N.Y. Mellon v. WMC Mortg., LLC*, 136 A.D.3d 1, 6 (1st Dep't 2015) (citation omitted). "[C]ourts may not by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties under the guise of interpreting the writing." *Id.* (citations omitted).

The plain text of the Settlement Agreement provides that the Trustees must follow each

trust's Governing Agreement when deciding the Order of Operations. First, Section 3.06(a) requires "distribution in accordance with the distribution provisions of the Governing Agreement." Second, Section 3.06(b) permits write-ups only "to the extent permitted under each Trust's Governing Agreement." Settlement Agmt. § 3.06(b). And third, prohibiting any creative reading of these Sections, Section 3.06(c) provides that if "the payment procedure described in Sections 3.06(a) and 3.06(b) may not conform to the terms of the Governing Agreement for a particular Accepting Trust," that procedure "shall be modified" to ensure "conformance with the terms of the Governing Agreement for a particular Trust." *Id.* § 3.06(c). The repeated emphasis on the Governing Agreements shows that the Settlement Agreement parties intended the Governing Agreements to determine the Order of Operations for each trust.

The Settlement Agreement's structure reinforces that result. The "distribution provisions" referenced in Section 3.06(a) necessarily include the provisions governing ***when*** the distribution takes place, and specifically, whether it precedes or follows the write-up of certificate balances. For example, the LMT 2007-2 Trust Agreement's distribution terms instruct the Trustee to distribute funds to various classes of certificates until the "Class Principal Amount thereof has been reduced to zero." LMT 2007-2 Trust Agmt. § 5.02(a)(iv). To carry out that instruction, the Trustee must determine, for each class of certificates, the "Class Principal Amount" – a term whose amount depends on the "Certificate Principal Amount." *Id.* § 1.01. And the definition of "Certificate Principal Amount," in turn, instructs the Trustee how to write up certificate balances and prescribes the Order of Operations. That cross-reference shows that, for the Trustee to distribute funds "in accordance with the distribution provisions of the Governing Agreement," Settlement Agmt. § 3.06(a), the Trustee must necessarily follow the Order of Operations that each Governing Agreement provides.

If there were any doubt about whether the Governing Agreements control, Section 3.06(c) of the Settlement Agreement removes it. That clause dictates that, "if the payment procedure described in Sections 3.06(a) and 3.06(b) ***may not conform*** to the terms of the Governing Agreement," that method "***shall be modified*** to distribute that Trust's Plan Payments as a payment of principal under the Governing Agreement for that Trust, or in such other manner . . . [that] is in conformance with the terms of the Governing Agreement." Settlement Agmt. § 3.06(c) (emphasis added). Thus, even if Sections 3.06(a) and 3.06(b) did not require referring the Order of Operations to the Governing Agreements – and they do – Section 3.06(c) would still overrule those provisions and require that the Trustees "conform[ ]" to the "terms of the Governing Agreement[s]" instead. *Id.* The Court should follow the Settlement Agreement's plain language and require the Trustees to make distributions "in accordance with the distribution provisions of the Governing Agreement," and write up certificate balances when "permitted under each Trust's Governing Agreement." *See Littleton Constr. Ltd.*, 27 N.Y.3d at 1081.[2]

The Trustees also understand that the Settlement Agreement leaves the Order of Operations to the Governing Agreements. First, the Trustees acknowledge that the Settlement Agreement "left unaddressed" whether "to apply the Settlement Payment Write-Up ***after*** making a distribution of the Settlement Payment to Certificateholders of those Subject Settlement Trusts, or before determining principal distribution amounts for each class of Certificateholders." Pet. ¶34. Second, the Trustees do not request judicial instruction for "trusts with Governing Agree-

[2] Section 3.06(c)'s clarifying language is not present in the JPMorgan settlement agreement. No. 657387/2017, Dkt. 3, § 3.06 (JPMorgan agreement). As Tilden Park has explained in the JP Morgan Article 77 proceeding, each component of Sections 3.06(a) & (b) in that settlement agreement applies on its own terms, referencing the Governing Agreements when appropriate. No additional provision compels conformance of those terms to the Governing Agreements.

ments that clearly specify a particular order of operations," instead describing the choice between the Pay First and Write-Up First Methods as "not problematic" for those Trusts. *Id.* ¶36.[3] As key parties to both the Governing Agreements and the Settlement Agreement, the Trustees' intent to follow the Governing Agreements dispels any doubt that those agreements control the order of operations here.

