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

In the matter of the application of

U.S. BANK NATIONAL ASSOCIATION, WELLS FARGO BANK, NATIONAL ASSOCIATION, WILMINGTON TRUST, NATIONAL ASSOCIATION, 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 CPLR Article 77 on the Administration and Distribution of a Settlement Payment.

Index No. 651625/2018

Friedman, J.

PETITIONERS' MEMORANDUM OF LAW IN OPPOSITION TO MOTION OF THE INSTITUTIONAL INVESTORS AND AIG TO DISMISS THE PETITION

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Other Authorities

Petitioners U.S. Bank National Association ("U.S. Bank"); Wells Fargo Bank, National Association ("Wells Fargo"); Wilmington Trust, National Association ("WT") and Wilmington Trust Company ("WTC" and collectively with WT, "Wilmington Trust"); and Citibank, N.A. ("Citibank"), solely in their respective and various capacities as trustees, indenture trustees, successor trustees, securities administrators, paying agents, and/or calculation agents (collectively, the "Petitioners"), submit this memorandum of law in opposition to the motion of the Institutional Investors and the AIG Parties[1] to dismiss the Petition.[2]

INTRODUCTION

The Institutional Investors' motion is premised on the assertion that, despite the appearance of numerous interested investors, represented by experienced counsel bound by rules of professional conduct, no parties other than themselves have presented "bona fide" or "honest" legal arguments in this proceeding. The Institutional Investors' brief and the five separate merits briefs filed alongside their own by other large sophisticated investment firms include many diametrically opposed interpretations of the Governing Agreements. Yet the Institutional Investors argue that the Petitioners were so unreasonable in (correctly) anticipating disputes regarding the complex issues of contract interpretation set forth in the Petition that the Petition must be dismissed and the Petitioners subjected to sanction. Even a cursory glance at the docket in this proceeding dooms the Institutional Investors' motion.

As demonstrated repeatedly, the issues described in the Petition are subject to multiple reasonable methods, and the Governing Agreements, which were not drafted with complex and large-dollar settlements like these in mind, do not unambiguously resolve the divergent

[1] The Institutional Investors and AIG Parties are referred to collectively as the Institutional Investors for purposes of this memorandum of law.
[2] Capitalized terms not otherwise defined herein have the meanings ascribed in the Petition.

approaches. Unlike in past global RMBS settlements that resulted in follow-on interpretative proceedings like this one, here the Institutional Investors ***expressly agreed*** that the Petitioners would have a right to file a proceeding in a court of competent jurisdiction to seek resolution of issues just like those presented here. It is nonsensical that the Institutional Investors would acknowledge the Petitioners' right to seek judicial guidance on the interpretation of their Governing Agreements and then seek sanctions just months later when Petitioners availed themselves of that right, arguing that Petitioners never had any "honest doubt" about interpretation issues.

The motion should be denied for at least the following five reasons:

1) The Petitioners recognized the likelihood of disputes regarding the issues raised in the Petition, and their judgment has been borne out by the filing of numerous positions opposing the Institutional Investors' preferred interpretation of the Governing Agreements;
2) The Governing Agreements are not unambiguously *silent* on the order of payment distribution and certificate balance write-ups issue described in the Petition, as demonstrated by the filing of facially reasonable arguments by other parties concerning the meaning of and guidance provided by particular terms in the Governing Agreements;
3) It is not unambiguously clear that the Settlement Agreements address order of operations issues at all;
4) The Institutional Investors admit that the Governing Agreements address the OC Trust issues described in the Petition, but other investors assert that their preferred interpretation was *rejected* by a court considering a similar global RMBS settlement and similar arguments; and

5) It is a reasonable argument, which has been previously advanced, that the imposition of a bar on distributions to classes of certificates with no current balance may be contrary to the "basic methodology" of the Governing Agreements cited by the Institutional Investors themselves.

BACKGROUND

The Petition concerns two settlement agreements—the Covered Loan Settlement Agreement (or the "CLSA") and the Transferor Loan Settlement Agreement (or the "TLSA," and collectively with the CLSA, the "Settlement Agreements"). Petition ¶¶ 1, 4. The Settlement Agreements were the subject of lengthy negotiations among Lehman Brothers Holdings Inc. and other debtors (the "LBHI Debtors"), the Institutional Investors (with respect to the CLSA), and, as to certain provisions, certain RMBS trustees (some, but not all, of which are Petitioners in this proceeding). *Id.*, ¶ 1. The two Settlement Agreements cover different mortgage loans, and Trusts that are the subject of the Petition may be impacted by either, or both, of those agreements. *See id.* ¶ 4.

