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

In the Matter of the Application of THE BANK OF NEW YORK MELLON, in its Capacity as Trustee or Indenture Trustee of 530 Countrywide Residential Mortgage-Backed Securitization Trusts, Petitioner, For Judicial Instructions under CPLR Article 77 on the Distribution of a Settlement Payment	Index # 150973/2016 IAS Part 39 Honorable Saliann Scarpulla

MEMORANDUM OF LAW IN SUPPORT OF RESPONDENTS' VERIFIED ANSWER TO THE VERIFIED PETITION

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Respondents Prosiris Capital Management LP ("Prosiris") and Tilden Park Capital Management LP ("Tilden Park" and, together with Prosiris, "Respondents") respectfully submit this memorandum of law in support of their concurrently filed verified answer to the verified petition for judicial instructions ("Petition") filed by Petitioner The Bank of New York Mellon ("BNY Mellon" or "Petitioner"), in its capacity as Trustee or Indenture Trustee of 530 Countrywide residential mortgage-backed securitization trusts ("Covered Trusts").

PRELIMINARY STATEMENT

Respondents own certificates related to 14 of the Covered Trusts (the "14 Trusts"). This response applies only to those 14 Trusts and does not take a position as to the remaining 516 Covered Trusts.

The analysis of how settlement proceeds are to be distributed must begin with the Settlement Agreement itself. Here, the Settlement Agreement expressly states that the settlement proceeds are to be distributed "to investors in accordance with the distribution provisions of the Governing Agreements . . . as though it was a Subsequent Recovery available for distribution on that distribution date." *See* Settlement Agreement § 3(d)(i). It further provides that "*after* the distribution of the Allocable Share to Investors . . . the Trustee will allocate the amount of the Allocable Share for that Covered Trust . . . to increase the Class Certificate Balance . . . of each class of Certificates . . . to which Realized Losses have been previously allocated." *See* Settlement Agreement § 3(d)(ii) (emphasis added).

The Petition ignores this language and asks this Court to endorse a single distribution methodology for the entire $8.5 billion settlement regardless of the disparate terms governing the hundreds of heterogeneous trusts covered by the Settlement Agreement. Rather than examining the language of the variety of individual agreements that govern the Covered Trusts ("Governing

Agreements"), Petitioner asserts that there is only one question: how to apply provisions governing the "write up" of certificate principal balances when the settlement funds are received by a Covered Trust. To resolve this question, Petitioner asks the Court to pick one of three instructions and apply them across the board without any mention of what the individual Governing Agreements say. Petitioner claims that either (a) switching the order of certain distribution operations or (b) calculating overcollateralization as Petitioner suggests (rather than in accordance with the terms of the relevant Governing Agreement) will preclude what the Trustee characterizes as "leakage" of proceeds to classes that—according to the Trustee—should not receive them. To be sure, Petitioner's request may be well founded as to some portion of the 516 Covered Trusts that Respondents do not own certificates in, but the express terms of the Governing Agreements for the 14 Trusts preclude the application of a one-size fits all methodology.

While many Governing Agreements may in fact be silent or ambiguous on the "write up" issue, the Pooling and Servicing Agreements governing the 14 Trusts are not. The Pooling and Servicing Agreements that govern the 14 Trusts ("PSAs") are different in key respects from the Governing Agreements for the majority of other Covered Trusts and leave no doubt that the portion of the settlement payment that has been allocated to each of the 14 Trusts should be distributed prior to any write up of the certificate principal balance and without alteration to any calculations of overcollateralization. This certainty derives from several features.

First, the PSAs for the 14 Trusts are not silent or ambiguous on when the certificate principal balance is calculated for the purposes of making a distribution of principal in a particular month and when the certificate principal balance is written up to account for a Subsequent Recovery. The PSAs for the 14 Trusts expressly provide that the entire distribution

of principal is based on the certificate principal balance prior to the date funds are distributed, whereas any write up (and any change to the certificate principal balances) must occur on the distribution date.

Second, for calculating limits on principal distribution, many of the Governing Agreements require the use of an overcollateralization *amount*, whereas the PSAs for the 14 Trusts require the use of an overcollateralization *target*.[1] The overcollateralization *amount* typically takes into account certificate principal balances, subsequent recoveries, and stated principal balances of mortgage loans. In contrast, the overcollateralization *target* only depends on stated principal balances of mortgage loans and is not currently impacted by subsequent recoveries. Because the 14 Trusts only require an overcollateralization *target* to determine principal distributions, the effect of subsequent recoveries on the calculation of overcollateralization *amount* cited in the Petition (¶¶ 25-26) is inapplicable to the 14 Trusts.

