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

In the Matter of the Application of

U.S. BANK NATIONAL ASSOCIATION (as Trustee, Securities Administrator, Paying Agent, and/or Calculation Agent under various Pooling and Servicing Agreements),

Petitioner,

For Judicial Instructions Under CPLR Article 77.

Index No. 656028/2021

Justice Andrew Borrok

IAS Part 53

HBK MASTER FUND L.P.'S REBUTTAL MERITS BRIEF

AKIN GUMP STRAUSS HAUER & FELD LLP

Uri. A. Itkin
Richard D'Amato
Andrew A. McWhorter

One Bryant Park
New York, NY 10036
Tel: (212) 872-1000

Attorneys for HBK Master Fund L.P.

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Respondent HBK Master Fund L.P. ("HBK") respectfully submits this rebuttal merits brief in further response to the Petition. Capitalized undefined terms have the meanings given in HBK's opening merits brief, NYSCEF No. 231 ("HBK Br.").

PRELIMINARY STATEMENT

The Petition seeks instruction on how to treat deferred principal proceeds and how to distribute the Trusts' cashflow after the Primary Classes' balances have been reduced to zero. The answers to both questions are in the PSAs, and the PSAs should be followed.

As to the first question, deferred principal proceeds are principal payments collected after loans were modified to defer that principal to a later date. Many of the HBK Trusts' PSAs explicitly contemplate these types of modifications. *None*, however, define deferred principal proceeds as Subsequent Recoveries or otherwise provide a mechanism to use them to write up Certificates. U.S. Bank has consistently distributed the Trusts' deferred principal proceeds without write-ups in accordance with the PSAs, and it should be instructed to continue doing so.

As to the second question, the PSAs divert the Trusts' cashflow to the Primary Classes while they are outstanding as a form of overcollateralization for those Certificates. After the Primary Classes' balances reach zero, however, the overcollateralization is no longer necessary. At that point, the PSAs direct all of the Trusts' cashflow through the excess cashflow waterfall to the Class CE Certificates. U.S. Bank should be instructed to follow the PSAs here too.

Out of the other four respondents who submitted merits briefs, not a single one contends that deferred principal proceeds constitute Subsequent Recoveries. And not a single one identifies any *other* write-up mechanism for deferred principal proceeds in the PSAs. Rightly so, because there is none. Still, they ask the Court to depart from the PSAs and use deferred principal proceeds to write up their Primary Class Certificates anyway. Their argument, essentially, is that it would be unfair *not* to write up the Primary Classes. This argument fails.

Since the PSAs do not support their position, these respondents resort to a jumble of theories to justify rewriting the PSAs. They claim that the losses created by HAMP were a "fiction," that HAMP caused unforeseen circumstances, and that the Primary Classes should get special treatment. None of these justifications are true, none of them make logical sense, and none of them justify rewriting the PSAs. To start, the losses were not a "fiction." HAMP was enacted by Treasury with the participation and input of RMBS industry participants. Some of those participants advocated for taking losses on the deferred principal to increase distributions to their senior Certificates, and Treasury adopted that proposal. Now, many years after the losses materialized, there is no basis to rewrite history or the PSAs.

Nor did HAMP create unforeseen consequences as relevant here. HAMP did not create deferral modifications out of thin air; they existed before HAMP, and many of the PSAs here explicitly contemplate them. The natural consequence — indeed, the requirement — of a deferral is that the deferred principal will be repaid. Back in 2009, industry participants anticipated those repayments and advocated using them to write up certificates. Treasury did *not* adopt that proposal, however, leaving the issue to be governed by the PSAs. Thus, no respondent can claim surprise about the consequences of following HAMP and the PSAs.

Nor is there any reason to give the Primary Classes special treatment simply because they took losses from HAMP. While certain features in these PSAs were designed to minimize losses to the Primary Classes, that protection was by no means absolute. There are PSAs where certain Certificates recognize no losses and get repaid by any amounts that come into the trusts. But *these* PSAs are different. These PSAs, by contrast, write down the Primary Classes for losses and write them up only for Subsequent Recoveries. So there is no basis to rewrite the PSAs merely because the HAMP losses that industry participants advocated for 13 years ago

materialized in a way that is consistent with the PSAs.