The Settlement Agreements were negotiated during the pendency of another Article 77 proceeding involving unrelated trusts filed before Justice Scarpulla concerning the interpretation of distribution and write-up provisions in trust governing agreements and a settlement agreement with, among others, Countrywide Home Loans, Inc. (the "*Countrywide II* Article 77"). *See In re Bank of N.Y. Mellon*, 51 N.Y.S.3d 356 (N.Y. Sup. Ct. 2017) ("*Countrywide II*"). While in many respects the Settlement Agreements resemble prior global RMBS settlement agreements, including the agreement at issue in the *Countrywide II* Article 77, the distribution and write-up provisions in the Settlement Agreements, drafted with the benefit of knowing what issues necessitated the *Countrywide II* Article 77 and how that proceeding transpired, are different in at least two important respects: (1) they make clear that the Governing Agreements would trump any

conflicting distribution or write-up provisions in the Settlement Agreements,[3] and (2) they expressly provide the Petitioners a right "to seek further guidance from a court of competent jurisdiction regarding the applicable procedures under the Governing Agreements related to the distribution of Plan Payments or determining the balance of securities potentially affected by distribution of the Plan Payments" (the "Judicial Guidance Provision").[4]

The CLSA did not provide for a particular claims value, but rather set forth a mechanism by which the claims would be valued by the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") in an estimation proceeding. CLSA § 3.02. The Bankruptcy Court issued a March 15, 2018 estimation order valuing the claims covered by the Covered Loan Settlement Agreement. The estimation order resulted in the valuation of claims under the Covered Loan Settlement Agreement and ordered implementation of that agreement. In contrast to the Covered Loan Settlement Agreement, the Transferor Loan Settlement Agreement provided for a fixed claim amount that was not the subject of an estimation proceeding and did not result in any implementing order from the Bankruptcy Court. TLSA § 3.01.

The Lehman estate made a distribution on claims, including those provided for in the two Settlement Agreements, in April 2018. *See* Petition ¶ 28. For dozens of trusts as to which they were able to determine there were no material questions concerning the appropriate distribution,

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[3] Section 3.06(c) of the CLSA provides:

> 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.

[4] CLSA § 3.06(d).

the Petitioners distributed funds without seeking judicial guidance.[5] Even as to the Trusts that are at issue in the Petition, Petitioners did not seek guidance on many waterfall questions relating to the Trusts. Only as to a subset of the Trusts, the Petitioners filed this action seeking guidance on three issues: (1) the order of operations in applying the distribution of the settlement funds and the write-ups of certificate principal balances (the "Order of Operations" issue), Petition ¶ 14; (2) the distribution of settlement funds as excess cashflow to junior certificates as a result of temporary overcollateralization (the "Temporary OC" issue); *id.*, at ¶ 48; and (3) the distribution of funds to classes of certificates written off because of realized by losses incurred by the Trusts (the "Zero Distribution" issue), *id.*, at ¶ 56.

Notwithstanding the Judicial Guidance Provision granting the Petitioners the express right to seek judicial guidance in a court of competent jurisdiction concerning these questions, the Institutional Investors filed a motion in bankruptcy court seeking to enjoin the action before this Court. *See* Affirmation of Kurt W. Rademacher ("Rademacher Aff."), Ex. A. The Institutional Investors—unopposed by any other investors, because no one else had received notice of the hearing—asserted the Order of Operations issue was "resolved conclusively" by one sentence in Section 3.06. At the hearing, the Institutional Investors pressed the Bankruptcy Court to adopt their preferred interpretation of this provision as mandating a "pay first" order of operations. *See id.*, Ex. B at 55:7-12. The Bankruptcy Court declined to do so, noting on the record: "That's just getting to the substantive results that you're seeking. And what I'm saying is that I'm not going to do that." *See id.*, Ex. B at 55:13-15. Nonetheless, the Institutional Investors submitted a form of proposed injunction order in which the Institutional Investors sought to have the Bankruptcy Court impose their preferred, late-raised interpretation of the CLSA. *See id.*, Ex. C. The Bankruptcy

[5] *Compare* CLSA at 28-39 (listing accepting trusts subject to the CLSA) *and* TLSA at 20-32 (listing accepting trusts subject to the TLSA) *with* Petition, Ex. A (listing trusts at issue in this proceeding).

Court rejected their language and entered an order permitting the Petitioners to proceed in this venue. *See id.*, Ex. D.