Third, unlike many of the Governing Agreements, the PSAs for the 14 Trusts require the distribution of funds not just to pay down the principal balance of the senior-most certificates, but also to compensate certificateholders for unpaid realized losses. Repayment of unpaid realized losses is an essential feature of the 14 Trusts that is explicitly required by the PSAs. Likely for that very reason, when Petitioner has in the past made distributions of subsequent recoveries (in at least one case, a very large subsequent recovery) to trusts governed by nearly identical Pooling and Servicing Agreements, it has distributed first and written up certificate principal balance second; proceeding in that manner resulted in distributions to subordinated

[1] When the Petition refers simply to "overcollateralization" (*see, e.g.*, ¶¶ 26-30) it is referring to what Covered Trusts other than the 14 Trusts typically define as the "overcollateralization amount" or "overcollateralized amount".

certificate classes. For these 14 Trusts, contrary to Petitioner's generalization, this repayment of earlier losses is not "leakage," an anomaly, an unintended consequence, or a windfall.

While Petitioner invites this Court to alter the "write up" mechanics, the plain language and framework set forth in the PSAs for the 14 Trusts are already clear on all of the issues highlighted by Petitioner. Any ruling other than instructing Petitioner to distribute settlement funds to the 14 Trusts before writing up certificate principal balances, in accordance with the PSAs, would rewrite the PSAs in violation of the Settlement Agreement and black letter contract law.

Finally, in addition to leaving undisturbed the "write up" procedures specified in the PSAs, any instructions issued by the Court should direct Petitioner to distribute the funds allocated to the 14 Trusts as though they were being distributed on the distribution date (as defined by the PSAs) in February 2016. As Petitioner concedes in the Petition and supporting papers, absent its request to divert the proceeds of the litigated Settlement Agreement into an escrow account, the settlement funds would have been transferred to the certificate accounts of each Covered Trust upon receipt in February 2016 and distributed on the next distribution date in accordance with the PSAs. Petitioner's decision to commence this proceeding should not change the relative positions of certificateholders.[2] Any instructions from the Court should reflect this principle, requiring the Trustee to Distribute Allocable Shares as if the distribution had occurred as of the next distribution date following February 10, 2016 receipt of funds.

[2] To be clear, additional losses may be realized by the 14 Trusts in the period between the distribution date when the funds would have been distributed but for the Petition and the time when the Court renders a decision in this matter. Such losses should not be allowed to alter the waterfall distribution of the Allocable Shares between certificates in the 14 Trusts (which, as set forth in the PSAs for the 14 Trusts, depends on unpaid realized losses).

STATEMENT OF FACTS

A. Respondents and Their Certificates

Respondent Prosiris Capital Management LP is a credit-oriented investment manager based in New York City, and Respondent Tilden Park Capital Management LP is a multi-strategy fixed-income-focused alternative asset manager based in New York City. Respondents, on behalf of their advisory clients, which are private investment vehicles with interests held by public and private pension plans, endowments, and foundations, among others, hold pass-through certificates that represent interests in the cash flows associated with the 14 Trusts, all of which are overcollateralization trusts.[3] All but one of the certificates Respondents hold are "senior certificates", such as Class 1-A-2, Class 2-A-2, etc., which the PSAs for the 14 Trusts designate as "Super Senior Support Certificates" because they are subordinate to the Class 1-A-1 and Class 2-A-1 Certificates ("Super Senior Certificates").[4] For any particular securitization, Respondents' Class 1 Certificates are collateralized by mortgage loans in the related Loan Group 1, and their Class 2 Certificates are collateralized by mortgage loans in the related Loan Group 2.

Respondent Tilden Park holds the following certificates representing interests in certain of the 14 Trusts:

Covered Trust	Trust Type	Certificate Class	Relevant Loan Group
CWALT 2005-61	Overcollateralization	1-M-1, 2-A-4	1, 2
CWALT 2005-69	Overcollateralization	A-2	Full Deal
CWALT 2005-72	Overcollateralization	A-4	Full Deal
CWALT 2005-76	Overcollateralization	2-A-2, 3-A-2	2, 3

[3] An overcollateralization trust is a residential mortgage-backed security that is structured to create credit enhancement, or protection, for certificateholders in the trust through "overcollateralization." In general, overcollateralization is the amount by which the aggregate principal balance of the mortgage loans in the trust exceeds the aggregate principal balance of the certificates issued by the trust.

[4] Respondents own a single "Mezzanine Certificate" in CWALT 2005-61, which is subordinate to all the senior classes. Even though this certificate is not a senior certificate, this does not alter any of the arguments involving cash flow distribution with respect to it.