C. Arguments Against The Governing Agreements' Order of Operations Fail

Some investors defy Section 3.06(a)'s plain text and insist that the Trustees should exclusively apply either the Pay First Method or the Write-Up First Method to all trusts. Those investors are wrong.

1. *Section 3.06(b) Does Not Overrule the Governing Agreements*

AIG and the Institutional Investors contend that the Settlement Agreement requires the Trustees to ignore the Governing Agreements and apply the Pay First Method for all trusts instead. Dkt. 70 ("II Answer") at 2 & n.7; Dkt. 54 ("AIG Answer") at 2.[4] Their contention relies on the final sentence of Section 3.06(b), which states: "For 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 Plan Payments on the Net Allowed Claim provided for in Subsection 3.06(a)." II Answer at 2 n.7 (quoting Settlement Agmt.

[3] The Trustees mistakenly contend, however, that the two Trusts in which Tilden Park Capital Management LP has an interest, LMT 2007-2 and LMT 2007-4, do not specify whether the Pay First or Write-Up First Method should apply. *See* Pet. Ex. A, Dkt. 2, at 1, 3. As described below in Part II, both Trusts specify the Pay First Method. *See infra* Part II.

[4] However, both respondents hedge their bets and say that the Governing Agreements "do not clearly call for them to deviate from the Settlement Agreement's prescribed order of operations." AIG Answer at 2-3; *see also* II Answer at 2 ("The settlement agreement requires Pay First, and the trust instruments do not require otherwise."). Thus, no party asserts that even an unambiguous Governing Agreement is trumped by any Order of Operations that may be set forth in the Settlement Agreement.

§ 3.06(b)); AIG Answer at 2 (same). According to these investors, if the Trustees apply the Write-Up First Method, then the write-up envisioned by Section 3.06(b) will "affect the distribution of Plan Payments on the Net Allowed Claim," thereby contravening the final sentence of Section 3.06(b).

The Institutional Investors misread the language they cite. Section 3.06(b) provides that the write-up must not "affect the distribution . . . ***provided for in Subsection 3.06(a)***." Settlement Agmt. § 3.06(b) (emphasis added). And the distribution provided for in Section 3.06(a) is a "distribution in accordance with the distribution provisions of the Governing Agreements." *Id.* § 3.06(a). Thus, reading Sections 3.06(a) and 3.06(b) together – as the Court must – the last sentence of Section 3.06(b) requires that writing up must not affect the Trustee's duty to distribute funds in accordance with the Governing Agreements. *See Diamond Castle Partners IV PRC, L.P. v. IAC/InterActivecorp*, 82 A.D.3d 421, 422 (1st Dep't 2011) ("[C]lauses of a contract should be read together contextually in order to give them meaning." (quotation omitted)).

That reading is reinforced by the first sentence of § 3.06(b), which provides for a write-up "to the extent permitted under each Trust's Governing Agreement." Settlement Agmt. § 3.06(b). Ironically, the Institutional Investors' own position would violate the very sentence of Section 3.06(b) they invoke by "affect[ing] the distribution provided for in Subsection 3.06(a)." If, as AIG and the Institutional Investors claim, the Trustees should ***always*** pay first, regardless of the Governing Agreements, the Trustees would violate Section 3.06(a) by failing to follow the distribution provisions of Governing Agreements that require writing up first.

Additionally, the Institutional Investors' interpretation of Section 3.06(b) would bring that provision into irreconcilable conflict with Section 3.06(c). As noted above, Section 3.06(c) provides that, if "the payment procedure described in Sections 3.06(a) and 3.06(b) may not

conform to the terms of the Governing Agreement," then the "distribution described above ***shall be modified***" to ensure "conformance with the terms of the Governing Agreement for a particular Trust." Settlement Agmt. § 3.06(c) (emphasis added). The Institutional Investors' interpretation would cause a paradox: Section 3.06(b) would always require Pay First, but Section 3.06(c) would require that Section 3.06(b) "shall be modified" wherever it did not "conform to the terms of the Governing Agreement" because those Governing Agreements required Write-Up First. *Id.* And that paradox would imply, bizarrely, that the Settlement Agreement's drafters in one breath required Pay First with the final sentence of Section 3.06(b), only to nullify that result in the next breath with Section 3.06(c), the immediately adjacent clause.