ARGUMENT

A. Standard of Review

CPLR § 7701 provides that "[a] special proceeding may be brought to determine a matter relating to any express trust . . . ." In considering a motion to dismiss, courts accept the facts alleged in the pleading as true, and accord "every possible favorable inference" to the nonmoving party. *Fin. Guar. Ins. Co. v. Morgan Stanley ABS Capital I Inc.*, 2017 WL 593142 (N.Y. Sup. Ct. 2017) (Friedman, J.).

B. The Petitioners Are Properly Seeking Guidance Under Article 77

As demonstrated below, very real disputes exist regarding the issues raised in the Petition, and therefore the Institutional Investors' motion to dismiss the Petition must fail. A proceeding such as this one is appropriate if there is a "legitimate concern that a particular beneficiary's insistence upon an unreasonable position might, without instruction on the matter, lead to significantly costlier and disruptive litigation." RESTATEMENT (THIRD) OF TRUSTS § 71, cmt. d.

The *Countrywide II* Article 77, along with the still-pending proceeding filed before this Court in *In re Wells Fargo Bank, N.A.*, No. 657387/2017 ("*JPMC II*"), concerning the JPMorgan Chase settlement agreement, amply demonstrates that it was a virtual certainty that trust beneficiaries would advance opposing views on the types of issues presented in the Petition, which has been borne out in this case. Numerous sophisticated beneficiaries, represented by experienced counsel, have opposed the relief sought by the Institutional Investors. Those arguments are best litigated here, where they can be resolved in an orderly and uniform manner, in a single forum with jurisdiction over all other trust beneficiaries, and avoid lawsuits brought against Petitioners in piecemeal fashion *after* a distribution that could be difficult, or even impossible, to reverse. The

filings by these beneficiaries conclusively demonstrate that the Petitioners were reasonable in anticipating disputes, and mandate dismissal of the Institutional Investors' motion.

C. There Are "Bona Fide" Disputes Regarding the Interpretation of the Governing Agreements

Petitioners are not advocating for any particular interpretation with respect to any of the three main issues raised in the Petition. However, for reasons shown below, the fact that large, sophisticated institutions are advocating for very different interpretations of the agreements at issue and raising facially reasonable positions is fatal to the challenges raised by the Institutional Investors, and instead supports the relief sought in the Petition.

1. The Order of Operations Is Susceptible to Multiple Interpretations

a. The Governing Agreements Are Ambiguous Concerning the Appropriate Order of Operations

The Institutional Investors premise their argument that there is no Order of Operations issue on their assertions that (1) the Governing Agreements are entirely "silent"—containing not a single term of an even arguable impact—on the issue, *see* Opening Brief of the Institutional Investors and AIG Concerning the Petition ("II's Mot.") at 2; and (2) any doubt that the Petitioners harbor on this point is not "honest," *id.* at 6. What the Petition alleges is that the order of operations is "not *clearly* specified" by the Governing Agreements,[6] and as the Petitioners reasonably anticipated, multiple investors have since taken the position that not only do the Governing Agreements expressly control on the Order of Operations issue, they mandate an outcome opposite of that preferred by the Institutional Investors.[7]

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[6] Petition ¶ 36 (emphasis added).

[7] *See* Opening Merits Br. of Olifant Fund, Ltd., FFI Fund Ltd. and FYI Ltd. (collectively, the "Olifant Funds") at 4 ("The Language of the Governing Agreements for the Olifant Fund Trusts Is Unambiguous and Requires the Write-Up First Method"); Merits Br. of Poetic Holdings VII LLC ("Poetic") at 1 (adopting position of Olifant Funds); Merits Submission of Nover Ventures, LLC ("Nover," and collectively with the Olifant Funds and Poetic, the "Opposing Respondents"), at 2 ("The Write-Up First Method is consistent with the plain language of the Governing Agreements and the trusts' structures . . . ."); *cf.* Opening Merits Br. of Ambac Assurance Corp. at 3-4