CWALT 2005-IM1	Overcollateralization		
CWALT 2006-OA3	Overcollateralization	1-A-2, 2-A-2	1, 2
CWALT 2006-OA7	Overcollateralization	1-A-3, 2-A-2	1, 2
CWALT 2006-OA8	Overcollateralization	1-A-2, 2-A-4	1, 2
CWALT 2006-OA10	Overcollateralization	1-A-2, 2-A-2, 3-A-2, 4-A-2	1, 2, 3, 4
CWALT 2006-OA14	Overcollateralization	1-A-2, 2-A-2	2
CWALT 2007-OA3	Overcollateralization	1-A-2, 2-A-2	1, 2
CWALT 2007-OA8	Overcollateralization	1-A-2, 2-A-2	1, 2
CWMBS 2006-3	Overcollateralization	1-A-2, 1-A-3, 2-A-3, 3-A-2	1, 2, 3
CWMBS 2006-OA5	Overcollateralization	1-A-2, 2-A-2, 3-A-2	1, 2, 3

Respondent Prosiris holds the following certificates representing interests in certain of the 14 Trusts:

Covered Trust	Trust Type	Certificate Class	Relevant Loan Group
CWALT 2005-61	Overcollateralization	2-A-4	2
CWALT 2005-69	Overcollateralization		
CWALT 2005-72	Overcollateralization		
CWALT 2005-76	Overcollateralization		
CWALT 2005-IM1	Overcollateralization	A-2	Full Deal
CWALT 2006-OA3	Overcollateralization	1-A-2, 2-A-2	1, 2
CWALT 2006-OA7	Overcollateralization		
CWALT 2006-OA8	Overcollateralization	1-A-2	1
CWALT 2006-OA10	Overcollateralization		
CWALT 2006-OA14	Overcollateralization	1-A-2, 2-A-2	1, 2
CWALT 2007-OA3	Overcollateralization		
CWALT 2007-OA8	Overcollateralization	1-A-2, 2-A-2	1, 2
CWMBS 2006-3	Overcollateralization	1-A-2	1
CWMBS 2006-OA5	Overcollateralization	1-A-2, 2-A-2, 3-A-2	1, 2, 3

B. The Settlement Agreement

On June 28, 2011, Petitioner The Bank of New York Mellon, in its capacity as Trustee or Indenture Trustee of the Covered Trusts, entered into a settlement agreement with Bank of America Corporation, Countrywide Financial Corporation, and related entities ("Settlement Agreement").[5] The Settlement Agreement, which was approved on April 27, 2015, required the

[5] The Settlement Agreement is attached as Exhibit B to the Petition.

payment of $8.5 billion to BNY Mellon for the benefit of investors in the Covered Trusts. Pursuant to the Settlement Agreement, Petitioner retained an expert to allocate the $8.5 billion among the Covered Trusts according to an allocation formula. *See* Settlement Agreement § 3(c). In cases where a trust was collateralized by multiple loan groups, the expert treated each class of certificates supported by a distinct loan group as a separate Covered Trust. *Id.* On January 11, 2016, the expert produced a report that identified the portion of the Settlement Amount that had been allocated to each Covered Trust ("Allocable Share").

The Settlement Agreement requires Petitioner to distribute each Allocable Share "to investors in accordance with the distribution provisions of the Governing Agreements . . . as though it was a Subsequent Recovery available for distribution on that distribution date." *See* Settlement Agreement § 3(d)(i). It further provides that "*after* the distribution of the Allocable Share to Investors . . . the Trustee will allocate the amount of the Allocable Share for that Covered Trust . . . to increase the Class Certificate Balance . . . of each class of Certificates . . . to which Realized Losses have been previously allocated." *See* Settlement Agreement § 3(d)(ii) (emphasis added).

As the Petition notes, the Settlement Agreement makes clear that no part of the Agreement, including the provisions concerning the distribution of the Allocable Shares and writing up of certificate principal balances, amends the Governing Agreements for the Covered Trusts. *See* Settlement Agreement § 3(d)(v).

C. Distribution of Subsequent Recoveries Under the PSAs for the 14 Trusts

1. Subsequent Recoveries Are Distributed to Certificates as Available Funds

The Settlement Agreement requires Petitioner to treat the Allocable Shares as "Subsequent Recoveries" pursuant to the Governing Agreements, and to distribute them

accordingly. *See* Settlement Agreement § 3(d)(i). In contrast with many of the Governing Agreements for other Covered Trusts, the PSAs for the 14 Trusts treat Subsequent Recoveries as "Available Funds." *See* Excerpts from the PSAs for the 14 Trusts attached hereto as Exhibit A at 1–7.[6] By way of example, the PSA for CWALT 2006-OA3 defines Available Funds to include Subsequent Recoveries as follows:

> Available Funds: As to any Distribution Date and each Loan Group, the sum of (a) the aggregate amount held in the Certificate Account at the close of business on the related Determination Date, including any Subsequent Recoveries, in respect of such Mortgage Loans net of the related Amount Held for Future Distribution and net of Prepayment Charges and amounts permitted to be withdrawn from the Certificate Account pursuant to clauses (i) - (viii) of Section 3.08(a) in respect of such Mortgage Loans and amounts permitted to be withdrawn from the Distribution Account pursuant to clauses (i) - (iii) of Section 3.08(b) in respect of such Mortgage Loans, (b) the amount of the related Advance and (c) in connection with Defective Mortgage Loans in such Loan Group, as applicable, the aggregate of the Purchase Prices and Substitution Adjustment Amounts deposited on the related Distribution Account Deposit Date.