The Court need not – and should not – impose that paradox on the Trustees. "[W]here two seemingly conflicting contract provisions reasonably can be reconciled, a court is ***required*** to do so and to give both effect." *Moulton Paving, LLC v. Town of Poughkeepsie*, 950 N.Y.S.2d 762, 766 (2d Dep't 2012) (quoting *LI Equity Network, LLC v. Vill. In the Woods Owners Corp.*, 79 A.D.3d 26, 35 (2d Dep't 2010) (emphasis added)). There is an easy way to reconcile the two clauses here: Section 3.06(b) provides for the existence of, and method for, a write-up, but also makes clear at the same time that writing up "shall not affect" the method of "distribution . . . provided for in Subsection 3.06(a)" – distribution according to the Governing Agreements. Settlement Agmt. § 3.06(b). The Court should adopt that interpretation and avoid the conflict with Section 3.06(c) that the Institutional Investors' position would cause.[5]

[5] AIG also argues that paying certificates must occur before writing them up because Section 3.06(a) appears in the Settlement Agreement before Section 3.06(b). Dkt. No. 54 (AIG Answer) at 2. That is nonsense: The Settlement Agreement does not organize its terms by temporal order. By AIG's logic, for example, the "Plan Payments" that pay out Settlement funds have to occur before the REMIC tax opinion approving those payments because the former term appears first in the Settlement Agreement. *See* Settlement Agmt. §§ 1.28 ("Plan Payments" definition),

2. *Section 6.04 Does Not Overrule the Governing Agreements*

For similar reasons, AIG is wrong to assert that Section 6.04 "forbids" applying the Governing Agreements' order of operations instead of the Settlement Agreement. Dkt. 54 (AIG Answer) at 2. Section 6.04 merely states that "compliance with this Settlement Agreement and its Exhibits, including the provisions relating to Plan Payments, shall be deemed compliance with the applicable Governing Agreements and no Party or Investor shall make any subsequent claim to the contrary." Settlement Agmt. § 6.04. Section 6.04 does provide that the Settlement Agreement controls over the Governing Agreements ***if*** there is a conflict. But there is no conflict because Section 3.06(a) clearly requires the Trustees to refer the order of operations to the Governing Agreements.

If, by contrast, AIG were right that Section 6.04 always requires Pay First, that would contradict Section 3.06(c), which requires avoiding readings of the "payment procedure described in Sections 3.06(a) and 3.06(b)" that do "not conform to the terms of the Governing Agreement." Settlement Agmt. § 3.06(c). The Court can easily avoid that contradiction and reconcile Sections 3.06(c) and 6.04. Complying with Section 3.06(a)'s dictate to refer the order of operations to the Governing Agreements is "compliance with th[e] Settlement Agreement" under Section 6.04. Settlement Agmt. § 6.04. Even if the last sentence of Section 3.06(b) were interpreted as AIG reads it, to require Pay First, Section 3.06(c) would overrule that instruction whenever the Governing Agreements require an Order of Operations, again in compliance with the Settlement Agreement. There is no need to deem compliance with the Settlement Agreement

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1.31 ("REMIC Opinion" definition). The Court should avoid that absurd result and interpret the Settlement Agreement based on what its text says, not the order in which its terms occur.

to comply with the Governing Agreements because the two do not conflict.[6] *Moulton Paving*, 950 N.Y.S.2d at 766.

3. *The Bankruptcy Court's Non-Ruling Does Not Control*

The Institutional Investors have also argued in the JPMorgan Article 77 case that certain extemporaneous comments by the Bankruptcy Court at a hearing require the Trustees to pay first here in all circumstances. *See* Ellis Decl. Ex. C (transcript); No. 657387/2017, Dkt. 663 (Institutional Investors' brief), at 8. Because the Bankruptcy Court ***refused*** to rule as the Institutional Investors wanted, however, that court's offhand comments – which it later retracted – are not binding on, or even informative for, this Court.

The Bankruptcy Court's comments stem from a motion the Institutional Investors filed there to enjoin this Petition and stop the Trustees from purportedly evading the Bankruptcy Court's "exclusive jurisdiction" over the Settlement Agreement. *See* Ellis Decl. Ex. D (bankruptcy order). The Bankruptcy Court denied that motion and directed the Trustees only to "strictly enforce[ ]" the Settlement Agreement. *Id.* at 2-3. At a hearing on that motion, after the Institutional Investors had argued at length for a Pay First interpretation of the Settlement Agreement – and cited the final sentence of Section 3.06(b) without informing the court of Section 3.06(c) – the Bankruptcy Court at first stated that it thought that interpretation was "clear." *See, e.g.*, *id.* Ex. C (transcript) at 45:7-10. In the JPMorgan Article 77 proceeding, the Institutional Investors have cited such statements as proof that Section 3.06(b) requires paying first. *See, e.g.*, No. 657387/2017, Dkt. 576, at 13-14.