At bottom, it is not the Court's role to rewrite the PSAs or supplement HAMP to fit investors' subjective notions of fairness. Doing so would upend certainty and predictability in the RMBS market, where participants expect and depend on the principle that PSAs will be followed as written. Deferred principal proceeds should continue to be treated as deferred principal proceeds, not Subsequent Recoveries, and the Trusts' cashflow should be distributed through the excess cashflow waterfall when the Primary Classes' balances are reduced to zero. The Court should instruct U.S. Bank accordingly.

ARGUMENT

I. Deferred Principal Proceeds Cannot Be Used To Write Up Certificates In The HBK Trusts

As shown in HBK's opening merits brief, deferred principal proceeds cannot be used to write up Certificates. The only mechanism in the PSAs for writing up Certificates is through Subsequent Recoveries, but deferred principal proceeds do not fit that definition. No party in this case disputes that unremarkable fact. Notably, most parties in the parallel *Wells* proceeding, including the senior Certificateholders, support this conclusion as well.[1]

Unable to find a way to write up their Certificates through the PSAs, the Primary Class Certificateholders assert various theories asking the Court to *depart* from the PSAs. They claim that the PSAs are ambiguous, Opening Merits Br. of Ellington Mgt. Grp, L.L.C., NYSCEF No. 207 ("Ellington Br."), at 7-13; that the losses taken under HAMP were "fiction," PIMCO's Merits Br., NYSCEF No. 196 ("PIMCO Br."), at 1-2, 10; and that the Court should rewrite the

[1] Only a single respondent in this case contended that deferred principal proceeds are Subsequent Recoveries. *See* ASO Atlantic Fund LLC's Answer to the First Amended Petition, NYSCEF No. 86, at 4-6. But that respondent did not submit a merits brief.

PSAs under the guise of fairness, Opening Merits Br. of Olifant Funds, *et al.*, NYSCEF No. 178 ("Olifant Br."), at 13-15, 23. None of these theories justify departing from the PSAs.

A. The PSAs Are Not Ambiguous

Only one party here — Ellington Management Group, L.L.C. ("Ellington") — contends that the PSAs are ambiguous. Its purported basis is that the PSAs are "silent" on whether deferred principal proceeds can be used for write-ups. But under the doctrine of *expressio unius est exclusio alterius*, which the First Department already applied to a similar question, "silence" about write-ups for proceeds that are not Subsequent Recoveries (including deferred principal proceeds) is not an ambiguity — it is a deliberate omission that must be respected and enforced. *See Quadrant Structured Prods. Co. v. Vertin*, 23 N.Y.3d 549, 560 (2014) ("Even where there is ambiguity, if parties to a contract omit terms — particularly, terms that are readily found in other, similar contracts — the inescapable conclusion is that the parties intended the omission. The maxim, as used in the interpretation of contracts, supports precisely this conclusion."); *accord* JPM Appellate Order, 198 A.D.3d 156, 162 (1st Dept. 2021) (omission of a senior certificate write-up provision reflects a "plain and unambiguous intent" to preclude write-ups for those certificates).[2]

Ellington first cites the general "senior-subordinate" structure of the PSAs. Ellington Br. at 10-12. But like in the JPM Appellate Order, the mere fact that there are senior and subordinate Certificates in the Trusts does not mean that this structure should be used to override

[2] Ellington's reliance on *Top Grade Excavating New York Inc. v. HDMI Holdings LLC*, 194 A.D.3d 505, 505-06 (1st Dept. 2021) is misplaced. Ellington Br. at 12-13. In that case, the First Department held that extrinsic evidence could be used to determine a question on which the contract provided no guidance at all — specifically, how "the quantity of rock broken by plaintiff was to be measured." *Top Grade*, 194 A.D.3d at 505. There is no such gap here. The PSAs here plainly provide which proceeds may be used for write-ups, and — critically — which may not.