See id. at 6 (emphasis added). As the above definition makes clear, Available Funds include any funds in the trust's "Certificate Account," which is the account in which the Trustee holds funds prior to distributing them to certificateholders. In the case of the 14 Trusts, in addition to Subsequent Recoveries, the Certificate Account also holds principal and interest payments made by borrowers on the underlying loans on the most recent due date. In other words, Subsequent Recoveries are not segregated into a separate account for distribution to certificateholders in a special way. Rather, they are distributed in the same manner as borrowers' principal and interest payments.

2. Available Funds Are Distributed on the Distribution Date in Accordance with the Distribution Waterfall Set Forth in the PSAs

For the 14 Trusts, on the 25th of every month ("Distribution Date"), Available Funds in

[6] Respondents attach only the relevant excerpts for the Court's convenience and are prepared to produce complete copies of the PSAs for the 14 Trusts at the Court's request.

the Trust's Certificate Account are distributed in accordance with Section 4.02(a) of the applicable PSA, which sets forth the distribution waterfall. *See* Ex. A at 8–9 (excerpting the definition of Distribution Date in each PSA), 10–69 (excerpting the relevant portions of the distribution waterfall set forth in each PSA). Broadly speaking, the waterfall for the 14 Trusts requires funds to be distributed in the following manner: *first,* to pay interest (coupon payments) on the certificates in a specified sequence; *second*, to reduce the principal balance of the certificates in a specified order up to a specified amount; and *third*, to compensate certificates for unpaid realized losses in a specified sequence.

The key feature of this distribution waterfall is that the distribution of Available Funds to reduce the principal balance of the certificates is *limited* to an amount defined in the PSAs as the "Principal Distribution Amount." *See* Ex. A at 10–69 (providing for reductions in certificate principal balance "in an amount up to the Principal Distribution Amount"). The Principal Distribution Amount can be roughly defined as the certificate principal balance immediately prior to the Distribution Date, minus the difference between the stated principal balance of the mortgage loans on the Distribution Date and the "Overcollateralization Target Amount" for the Distribution Date. *Id.* at 81–84 (excerpting the definition of Principal Distribution Amount set forth in each PSA). The Overcollateralization Target Amount is currently based only on the initial stated principal balances of the mortgage loans and on loan performance and does not depend on the certificate principal balances or Subsequent Recoveries, and consequently it is not subject to the ambiguities described in the Verified Petition. (At this point in the life of the 14 Trusts, the Overcollateralization Target Amount is actually a fixed amount and does not vary on a month-to-month basis, because a Trigger Event is in effect.) *See id.* at 70–80 (excerpting the definition of "Overcollateralization Target Amount" set forth in each PSA).

To simplify, the Principal Distribution Amount represents the sum of (i) the principal payments made by the borrowers of the underlying mortgage loans over the prior month, (ii) the Overcollateralization Target Amount, and (iii) the current month's realized liquidation amount on the mortgage loans. Ex. A at 81–84.[7] The important points are that the Principal Distribution Amount (i) acts as a limitation on the amount of Available Funds that can be distributed to reduce the certificate principal balance, and (ii) is calculated independent of the size of any Subsequent Recovery that has been received.

For the 14 Trusts, after the Trustee distributes Available Funds to pay interest on the certificates (in a specified sequence) it then distributes Available Funds to reduce the principal balance of the certificates (in a specified sequence) but only "*up to the Principal Distribution Amount*." Ex. A at 10–69. After that, remaining Available Funds are distributed to compensate certificates for unpaid realized losses—that is, actual losses previously incurred by Super Senior Certificates, then Super Senior Support Certificates (and then potentially to Mezzanine Certificates) due to defaults in the underlying pool of mortgages. *Id.* If this is an example of the "leakage" identified by the Petition, it is certainly not an anomaly, an unintended consequence, or a windfall. Not only do the PSAs contemplate what Petitioner refers to as "leakage," they *require* these payments to compensate certificates for unpaid realized loss.

D. Writing Up the Certificate Principal Balance under the PSAs for the 14 Trusts

The PSAs also provide for the "writing up" of certificate principal balances in the event of a Subsequent Recovery. Ex. A at 85-92. When mortgages prepay or default, the aggregate principal balance of the collateral decreases. If the aggregate principal balance of the collateral

[7] The current month's realized loss amount on the mortgage loans is included in the Principal Distribution Amount because on the Distribution Date, mortgage loans that experienced a loss have already experienced a corresponding reduction to their principal balances, whereas the certificates do not have losses applied to them until the distribution waterfall is applied on the Distribution Date.

falls below the aggregate certificate principal balance, the Trust "realizes" the losses by writing down the principal balance of certificates, generally writing down subordinated certificates prior to writing down senior certificates, following a specific write-down waterfall. When Subsequent Recoveries are received by the trust, the Trustee must allocate those Subsequent Recoveries to "write up" the principal balance. For example, the PSA for CWALT 2006-OA3 provides as follows:

> Application of Subsequent Recoveries. On each Distribution Date, the Trustee shall allocate the amount of the Subsequent Recoveries, if any, to increase the Class Certificate Balance of the Classes of Certificates to which Applied Realized Loss Amounts have been previously allocated, first, pro rata based on the Applied Realized Loss Amounts previously allocated the Group 1 Senior Certificates and Group 2 Senior Certificates, a) sequentially, to the Class 1-A-1, Class 1-A-2 and Class 1-A-3 Certificates, in that order, in each case by not more than the amount of the Unpaid Realized Loss Amount for such Class and (b) sequentially, to the Class 2-A-1, Class 2-A-2 and Class 2-A-3 Certificates, in that order, in each case by not more than the amount of the Unpaid Realized Loss Amount for such Class, and second, sequentially, to the Class M-1, Class M-2, Class M-3, Class M-4, Class M-5, Class M-6 and Class M-7 Certificates, in that order, in each case by not more than the amount of the Unpaid Realized Loss Amount of such Class.

Id.. Importantly, Subsequent Recoveries are applied "[o]n each Distribution Date" whereas the Principal Distribution Amount described above is calculated based on the certificate principal balance "immediately prior to such Distribution Date," and thus by definition before the certificate principal balance is written up. *Compare id.* at 85–87 (excerpting the provisions of the PSAs for the 14 Trusts requiring Subsequent Recoveries to be applied "[o]n each Distribution Date") *with id.* at 81–84 (excerpting the provisions of the PSAs for the 14 Trusts specifying that Principal Distribution Amount must be calculated based on certificate principal balance "immediately prior to such Distribution Date"). Because the certificate principal balance is calculated as of any Distribution Date, *i.e.*, once a month, "immediately prior" to such

Distribution Date really means the certificate principal balance as of the previous Distribution Date.

ARGUMENT

I. The Settlement Agreement Requires the Trustee to Distribute the Allocable Shares Prior to Writing Up the Certificate Principal Balance

"[W]hen parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms". *R/S Assoc. v. New York Job Dev. Auth.*, 98 N.Y.2d 29, 32 (2002). The Settlement Agreement is clear that the Allocable Shares should be distributed consistent with the Governing Agreements and prior to any write up of the certificate principal balance. Settlement Agreement § 3(d). Moreover, there is no qualification to these requirements.

While Petitioner concedes that the Settlement Agreement prohibits writing up the certificate principal balance prior to any distribution (Petition ¶ 34 ("The 'write up first and pay second' order of operations is inconsistent with Subparagraph 3(d)(ii) of the Settlement Agreement")), it also asserts that nothing in the Settlement Agreement precludes writing up the certificate principal balance "solely for the purpose of determining the overcollateralization level of the OC Trust" (Petition ¶ 30). The Settlement Agreement's unqualified prohibition of writing up the certificate principal balance prior to payment cannot be read to authorize writing up the certificate principal balance for a particular purpose subsequently identified by Petitioner. "The court's role is limited to interpretation and enforcement of the terms agreed to by the parties; it does not include the rewriting of their contract and the imposition of additional terms." *Salvano v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 85 N.Y.2d 173, 182 (1995).

II. The Text and Structure of the PSAs for the 14 Trusts Compel the Distribution of the Funds Prior to Any Write Up

While Petitioner's contention that the Governing Agreements are silent as to whether the certificate principal balance is written up prior to or following a distribution may be accurate as to some of the Covered Trusts, the text and structure of the PSAs for these 14 Trusts contain unique wording and a series of features that preclude writing up the certificate principal balance prior to making a distribution.

First, the PSAs for the 14 Trusts explicitly state that the Trustee must calculate the Principal Distribution Amount by reference to the certificate principal balance "immediately prior to such Distribution Date" while the application of Subsequent Recoveries, as described above, are applied "on the Distribution Date". *See* Ex. A at 81–92.[8] The provision outlining how the Trustee must distribute Available Funds first addresses the distribution of interest and principal. *Id.* at 10–69. It is not until the last subsection of this provision that the PSAs address a write up. *Id.* at 85–92. This placement alone suggests the write up is to be done following a distribution of principal. Thus, the order of operations is clearly delineated: calculate and distribute based on the certificate principal balance "immediately prior" to the Distribution Date and write up the certificate principal balance as necessary thereafter, on the Distribution Date. Any hypothetical write up that changed, or had the effect of changing, the order of operations would leave the words "immediately prior to such Distribution Date" without force and effect. It is a well settled principle of law that a court should not adopt a construction of a contract "which will operate to leave a provision of a contract . . . without force and effect", and therefore any

[8] This stands in stark contrast to the Governing Agreements for many of the other Covered Trusts, which provide that the Trustee must use the certificate principal balance *as of the Distribution Date* for calculating the overcollateralization amount, which in turn is a factor in how much principal is distributed.

write up of the certificate principal balance prior to the Distribution Date would violate the applicable PSAs. *Ruttenberg v. Davidge Data Sys. Corp.*, 626 N.Y.S.2d 174, 177 (1995) (internal quotation marks and citations omitted).