[6] If there were any conflict between Section 3.06(a) and Section 6.04, Section 3.06(a) would control. Section 3.06(a)'s decision to delegate the order of operations is more specific than Section 6.04's general rule for interpreting the Settlement Agreement. If there is "inconsistency between a specific provision and a general provision of a contract," "the specific provision controls." *Muzak Corp. v. Hotel Taft Corp.*, 1 N.Y.2d 42, 46 (1956).

Read in its entirety, however, the transcript shows that the Bankruptcy Court did not accept the Institutional Investors' self-serving statements wholesale. Following the interchange cited by the Institutional Investors, counsel for the Trustees noted that Section 3.06(c) "says that if the distributions required by the settlement agreement deviate from the terms of the governing agreements, then we don't follow the settlement agreement, we follow[ ] the governing agreements." Ellis Decl. Ex. C at 50:6-9. The Bankruptcy Court then said, "[y]ou're right. We were focusing on the one provision, and it's more complicated than that." *Id.* at 51:10-12. Moreover, counsel for certain noteholders (including Tilden Park) advised the Bankruptcy Court that they had not received "notice" or a chance to "weigh in" on interpreting the Settlement Agreement. *Id.* at 49:20-23. Realizing that fact, the Bankruptcy Court made clear that it was ***not*** ruling on the Settlement Agreement and assured the parties that it was "not making evidentiary findings" because "the due process point is a serious point"; "[d]ue process is a nonnegotiable right and it is of concern to me that appropriate notice be given." *Id.* at 51:15-20. The Bankruptcy Court then entered an order that did not address the order of operations. Ellis Decl. Ex. D. At best, the April 19 transcript shows that the Bankruptcy Court withdrew its first impression after realizing it was formed without the benefit of full briefing and argument. Contrary to the claims of the Institutional Investors, those retracted comments do not – and should not – bind this Court.

4. *The Court Should Not Refer The Order of Operations To The Bankruptcy Court*

The Court also should not refer any issue relating to the Order of Operations to the Bankruptcy Court. The Bankruptcy Court requested that this Court refer questions to that court only "if issues arise . . . regarding the interpretation of the RMBS Settlement Agreement." Ellis Decl. Ex. D at 2. Because the only issues in this case are what the ***Governing Agreements*** mean, there

is no issue regarding the Settlement Agreement for either this Court or the Bankruptcy Court to decide.

From the face of the Petition, the answers, and the parties' positions in the JPMorgan case, no party argues that the Settlement Agreement overrides any unambiguous Order of Operations set forth in such trust's Governing Agreement. Indeed, that approach is mandated by the Settlement Agreement's plain text. *See* pp. 8-10, *supra*. And the Settlement Agreement does not purport to dictate any method by which this Court should interpret the Governing Agreements' order of operations. Thus, all the interpretive work to be done in this case will involve what the ***Governing Agreements*** mean, not the Settlement Agreement. And determining the meaning of the Governing Agreements is plainly a job for this Court, not the Bankruptcy Court. Ellis Decl. Ex. C (transcript) at 53:9-14 (interpreting the Governing Agreements is not "an appropriate exercise of [the Bankruptcy Court's] jurisdiction").

In most, if not all, cases, the Governing Agreements straightforwardly provide an Order of Operations. But interpreting the Governing Agreements remains this Court's job even if those Governing Agreements' Order of Operations is less than entirely clear. If any given Governing Agreement is ambiguous or silent, then this Court can decide, using traditional rules of New York law for contract interpretation, what Order of Operations should apply. *Impala Partners v. Borom*, 133 A.D.3d 498, 499 (1st Dep't 2015) ("where a contract term is ambiguous," "parol evidence" can "be considered to clarify the disputed portions of the parties' agreement[s]"); *In re World Trade Ctr. Disaster Site Litig.*, 754 F.3d 114, 122 (2d Cir. 2014) (an "'omission as to a material issue can create an ambiguity'" to be resolved by extrinsic evidence where "'the context within the document's four corners suggests that the parties intended a result not expressly stated'" (quoting *Hart v. Kinney Drugs, Inc.*, 67 A.D.3d 1154 (3d Dep't 2009))). It is obvious

that every Governing Agreement intended ***some*** Order of Operations so that the Trustees could coherently make distributions. As a result, even if any Governing Agreement is silent, ambiguous, or even contradictory, this Court can and should use parol evidence to interpret that agreement as a matter of New York law, not federal bankruptcy law.