the PSAs' unambiguous write-down and write-up provisions. New York law and industry practice is to the contrary. *See Greenfield v. Philles Recs., Inc.*, 98 N.Y.2d 562, 569 (2002) ("[A] written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms."); *see also* Affirmation of Uri A. Itkin in Support of HBK's Rebuttal Merits Brief ("Itkin Rebuttal Aff."), Ex. 14, Rebuttal Affidavit of James H. Aronoff ("Aronoff Rebuttal Aff.") ¶¶ 16-17 ("[T]he commonly accepted understanding within the RMBS industry is that general subordination principles do not, and should not be used to, override or invalidate a particular PSA's plain language and provisions.").

Nor can Ellington manufacture an ambiguity from other "extrinsic evidence," such as third-party opinions or course of performance. Ellington Br. at 13-23. Whether the PSAs are ambiguous is determined from the PSAs alone, and the PSAs are clear that write-ups only occur from Subsequent Recoveries. *See Reiss v. Fin. Performance Corp.*, 97 N.Y.2d 195, 199 (2001) ("An omission or mistake in a contract does not constitute an ambiguity . . . the question of whether an ambiguity exists must be ascertained from the face of an agreement without regard to extrinsic evidence") (citations omitted); *Jade Realty LLC v. Citigroup Com. Mortg. Tr. 2005-EMG*, 83 A.D.3d 567, 568 (1st Dept. 2011) (same), *aff'd*, 20 N.Y.3d 881 (2012).

Regardless, Ellington's extrinsic evidence is meaningless. Ellington cites a 2009 letter from the American Securitization Forum ("ASF") to Treasury advocating for deferred principal proceeds to be used to write up certificates. Ellington Br. at 13-14. But despite that letter, Treasury *did not* adopt the ASF's proposal on this issue. *See* Section I.C *infra*. That only proves that the PSAs continue to control.

The same is true of Ellington's reference to a 2009 opinion piece from a ratings agency. Ellington Br. at 14 (citing NYSCEF No. 208, Ex. K). That piece on its face applies only to trusts

or amendments issued after 2008, states that it was superseded in 2018, and defers to the PSAs. Gradman Affirmation ("Gradman Aff.") Ex. K, NYSCEF No. 208, at 1 & ¶¶ 2, 8 ("[W]e will consider whether the transaction documents treat any amounts received with respect to the forbearance plans similarly to subsequent recoveries."). In other words, neither of these third-party statements have any legal or substantive bearing on how the PSAs should be interpreted. *See Chun Hye Kang-Kim v. Feldman*, 121 A.D.2d 590, 591 (2d Dept. 1986) (statement made by nonparty about contract was "irrelevant in view of the contract's . . . clear and unambiguous language"); *I.P.L. Corp. v. Indus. Power & Lighting Corp.*, 202 A.D.2d 1029, 1030 (4th Dept. 1994) ("[T]he 'understanding' of defendants' affiant . . . a nonparty to the contract, is irrelevant").

Ellington's and other parties' reliance on some servicers' or trustees' historical practices is equally inapposite. Ellington Br. at 14, 16-23; Olifant Br. at 21-22. Ellington readily admits that it took a conflicting position in the parallel *Wells* proceeding on the relevance of historical practices. Ellington Br. at 17 n.4. More importantly, while U.S. Bank's historical practices were consistent with the PSAs, it is the PSAs themselves that control. *See* PSA § 9.01(d)(i) ("[T]he duties and obligations of the Trustee shall be determined solely by the express provisions of this Agreement").

The Court should thus instruct U.S. Bank to continue following the PSAs. *See*, *e.g.*, *Bank of N.Y. Mellon v. BlackRock Fin. Mgt.*, 202 A.D.3d 465, 466 (1st Dept. 2022) ("[W]here a contract is clear and unambiguous, a party's course of conduct could not change its meaning."); *Spicer v. GardaWorld Consulting (UK) Ltd.*, 181 A.D.3d 413, 415 (1st Dept. 2020) ("To the extent the parties make arguments based on their course of conduct, the arguments are not properly considered, because the [contract] is unambiguous").