Second, the Petitioner's proposal to write up the certificate principal balance "solely for the purpose of determining the overcollateralization level of the OC Trust" (Petition ¶ 30) is contrary to the express language of the PSAs for the 14 Trusts. The 14 Trusts only require an overcollateralization *target*, not an overcollateralization *amount,* to determine principal distributions.[9] Their PSAs currently set the overcollateralization target to be a fixed percentage of the original principal balance of the mortgage loans. Ex. A at 70–80.[10] Consequently, there is no relationship whatsoever between the current certificate principal balance and the current overcollateralization target for the 14 Trusts. The Principal Distribution Amount is calculated by subtracting the overcollateralization target and the stated principal balance of the mortgage loans on the Distribution Date from the aggregate certificate principal balance immediately prior to the Distribution Date. The amount of principal that is distributed on a monthly basis is not couched in terms of whether a particular overcollateralization level has been reached, nor is it contingent upon any order of calculations involving the certificate principal balance occurring on the Distribution Date. Instead any Available Funds in excess of the Principal Distribution Amount

[9] All overcollateralization trusts, including the 14 Trusts, generally include defined overcollateralization *targets*. Some Covered Trusts also include a defined term for overcollateralization (or overcollateralized) amounts. The distinction we are raising here between such *targets* and such *amounts* is not simply that the 14 Trusts lack overcollateralization *amounts* entirely, but merely that the Principal Distribution Amount in the 14 Trusts is defined in terms of the much simpler overcollateralization *targets*, in lieu of the more complex *amounts* used in many other trusts.

[10] By comparison, many of the other Governing Agreements base their overcollateralization amount on the certificate principal balance, which changes each month, and then base their Principal Distribution Amount on the overcollateralization amount. Some of the Governing Agreements also contain language suggesting that the aggregate certificate principal balance must be adjusted to bring it up to date prior to the calculation of the overcollateralization amount.

are distributed to compensate certificateholders, in order of seniority, for any unpaid realized losses on their certificates. Ex. A at 10–69. Thereafter, the certificate principal balance is written up. There is no middle-ground in which the certificate principal balance is written up for some purpose but not another.

Third, the PSAs applicable to the 14 Trusts explicitly cap the amount of proceeds that must go to paying down the certificate principal balance, through the Principal Distribution Amount calculation. Ex. A at 81–84.[11] As described *infra*, the 14 Trusts provide that Available Funds, which is defined to include Subsequent Recoveries such as the Allocable Share, are first to be distributed to certain categories of interest. Ex. A at 10–69. Thereafter, they are distributed "up to" the Principal Distribution Amount. *Id*. Any remaining funds are then distributed, starting with the senior-most class that has incurred losses, in an amount up to the unpaid realized loss for such class. *Id*. Thus, when Subsequent Recoveries are substantial enough to allow Available Funds to surpass the Principal Distribution Amount in the Principal portion of the waterfall, remaining funds must fall through to the lower section of the waterfall and be used to pay unpaid realized losses. This is true even when there is still outstanding principal owed to senior certificateholders in future months.

The 14 Trusts were not designed to insulate the senior-most class from the risk of any potential loss to their principal. Instead they afford limited protection of principal after which distributions are made to certificates in order of seniority for any unpaid realized loss. If the PSAs for the 14 Trusts were intended to insulate the most senior certificates from any potential loss of principal in the future, they would stipulate that no principal may be distributed to any

[11] The Governing Agreements for many other Covered Trusts, on the other hand, define the amount of principal to be distributed in terms of the size of a Subsequent Recovery. If there is a Subsequent Recovery, it is applied to reduce the certificate principal balance of the security. This limits the portion of the Allocable Share that flows to less senior certificates.

other class of certificates until both the certificate principal balance and the unpaid realized loss Amount of the senior-most class were both zero. Instead, the PSAs allow even a subordinate class of certificates that has been written down to zero to receive cash flow in the event more senior classes have been paid the interest, the Principal Distribution Amount, and unpaid realized loss to which they are entitled. Few of the senior-most classes of the 14 Trusts currently have any unpaid realized loss, but the Super Senior Support Certificates that Respondents own do. For this reason, the PSAs for the 14 Trusts provide that Respondents will receive a portion of the Allocable Shares, following the distribution of interest and principal, up to the unpaid realized loss on their certificates.

BNY Mellon's recent submission demonstrates that the 14 Trusts are structured in a fundamentally different way than the other Covered Trusts. In Exhibit 1 to the Trustee's Submission under the Order of February 29, BNY Mellon reports that a provision addressing the distribution of excess cash flow (*i.e.* cash flow in excess of what is deemed payable as interest and principal) is absent in only 17 of the Covered Trusts. Of the 14 Trusts, BNY Mellon's submission indicates an excess cash flow waterfall is absent in 13 of them. This is not a coincidence. Instead of having provisions that define excess cash flow and determine how it is distributed like many other trusts, the 14 Trusts distribute funds in excess of the principal distribution amount to certificates in order of seniority based on their respective unpaid realized losses. The 14 Trusts simplify the handling of both overcollateralization and non-principal/non-interest cash flow throughout the waterfall by eliminating the explicit labeling of both of these waterfall features.