Petitioners have no basis to conclude that the Opposing Respondents were *unreasonable* or *dishonest* in their arguments concerning the Governing Agreements, as the Institutional Investors claim. The Olifant Funds (with its arguments adopted by Poetic), for example, provide a detailed analysis of the definition of "Certificate Principal Amount" in an exemplar governing agreement. While that definition does not use the words "write-up first" to mandate an outcome, the Olifant Funds highlight language that, at least in isolation, could reasonably suggest a write-up-first order of operations. *See* Opening Merits Br. of the Olifant Funds at 5-6 ("Because the Allocable Shares are distributed 'on such Distribution Date' and the Certificate Principal Amount is calculated before any distribution, the Certificate Principal Amount must be written up by the amount of the Allocable Shares before the Allocable Shares are distributed as principal via the principal distribution waterfall."). Despite the fact that agreements governing Trusts in which they are invested contain similar language to that cited by the Olifant Funds,[8] Tilden Park highlights *different* language in the definition of Certificate Principal Amount for its Trusts to reach the *opposite* conclusion. Merits Br. of Tilden Park at 6-7 ("That distinction between 'determining' the Certificate Principal Amount and 'giving effect to all distributions' requires paying first."). Such disputes provide a sound basis for Petitioners to invoke CPLR Article 77.

The Institutional Investors' assertion that the Governing Agreements could not possibly have any bearing on the Order of Operations issue comes as a surprise given provisions in the

(notwithstanding write-up language contained in CLSA, Governing Agreements bar any write-up of insured certificates).

[8] *Compare* LMT 2007-2 PSA Def. of Certificate Principal Amount ("on any Distribution Date on which a Subsequent Recovery is distributed, the Certificate Principal Amount of any Class of Certificates then outstanding for which any Realized Loss or any Subordinate Certificate Writedown Amount has been applied will be increased") *with* LXS 2007-1 PSA Def. of Certificate Principal Amount ("[O]n each Distribution Date on which a Subsequent Recovery is distributed, the Certificate Principal Amount of any Class of Group 1 Senior Certificate, Group 2 Senior Certificate or Group 1-2 Subordinate Certificates whose Certificate Principal Amount has previously been reduced by application of a Pool 1-2 Applied Loss Amount and the Certificate Principal Amount of any Class of Group 3 Certificates whose Certificate Principal Amount has previously been reduced by application of a Pool 3 Applied Loss Amount, as applicable, will be increased.").

CLSA itself, which the Institutional Investors negotiated and signed. The parties that negotiated and signed the CLSA unquestionably understood that the distribution of the settlement payments could result in bona fide disputes under the Governing Agreements. *First*, Section 3.06(c) of the CLSA recognizes that a "party responsible for calculating distributions" may "determine the payment procedure" of the Settlement Agreement "may not conform to the terms of the Governing Agreements . . . .". If the Institutional Investors believed at the time that no such conclusion could be reasonably reached, they would not have agreed to include that provision in the CLSA. *Second*, the CLSA granted Petitioners the express right "to seek further guidance from a court of competent jurisdiction regarding the applicable procedures under the Governing Agreements related to the distribution of Plan Payments or determining the balance of securities potentially affected by distribution of the Plan Payments." Again, if the Institutional Investors believed that the CLSA left no possible room for disagreement under the Governing Agreements, this provision would have been unnecessary.

b. The Settlement Agreement May Not Clearly Resolve the Order of Operations Issues in Favor of the Institutional Investors

Even if the Governing Agreements *were* entirely silent on the Order of Operations, the Institutional Investors could only prevail on their motion if the Settlement Agreements clearly and plainly resolved the issues on their own.

As the Olifant Funds argue, the CLSA differs from the Countrywide Agreement to which the Institutional Investors seek to compare it, namely by *removing* the ordinal term "after" that mandated the conclusion in *Countrywide II* that the write-up occur *after* the payment of settlement funds. *See* Olifant Funds Br. at 2. Instead, the Institutional Investors rely on the final sentence of Section 3.06(b):

> 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).

It is not clear, however, that this language was intended to have any impact whatsoever on the Order of Operations implemented by the Petitioners: Petitioners do not make distributions "of Plan Payments on the Net Allowed Claim." Distributions "on the Net Allowed Claim" are made by the LBHI Debtors' estate *to the Petitioners* pursuant to CLSA Section 3.06(a). One possible meaning of this provision is that distributions by Petitioners to Certificateholders will not affect how much money the Lehman estate would owe under the CLSA. Petitioners are not seeking resolution of this interpretation of the CLSA by this Court, only recognition that a party could reasonably interpret the Settlement Agreements as silent on the Order of Operations issue and reach the conclusion that judicial interpretation of the *Governing Agreements* was therefore the appropriate mechanism for resolution.

