

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., :

Petitioners, :

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

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Index No. 651625/2018

Friedman, J.

**INITIAL STATEMENT
OF AIG RESPONDENTS
CONCERNING
THE PETITION**

The undersigned AIG-affiliated respondents (collectively, the “AIG Respondents”), which hold certificates in the “Subject Settlement Trusts” listed on Exhibit 1 hereto, join in the position of the Institutional Investors that (i) the Petition should be dismissed pursuant to CPLR 3211(a)(2) and 3211(a)(7), (ii) the Trustees should be required to reimburse the trusts for the Trustees’ costs in bringing the proceeding, and (iii) the Settlement Agreement and Governing Agreements should be enforced as written. With regard to the last of these items, the AIG Respondents say as follows.¹

A. Settlement Proceeds Should Be Distributed Pay First, Write-Up Second.

The Settlement Agreement has already answered the question the Petition purports to raise regarding the proper order of operations for distributions: Section 3.06 of the Settlement Agreement makes clear that the correct order is pay first, write-up second. Specifically, Section 3.06(a) provides that distribution of the settlement payment should occur as if it were a subsequent recovery available for distribution on that date. Subsection 3.06(b) then provides for the write-up of the trusts’ certificate balances. Aside from the obvious order of these provisions, the last sentence of 3.06(b) expressly confirms that the write-up portion of the distribution is to occur *after* the distribution: “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).*” (Emphasis added). This language necessarily requires that payment come before write-up, as to perform the write-up first would “affect the distribution” of the Allocable Shares, in contravention of Section 3.06(b).

There is no basis for straying from the clear language of the Settlement Agreement; in fact, the Settlement Agreement forbids it. Section 6.04 expressly provides that “compliance with this Settlement Agreement and its Exhibits ... shall be deemed compliance with the applicable Governing Agreements *and no Party or Investor shall make any subsequent claim to the contrary.*” (Emphasis added.) The Trustees, moreover, concede that the Governing Agreements for the

¹ Capitalized terms shall have the meanings set forth in the Petition.

relevant Subject Settlement Trusts do not clearly call for them to deviate from the Settlement Agreement's prescribed order of operations. *See* Petition ¶ 36 (“the Governing Agreements for the Subject Settlement Trusts listed on Exhibit A hereto do not clearly specify whether the Petitioners should use the Pay First Method or the Write-Up First Method in this circumstance”). Accordingly, the Settlement Agreement should be enforced as written.

B. The Trustees Should Not Give Effect To Transitory Overcollateralization.

The clear intent of the overcollateralization provisions identified by the Trustees in the Petition (*see, e.g.*, ¶¶ 39, 41) is to ensure that principal is distributed primarily to the most senior bonds, except when the trust is overcollateralized (meaning that the principal value of the underlying mortgages exceeds the principal balance of the outstanding securities). Only then is principal permitted to divert as “excess cashflow” to more junior bonds.

The bonds at issue in the Petition are generally *not* overcollateralized; the principal value of the underlying mortgage loans does not exceed the principal value of the outstanding bonds. If the pay first, write-up second distribution methodology is followed, the trusts will not be overcollateralized at the beginning of the distribution or at the end of the distribution. To the extent there is some construction of the order of operations that could permit the trusts to be seen as being overcollateralized for a split-second in the middle of the distribution (and there is not), such an interpretation would be wholly inconsistent with the structure and intent of the Governing Agreements, the text of the Settlement Agreement, and common sense, as it would permit “leakage” of funds to junior bonds that should rightfully go to senior bonds.

C. Zero-Balance Certificates May Not Receive Distributions Or Be Written Up

The Zero Distribution Provision quoted in Paragraph 56 of the Petition is clear on its face in providing that zero-balance certificates may not receive distributions or be written up: “If on any Distribution Date the Class Principal Amount of the Class or Classes ... has been reduced to zero, the Senior Principal Distribution Amount for such Class or Classes ... for such date ... and each subsequent Distribution Date *shall be zero.*” (Emphasis in Petition.) The ambiguity the Petitioners claim to see simply is not there.

Dated: May 30, 2018
New York, New York

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Attorneys for Respondents American General Life Insurance Company, American Home Assurance Company, American International Reinsurance Company, Ltd., Lexington Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa., The United States Life Insurance Company in the City of New York, and The Variable Annuity Life Insurance Company

Exhibit 1

Trusts Subject To This Article 77 Proceeding In Which The AIG Respondents Hold An Interest

BNCMT 2007-3
LMT 2007-7
LMT 2005-1
LXS 2005-3
LXS 2005-10
LXS 2006-10N
LXS 2006-8
LXS 2006-11
LXS 2007-10H
LXS 2006-15
LXS 2006-20
LXS 2007-3
LXS 2007-11
LXS 2007-7N
LXS 2007-9
LXS 2007-15N
LXS 2007-12N
LXS 2007-20N
LXS 2007-16N
LXS 2007-18N
LMT 2008-6
LXS 2007-14H
SARM 2005-23
SARM 2006-1
SARM 2005-8XS
SARM 2005-12
SARM 2005-17
SARM 2006-3
SARM 2006-6
SAIL 2006-2
SAIL 2003-BC13
SAIL 2003-BC12
SAIL 2005-8
SAIL 2005-9
SAIL 2005-10
SAIL 2005-11
SASC 2005-1
SASC 2003-35
SASC 2004-4XS
SASC 2004-16XS
SASC 2005-9XS
SASC 2005-15

SASC 2005-17
SARM 2006-4
SARM 2006-5
SAIL 2006-4
SARM 2006-9
SARM 2006-10
SARM 2006-11
SARM 2007-8
SARM 2006-12
SARM 2007-3
SARM 2007-6
SARM 2008-2