The PSAs applicable to the 14 Trusts are clear and must be enforced as written. *R/S Assoc.*, 98 N.Y.2d at 32. Any write up prior to the distribution of Available Funds would violate

the unambiguous order of operations provided for by both the Settlement Agreement and, more importantly, the PSAs, and therefore must be rejected. Writing up the certificate principal balance prior to the Distribution Date would redefine and render irrelevant the Principal Distribution Amount, eviscerating the provisions that require any remaining funds be used to compensate certificateholders for unpaid realized losses. In effect, writing up the certificate principal balance prior to a distribution would require the court to rewrite the PSAs under the guise of contract interpretation. *Reiss v. Financial Performance Corp.*, 97 N.Y.2d 195, 199 (2001) (holding that courts 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") (internal quotation marks and citation omitted).

III. The Essential Purpose of the PSAs for the 14 Trusts Is to Allow Funds to Flow to Subordinate Classes under These Circumstances

Petitioner implies that allowing any portion of the Allocable Share to flow to less senior, subordinated certificateholders would violate the "essential purpose" of the overcollateralization structure, which Petitioner suggests is intended to protect the senior certificateholders from loss. (Petition ¶ 28.) This argument is erroneous, however, with respect to the 14 Trusts. Indeed, preventing Available Funds from flowing down the waterfall for the 14 Trusts would not only contradict the clear language of the PSAs, it would also controvert the essential purpose of how they were structured.

The 14 Trusts were structured to provide the Super Senior Certificates with only limited protection from the risk of loss and to allow subordinate certificateholders to obtain cash flow even before the Super Senior Certificates have a principal balance of zero. This reduced the risk of purchasing less senior certificates, by ensuring such certificateholders would recover some of their realized losses in the event of a sufficiently large Subsequent Recovery. While we cannot

know all the motivations of underwriters and original purchasers in structuring such provisions, it is worth noting that (nearly) all of the senior subordinated classes (*i.e.*, 1-A-2, 2-A-2, etc.) in the 14 Trusts were originally rated AAA, so the rating agencies may have taken such protection against loss into account in rating these classes. Investors such as Respondents also took it into account in making investment decisions. While certain investors may not like how the Available Funds are distributed under the PSAs, buyer's remorse does not entitle them to modify the distribution waterfall to achieve a different result.

Even if the clear text of the PSAs for the 14 Trusts were not in harmony with the "essential purpose" that Petitioner attributes to all of the Governing Agreements regardless of their specific distribution waterfall, this is not a valid basis for rewriting the PSAs. *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569-70 (2002) ("if the agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity"). Rather, the clear text of the PSAs would still control how the Allocable Shares must be distributed in the 14 Trusts. This is true even when the results are contrary to the expectations of one of the parties and result in a windfall to the other. *Reiss*, 97 N.Y.2d at 199.

IV. BNY Mellon's Historic Practice for Trusts with the Same Distribution Waterfalls as the 14 Trusts Has Been to Allow Funds to Flow to Subordinate Classes under These Circumstances

Allowing the Allocable Share to flow to less senior classes that have experienced unpaid realized losses is not only consistent with clear text of the PSAs, but also with the historic practice with respect to the Covered Trusts. Petitioner admits that the historic practice with respect to the Covered Trusts is to distribute funds prior to writing up the certificate principal balance. (Petition ¶ 25.) The only reason Petitioner now suggests that might provide a basis for flouting this historic practice is "the unique size of the Allocable Shares". The amount of money

available for distribution, however, is not a basis for defying the historic practice with respect to the 14 Trusts or effectively amending the PSAs.

Petitioner neglects to mention, however, that its historic practice for securities with the same distribution waterfall as the 14 Trusts has been to allow Available Funds in excess of the Principal Distribution Amount to flow to subordinate classes of securities for unpaid realized losses. This is precisely what happened when, in October 2010, Petitioner distributed Available Funds in excess of the Principal Distribution Amount to the subordinate certificateholders of CWALT 2007-OA10, which is another trust with waterfall construction akin to that of the 14 Trusts. That trust received a Subsequent Recovery, which caused Available Funds to exceed the Principal Distribution Amount. None of the senior classes had any unpaid realized losses. Neither did the M-1, M-2, M-3, M-4, M-5, M-6 mezzanine classes. Although the M-1, M-2, M-3, M-4, M-5, M-6 mezzanine classes received no principal in October 2010, the more junior M-7 certificateholders received $631,003, equal to the full amount of the unpaid realized loss suffered by this class, and the M-8 class received $110,909, representing a portion of the unpaid realized losses suffered by that class. *See, e.g.*, the Remittance Report for CWALT 2007-OA10, dated October 25, 2010, attached hereto as Exhibit B at 1, 5.

