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

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| In the matter of the application of | |
| U.S. BANK NATIONAL ASSOCIATION, et al., | Index No. 651625/2018 |
| | Friedman, J. |
| Petitioners, | |
| For Judicial Instructions under CPLR Article 77 on the Administration and Distribution of a Settlement Payment. | **RESPONSE BRIEF OF THE INSTITUTIONAL INVESTORS AND AIG CONCERNING THE PETITION** |

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Pursuant to the September 5, 2018 Stipulation Regarding Merits Briefing Schedule and Trustee Substitutions (Dkt. No. 132), the Institutional Investors and the AIG Parties submitted an Opening Brief on October 19, 2018 addressing the issues raised in the Petition concerning the distribution of over $230 million in settlement proceeds to 30 Lehman RMBS trusts identified in Exhibit 1 to the Affidavit of David M. Sheeren, filed therewith.[1]

With respect to 13 of those 30 trusts,[2] the Institutional Investors, AIG Parties, and other interested parties have now agreed in principal on the terms of a consensual distribution, which will avoid the need for further merits briefing. The Trustees and/or Payment Administrators are currently reviewing various draft proposed judgments for those 13 trusts. If entered by the Court, in excess of $170 million is expected to be distributed to those 13 trusts, leaving approximately $60 million in settlement funds in escrow for the 17 remaining disputed trusts held by the Institutional Investors and/or AIG Parties. This Response Brief is submitted with respect to those 17 remaining disputed trusts.[3]

## SUMMARY OF ARGUMENT

As set out in Section I of the Opening Brief of the Institutional Investors and AIG Parties, the Court should dismiss the Petition as to the remaining 17 trusts because it does not properly invoke Article 77. There are no *bona fide* questions concerning the order of operations or whether the Trustees should enforce the Zero Distribution Provision. The Trustees should also reimburse those 17 trusts for the costs of this proceeding.

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[1] Unless otherwise defined herein, all capitalized terms have the meaning given to them in the Petition.

[2] Those 13 trusts are: LXS 2005-2, LXS 2005-3, LXS 2006-5, LXS 2007-1, LXS 2007-6, LXS 2007-10H, LXS 2007-14H, LXS 2007-15N, LXS 2007-3, SAIL 2006-BNC3, SASCO 2004-S3, SASCO 2005-2XS, and SASCO 2005-SC1.

[3] The Institutional Investors and AIG Parties reserve the right to submit further merits briefing as to the 13 trusts identified in Footnote 2, in the event a consensual judgment is not submitted or entered as to those trusts.

In the alternative, if the Court declines to dismiss the Petition, the Trustees should be directed to distribute the Settlement on a Pay First basis, without temporary overcollateralization, and to enforce the Zero Distribution Provision.

As to the order of operations, Tilden Park agrees with the Institutional Investors that Pay First should be employed, while Nover and Poetic Holdings VII LLC argue for Write Up First.[4] Because the Settlement Agreement requires Pay First, and because the Governing Agreements are silent as to the order of operations, Pay First should be employed. Those arguing for Write Up First rely entirely on the definition of "Certificate Principal Amount." For the disputed trusts, however, that definition is ***silent*** as to whether subsequent recoveries should be added at the beginning or end of a distribution. The Settlement Agreement fills that silence.

Further, not a single investor has argued that the Settlement Payment itself can or should create temporary overcollateralization. So, the question of temporary overcollateralization is not in dispute. Pay First should therefore be employed in a manner that does not lead to the creation of temporary overcollateralization *during* a distribution.

The Zero Distribution Provision is in dispute for just 5 of the 17 trusts.[5] For those trusts, the Institutional Investors and AIG Parties argue that the provision should be enforced, while only Nover asserts that it should not. The Trustees' Petition answers itself on this point, because the Trustees simply ask the Court whether or not they should "apply" an unambiguous term of their contracts. They do not need judicial instructions to conclude that they should do so.

[4] Although Tilden Park's arguments are fundamentally different than those of the Institutional Investors and AIG Parties, the requested outcome is the same: Pay First. The Olifant Funds and Ambac previously argued that Write Up First should be employed, but the trusts for which they have appeared are included among the 13 trusts for which a consensual distribution is anticipated.

[5] Those five trusts are: LMT 2005-3, LMT 2006-1, LMT 2007-2, LMT 2007-4, and SARM 2006-8.

## I. The Trustees Must Employ the Pay First Method.

For the reasons described in Section II.A of the Institutional Investors' and AIG Parties' Opening Brief, the Settlement Agreement requires Pay First. However, as set out in that Opening Brief, Paragraph 3.06(c) of the Settlement Agreement provides a mechanism for the distribution methodology in the Governing Agreements to control over that in the Settlement Agreement to the extent that they conflict.[6]

Thus, the question here is whether the Governing Agreements unambiguously require Write Up First. They do not. In the Petition, the Trustees do not cite a single provision of any Governing Agreement bearing on the order of operations. To the contrary, the Trustees concede that the Governing Agreements "do not clearly specify" the order of operations.[7] They are correct. The Governing Agreements are silent on this question.