2. Distributions on OC Trusts Are Indisputably Governed by the Governing Agreements, Which Are the Subject to Multiple Reasonable Interpretations

Paradoxically, the Institutional Investors concede that the Governing Agreements *do* bear on the Temporary OC issue, and they require that no temporary overcollateralization occur. *See* II Mot. at 2, 11. The Institutional Investors further argue that temporary overcollateralization is "an absurd, commercially unreasonable" result barred under the Governing Agreements. *See id.*, at 12. However, Justice Scarpulla squarely *rejected* similar arguments offered by these same investors. *See Countrywide II*, 51 N.Y.S.3d at 365-68. Without any reference to the decision in *Countrywide II*, the Institutional Investors now argue that here, the three words "give effect to" (as apparently applied to both the distribution and write-up operations) conclusively resolve in their favor any possible questions concerning the flow of funds under each of the complex waterfall provisions at issue. *See* II Mot. at 11. Whether or not the Court ultimately agrees with the

Institutional Investors' position is academic as to whether Petitioners' decision to commence this proceeding was reasonable. Given a court has already ruled against some of the arguments the Institutional Investors have taken here, the reasonableness of Petitioners' belief that disagreement on this issue could arise seems self-evident.

3. Zero Distribution Provisions Are Reasonably Susceptible to Multiple Interpretations

Petitioners reasonably anticipated arguments by investors that Zero Distribution Provisions must be interpreted practically based on the structure of the transaction and the reasonable expectations of investors. In fact, the Institutional Investors elsewhere advance arguments that individual provisions in the Governing Agreements must be interpreted to "realize the parties' reasonable expectations" through a "practical" implementation of those terms. II Mot. at 12-13. One of these "practical" implementations, according to the Institutional Investors, is that "the basic allocation methodology in the settlement distributes the Settlement Payment across trusts *according to their past and future losses*." *Id.* at 13. For this reason, Petitioners reasonably anticipated argument in favor of a "practical" interpretation of the Governing Agreements such that the Zero Distribution Provisions should not be applied to *bar* distributions to certificates that have borne not only losses, but so *many* losses that their balances have been reduced to zero, and indeed this is what Tilden Park argued in its answer in this proceeding. *See* Answer of Tilden Park at ¶ 5. The positions and arguments made by the Institutional Investors on other issues—namely that the Governing Agreements be applied "practically" to reimburse losses caused by the LBHI Debtors' breaches—demonstrate why it was reasonable for the Petitioners to seek Court guidance with respect to the Zero Distribution Issue, which is reasonably subject to the same logic.

CONCLUSION

Multiple sophisticated investors, guided by experienced counsel, who have a financial interest in the interpretation of the waterfall issues raised in the Petition, have offered and supported different conclusions about how the Petitioners should distribute the settlement proceeds. The Institutional Investors assert that their positions are so obviously correct that Petitioners should be sanctioned for instituting a proceeding through which other investors could be heard on the issues. That position not only reflects remarkable hubris but also ignores the protections for which the Petitioners bargained in the Governing Agreements. Petitioners are not required to bear the risk that the Institutional Investors' interpretations are wrong, and given the arguments made in *Countrywide II* and *JPMC II* and the decision in *Countrywide II*, that risk is real. For the foregoing reasons, the Institutional Investors' motion to dismiss the Petition and sanction the Petitioners should be denied.

HAHN & HESSEN LLP

Zachary G. Newman
Stephen J. Grable
Brigitte R. Rose
488 Madison Avenue
New York, New York 10022
(212) 478-7200

FAEGRE BAKER DANIELS LLP

Robert L. Schnell*
Stephen M. Mertz*
Michael F. Doty*
Ryan G. Milligan*
2200 Wells Fargo Center
90 S. Seventh Street
Minneapolis, Minnesota 55402
(612) 766-6000

Attorneys for Petitioner Wells Fargo Bank, National Association

* admitted pro hac vice

MAYER BROWN LLP

Christopher J. Houpt
Jarman D. Russell
1221 Avenue of the Americas
New York, New York 10020-1001
Tel. (212) 506-2500

Attorneys for Petitioner Citibank, N.A.

ALSTON & BIRD LLP

Alexander S. Lorenzo
90 Park Avenue
New York, New York 10016
Tel.: 212-910-9400

Attorneys for Petitioners Wilmington Trust, National Association and Wilmington Trust Company

MORGAN, LEWIS & BOCKIUS LLP

Michael S. Kraut
101 Park Avenue
New York, New York 10178
Tel.: 212-309-6000

Kurt W. Rademacher
1701 Market Street
Philadelphia, Pennsylvania 19103
Tel.: 215-963-5000

Attorneys for Petitioner U.S. Bank National Association