Rather than first writing up the certificate principal balance, which would have resulted in principal payments to more senior certificateholders, BNY Mellon distributed Available Funds, consistent with the PSA for the CWALT 2007-OA10 trust, to the more junior classes based upon unpaid realized losses. Allowing the Allocable Shares for the 14 Trusts to pay less senior certificateholders for unpaid realized losses would not only be consistent with the PSAs, but the historic practice of BNY Mellon and the expectation of investors.

V. The Court Should Instruct the Trustee to Distribute the Allocable Shares for the 14 Trusts as of February 25, 2016, when the Funds Would Have Been Distributed Absent the Order to Show Cause

In the absence of Petitioner's actions and the Court entering the Order to Show Cause, the Settlement Amount—which was received on or about February 10, 2016—would have been deposited into accounts for the Covered Trusts in the amount of the Allocable Shares and distributed within weeks to certificateholders in accordance with the distribution waterfalls set forth in the applicable PSAs. (*See* Ware Aff. ¶ 7.) The Order to Show Cause entered by the Court instead directed Petitioner to divert the Allocable Shares to an escrow account "as an urgent interim measure" for the pendency of this Article 77 proceeding. Respondents do not object to the investment of the escrowed funds in the manner proposed by the Trustee and set forth by the Order to Show Cause.

However, the diversion of the Settlement Amount into an escrow account for what could be a several-month period raises a question as to whether the funds will ultimately be distributed to certificateholders (a) as of the date they would have been distributed to in the absence of the Order to Show Cause, (b) as of the date the Petition is resolved and any judicial instructions are given, or (c) as of some other date. This is a significant issue, as the passage of time affects the distribution of funds within the payment waterfall of a Covered Trust. Because the plain language of the Settlement Agreement required immediate transfer of the Settlement Funds to the Covered Trusts' accounts (assuming that the Allocable Shares had been determined, which they were), the Court should instruct the Trustee to distribute each Allocable Share as if it had been placed into the Covered Trusts' accounts on or around February 10, 2016.

The Settlement Agreement provides that "[e]ach Covered Trust's Allocable Share of the Settlement Payment shall be wired to the Certificate Account or Collection Account for such Covered Trust by Bank of America as directed by the Trustee following determination of the

Allocable Share of each Covered Trust." *See* Settlement Agreement § 3(b). It is clear that the Agreement requires the Trust to wire the Settlement Amount to Certificate and Collection Accounts immediately or nearly immediately, assuming that the Allocable Shares have been determined, because it provides for an escrow process if the Allocable Share of each Covered Trust has not been determined at the time the Settlement Payment is received. *Id.* In such a case, the Agreement calls for the transfer for the funds to the Certificate Accounts or Collection Accounts "at which time" the relevant Allocable Shares have been determined. *Id.*

Here, the Allocable Share of each Covered Trust was determined on January 11, 2016, and the Settlement Payment was received by Petitioner on or around February 10, 2016. Because the Allocable Share of Each Covered Trust had already been determined when the payments were received on February 10, 2016, the amount of the Allocable Share of each Covered Trust should have been immediately or nearly immediately wired to the Certificate Account or Collection Account for each Trust. Petitioner essentially concedes that it would have done this absent this Article 77 proceeding and the Order to Show Cause.

Had the Allocable Share of each of the 14 Trusts been deposited into the Collection Accounts or Certificate Accounts on or around February 10, 2016, the Allocable Share would have been treated as Available Funds and distributed on the next Distribution Date in accordance with the payment waterfall set forth in each PSA. For each of the 14 Trusts, the Distribution Date was the 25th of each calendar month. Ex. A at 8–9. As such, had the Allocable Share of Each Covered Trust been deposited into the Collection or Certificate Accounts on or around February 10, 2016, they would have been distributed to certificateholders on February 25, 2016.

The delay caused by this proceeding should not alter the relative positions of the certificateholders and how much of the Allocable Share any one of them receives. Unless the

Court requires the Trustee to distribute the funds to certificateholders as of the date they would have been distributed in the absence of the Order to Show Cause, the Super Senior Support Certificates may receive less money in the event the 14 Trusts realize additional losses, thus altering the distribution waterfall of the Allocable Shares between certificates in the 14 Trusts. This inequitable result would be inconsistent with the clear language of the Settlement Agreement and PSAs, and no certificateholder should benefit from the delay in the distribution of Available Funds.

To clarify how Respondents believe the Allocable Shares should be distributed consistent with the PSAs for the 14 Trusts, attached hereto as Exhibit C is the projected distribution waterfall for the CWALT 2006-OA3. Respondents believe had the Allocable Share been distributed as a Subsequent Recovery on February 25, 2016, this is how the Available Funds would have been distributed among the various classes of that securitization. Respondents ask the Court to instruct BNY Mellon to tie out the ultimate distribution of Available Funds to these figures, which are consistent with the PSAs for the 14 Trusts, whenever the Trustee ultimately distributes the Allocable Shares.

CONCLUSION

For all the foregoing reasons, Respondents request that the Court grant the relief requested in their verified answer.

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Respectfully submitted,

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