Investors arguing for Write Up First rely entirely on the definition of "Certificate Principal Amount" in the Governing Agreements, asserting that it requires Subsequent Recoveries to be added to certificate balances at the *beginning* of a given distribution. It says no such thing. The only temporal direction in the definition of Certificate Principal Amount is that subsequent recoveries be added to certificate balances <u>on the same day</u> as a given distribution. It does not specify whether that addition should take place <u>before</u> or <u>after</u> the distribution on that day. A representative definition of Certificate Principal Amount, for LXS 2005-10, states as follows:

[6] Paragraph 3.06(c) states: "Should the party responsible for calculating distributions and/or making distributions to Investors under the terms of the Governing Agreements of a given Trust or a court determine that 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, the distribution described above 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 as the party responsible for calculating distributions under the terms of the Governing Agreements of a given Trust or a court should determine is in conformance with the terms of the Governing Agreement for a particular Trust."

[7] Petition ¶ 36.

> **[O]n each Distribution Date on which a Subsequent Recovery is distributed, the Certificate Principal Amount** of any Group 1 Certificates whose Certificate Principal Amount has previously been reduced by application of Pool 1 Applied Loss Amounts or the Certificate Principal Amount of any Group 2 Certificates whose Certificate Principal Amount has previously been reduced by application of Pool 2 Applied Loss Amounts, as applicable, **will be increased, in order of seniority, by an amount** (to be applied pro rata to all Certificates of such Class) **equal to the lesser of** (1) any Deferred Amount for each such Class immediately prior to such date and (2) in the case of holders of the Group 1 Certificates and the Group 2 Certificates, **the total amount of any Subsequent Recovery from the related Mortgage Pool distributed on such Distribution Date** after application (for this purpose) to any more senior Classes of such Certificates; provided, further, that to the extent that any Applied Loss Amount was reimbursed under the Certificate Insurance Policy, any Subsequent Recovery otherwise payable on the Insured Certificates shall instead be payable to the Certificate Insurer.).

This definition simply provides that "***on each Distribution Date*** on which a Subsequent Recovery is distributed … the Certificate Principal Amount … ***will be increased*** … by an amount … equal to … the total amount of any Subsequent Recovery from the related Mortgage Pool ***distributed on such Distribution Date*** …."

That definition is silent as to whether subsequent recoveries must be added to certificate balances before or after the distribution. It merely requires that they be added to certificate balances "***on***" that "***Distribution Date***." No one disputes that subsequent recoveries must be added to certificate balances on the same day as the distribution. The dispute is whether they must be added ***before*** the distribution on that day, or ***after*** the distribution on that day. The definition of Class Principal does not speak to that question.

The Trustees have it right in the Petition: the Governing Agreements "do not clearly specify" the order of operations.[8] In light of that silence, the Pay First sequence in the Settlement Agreement controls.

[8] Petition ¶ 36.

## II. The Trustees Must Not Recognize Temporary Overcollateralization.

As set out in Section II.C of the Institutional Investors' and AIG Parties' Opening Brief, the definitions of Overcollateralization Amount preclude the creation of temporary overcollateralization during a distribution. Not a single investor argues otherwise. Therefore, this issue is not in dispute, and the Trustees should employ the Pay First method in a manner that does not recognize the creation of temporary overcollateralization.

## III. The Trustees Must Apply the Zero Distribution Provision.

The Trustees next ask the Court whether to "apply" the Zero Distribution Provision. As noted above, only Nover takes the position that the Trustees should not apply this provision, and it only makes this argument as to 5 of the 17 remaining disputed trusts.[9] However, Nover did not even submit a merits brief addressing the Zero Distribution Provision in those five Lehman trusts.

In any event, the Trustees do not allege that this provision is ambiguous or conflicts in any way with the Settlement Agreement. Moreover, the Settlement Agreement is silent as to the treatment of Zero Balance Classes. The Trustees should therefore "apply" this unambiguous provision of the Governing Agreements.

## CONCLUSION

In sum, there are far fewer disputes in this Lehman Article 77 than in the JPMorgan Article 77. Investors here have been able to reach agreements on *nearly all* of the trusts included in the Article 77. That fact speaks volumes to whether this Article 77 was necessary in the first place. As set out in the Opening Brief, the Petition does not meet the requirements of Article 77, and it should be dismissed, with costs awarded to the remaining Trusts. If the Court determines to provide the Trustees instructions as to the 17 remaining trusts, the Trustees should be directed to

[9] Those five trusts are: LMT 2005-3, LMT 2006-1, LMT 2007-2, LMT 2007-4, and SARM 2006-8.

Pay First, without temporary overcollateralization. As to the Zero Distribution Provision, which affects just 5 trusts, the Court should direct the Trustees to enforce that term of the Governing Agreements.

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