B. The HAMP Losses Were *Not* Fiction

PIMCO characterizes the treatment of deferred principal as losses as a "convenient fiction." PIMCO Br. at 2. This characterization is false and misleading. As noted, ASF lobbied Treasury on behalf of senior Certificateholders to treat deferred principal as losses in 2009. *See* Gradman Aff., Ex. D, NYSCEF No. 212, Dec. 19, 2009 ASF Letter ("ASF Letter") at 1-2, 4-5. The losses materialized after Treasury adopted that proposal in HAMP. That is not fiction, that is the reality.

Insofar as PIMCO is unhappy with that reality, this Court is not the proper forum for it to seek to undo Treasury's guidance or rewrite the PSAs 13 years after HAMP was issued. *See* *Campaign for Fiscal Equity v. State*, 8 N.Y.3d 14, 28 (2006) ("[S]eparation of power" principles generally preclude courts from "intrud[ing] upon the policy-making and discretionary decisions that are reserved to the legislative and executive branches") (citations omitted); *Brennan Ctr. for Justice v. N.Y. State Bd. of Elections*, 52 N.Y.S.3d 189, 192 (Sup. Ct., Albany Cnty. 2017) ("[I]t has been held that courts do not normally have overview of the lawful acts of appointive and elective officials involving questions of judgment, discretion, allocation of resources and priorities and cannot intrude upon the policy-making and discretionary decisions that are reserved to the legislative and executive branches.") (cleaned up), *aff'd*, 159 A.D.3d 1301 (1st Dept. 2018).

C. The Primary Classes Certificateholders' "Fairness" Arguments Ring Hollow

The Olifant Funds, Reliance Parties, and Taconic Funds (collectively, "Olifant") ask the Court to rewrite the PSAs on fairness grounds, including because the deferred principal proceeds were "unanticipated." Olifant Br. at 11. Not true.

1. The Deferred Principal Proceeds Were Anticipated

Deferrals by their nature lead to — indeed, require — repayments of the deferred principal. *See* HBK Br. at 4-6 (describing deferrals); *see also* Itkin Rebuttal Aff. Ex. 15, Feb. 5, 2019 Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages, at 118 (describing deferred principal as "fully due and payable"). While HAMP increased the *volume* of deferrals, the concept of deferrals existed before HAMP, and some of the deferral modifications at issue here occurred outside of HAMP. Many of the HBK Trusts' PSAs (at least 14) indeed explicitly reference deferral modifications and provide that the deferred principal remains due and owing. *See* PSA § 4.01 ("[I]f (x) Mortgage Loan is in default . . . the Master Servicer may also . . . (2) defer such amounts to a later date or the final payment date of such Mortgage Loan").[3] So the fact that the Trusts have collected deferred principal proceeds is by no means a surprise.

The treatment of deferred principal proceeds is also not a surprise. Quite the contrary. Those collections were explicitly discussed in ASF's 2009 letter to Treasury. *See* ASF Letter at 8, 16 ("How to Treat Forborne Principal That is Paid"). What's more, the ASF actually advocated using those collections to write up certificate balances — just as some respondents do here. *Id*. Treasury did *not* adopt ASF's proposal, and HAMP does *not* address write-ups. *See* Itkin Aff. Ex. 8, NYSCEF No. 240, Treasury Supplemental Directive 10-05, USBWaterfall-A77-00002781–00002791; Aff. of Dean Smith, NYSCEF No. 193, ¶¶ 48, 50, 57. So the PSAs continued to govern the treatment of those collection. *See Bailey v. Joy*, 810 N.Y.S.2d 644, 648 (Sup. Ct., Westchester Cnty. 2006) ("It is a canon of statutory interpretation that a court cannot

[3] As most parties in this case recognize, forbearance — unlike forgiveness — leaves the deferred principal due and owing, and repayment of the deferred principal is not just expected, it is required. *See*, *e.g.*, Ellington Br. at 8-9; PIMCO Br. at 6; Olifant Br. at 19.