Thus, referral to the Bankruptcy Court is simply unnecessary. There is "no reason" to certify interpretive questions when the proper reading "is dictated by the[] text." *United States v. Halloran*, 821 F.3d 321, 337 (2d Cir. 2016) (declining to certify question to New York Court of Appeals). And referring interpretive issues back to the Bankruptcy Court will also cause more delay, frustrating the Settlement Agreement's requirement that distributions occur "promptly." Settlement Agmt. §3.01. Thus, because the Settlement Agreement's terms unambiguously require the Trustees to follow the Governing Agreements' distribution procedures – and because the Governing Agreements' meaning is squarely a task for this Court – this Court should fully resolve the issues presented by the Trustee's petition.

5. *Referring The Order of Operations To The Governing Agreements is Commercially Reasonable*

Nover argues that the Tilden Park Trusts' Governing Agreements require Write-Up First and that Pay First would cause "absurd, commercially unreasonable distributions." Dkt. 73 ("Nover Answer") at 2. For the Tilden Park Trusts, Nover is incorrect: Those Trusts' Governing Agreements require Pay First. *See* pp. 6-7, *supra*. But purported "commercial[] unreasonable[ness]" is no reason to avoid the Order of Operations specified by each Governing Agreement. Dkt. 73 at 2.

"[A]n inquiry into commercial reasonableness is only warranted where a contract is ambiguous." *Fundamental Long Term Care Holdings, LLC v. Cammeby's Funding LLC*, 20 N.Y.3d 438, 445 (2013). The Settlement Agreement could hardly be clearer that the Governing

Agreements control the Order of Operations, and the Governing Agreements for the Tilden Park Trusts unambiguously require Pay First. *See* pp. 6-7, *supra.*

In any event, Nover identifies nothing "absurd" or "unreasonable" about applying Pay First where the Governing Agreements require it. Nover complains that Pay First might cause "leakage to subordinate certificateholders." Nover Answer at 2. Nover supplies no proof that material "leakage" would result in the Tilden Park Trusts.[7] And, contrary to Nover, courts recognize that what Nover calls "leakage" – the payment of Settlement funds as "excess cash flow" in certain Pay First trusts with overcollateralization or undercollateralization features – is reasonable and should be enforced where it exists. *See, e.g.*, *In re Bank of N.Y. Mellon*, 56 Misc. 3d 210, 223-24 (Sup. Ct. N.Y. Cty. 2017).

Regardless, the fact that the Governing Agreements might cause distributions that Nover does not like is no reason to rewrite those contracts. New York courts refuse to rewrite contracts on "purpose" grounds just because the contract might be "financially disadvantageous." *407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 282 (1968). Otherwise, "all commercial contracts" would be in "jeopardy." *Id.* Even where the terms are "novel or unconventional, this does not warrant an excursion beyond the four corners of the document." *Wallace v. 600 Partners Co.*, 86 N.Y.2d 543, 548 (1995); *see also Jade Realty LLC v. Citigroup Commercial Mortg. Trust 2005-EMG*, 20 N.Y.3d 881, 884 (2012). And as noted above, the Bankruptcy

[7] Nover also claims that "leakage" would cause "wild swings in recovery . . . not contemplated by the Settlement Agreement or the Governing Agreements." Nover Answer at 2. Once again, Nover offers only speculation that "wild swings in recovery" would occur in any Tilden Park Trust. But Nover's claim also makes no sense: Given prior Article 77 cases involving the order of operations, it is hard to suggest that the drafters of the Settlement Agreement were unaware that the Order of Operations would affect what certificateholders receive what amount of Settlement funds. It thus makes ample sense that the Settlement Agreement would specify a clear answer by delegating the order of operations to the Governing Agreements and by warning the Trustees to "conform" to those Governing Agreements. Settlement Agmt. §§ 3.06(a), 3.06(c).

Court already found the Settlement Agreement "reasonable, fair and equitable and supported by adequate consideration." *In re Lehman Bros.*, 2017 WL 2889658, at *1. Any argument now to the contrary is barred by *res judicata*. *HSBC Bank USA*, 10 N.Y.3d at 40. The Court should reject any absurdity or commercial unreasonableness arguments and enforce the Governing Agreements' payment terms as written.

CONCLUSION

The Court should instruct the Trustees (1) to follow the order of operations set forth in the Governing Agreement for a given trust, and (2) for the LMT 2007-2 and LMT 2007-4 Trusts, apply the Pay First Method.

Dated: October 19, 2018
New York, New York

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, on October 19, 2018, I caused the foregoing Merits Brief to be served on all counsel of record and unrepresented parties by filing the same with the Court's NYSCEF system.

/s/ Justin M. Ellis