by implication supply in a statute a provision which it is reasonable to suppose the Legislature intended to omit."). Thus, there can also be no surprise that U.S. Bank has treated deferred principal collections in accordance with the PSAs.[4]

To be sure, the *amount* of the deferred principal collections might not have been fully anticipated. That is entirely irrelevant. The PSAs merely provide for *how* the Certificates take losses and get paid; they do not guarantee the *amount* of those losses and payments, nor do they guarantee that any particular Class of Certificates will avoid losses or receive full payment. Such a guaranty should not be added by the Court simply because the deferred principal collections turned out to be larger than purportedly anticipated. *See Wallace v. 600 Partners Co*., 205 A.D.2d 202, 206 (1st Dept. 1994) ("Courts should not, under the guise of interpretation, rewrite part of an agreement which is clear and explicit simply because a party's expectation of the bargain does not materialize due to a change in economic climate."), *aff'd*, 86 N.Y.2d 543 (1995); *Urban Archaeology Ltd. v. 207 E. 57th St. LLC*, 34 Misc. 3d 1222(A), 2009 N.Y. Slip Op. 52825(U), at *4-5 (Sup. Ct., N.Y. Cnty. 2009) (enforcing contract where, as here, it "the precise cause or extent of such financial disadvantage was not foreseen at the time the contract was executed."), *aff'd*, 68 A.D.3d 562 (2009).

This is precisely why the Primary Class Certificateholders' "absurdity" and "commercial unreasonableness" arguments ring hollow. Ellington Br. at 15-16; Olifant Br. at 12, 23; PIMCO Br. at 13-14. There is no basis to give the Primary Classes special treatment. While the Primary Classes had certain protections from losses, those protections were not absolute. There are

[4] The only guidance Treasury issued regarding deferred principal collections was in July 2009, months *before* the ASF's December 2009 letter. *See* Itkin Aff. Ex. 7, NYSCEF No. 239, USBWaterfall-A77-00002485–00002508 at USBWaterfall-A77-00002492. But the Treasury's guidance merely provided that the collections should be treated as a recovery of principal, rather than interest, with no instructions to write up certificates. *See id.*

RMBS trusts where losses do *not* result in write-downs to senior certificates and instead get repaid by all collected amounts. *See*, *e.g.*, Itkin Rebuttal Aff. Ex. 16 (Home Equity Mortgage Trust 2006-2 Indenture) § 3.26 (providing that Class 1A Certificates "will not be so reduced" by realized losses). But the Trusts at issue here, by contrast, do in fact provide for write-downs as a result of losses, and that is the deal that all respondents here made. Rewriting the PSAs so that certain respondents would get the benefit of provisions explicitly included in other trusts but not the Trusts at issue here would be the truly "absurd" and "commercially unreasonable" result. *See* *Quadrant*, 23 N.Y.3d at 560 ("[I]f parties to a contract omit terms — particularly, terms that are readily found in other, similar contracts — the inescapable conclusion is that the parties intended the omission."); *accord* Aronoff Rebuttal Aff. ¶¶ 19-22 (explaining that investors in these PSAs "accepted the possibility" that losses could reduce their certificate balances to zero, and that "departing from or rewriting PSA terms that investors expressly agreed to" would "imperil RMBS market participants' expectation[s]" and "do violence to the certainty and predictability that is essential to the RMBS market").

As such, there is no basis for rewriting the PSAs under the guise of fairness or surprise. *See Greenfield*, 98 N.Y.2d at 569-70 ("[I]f 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."); *First Natl. Stores v. Yellowstone Shopping Ctr.*, 21 N.Y.2d 630, 638 (1968) ("Stability of contract obligations must not be undermined by judicial sympathy.") (citations omitted).

2. There Is No Legal Basis To Rewrite The PSAs

Olifant's reference to "equitable deviation" is inapposite. Olifant Br. at 13-15. That doctrine is limited to extreme circumstances where a trust's fundamental purpose has been

defeated. *See In re Aberlin*, 264 A.D.2d 775, 775 (2d Dept. 1999) (Equitable deviation "has been applied to allow trustees to depart from the terms of a trust instrument where there has been an unforeseen change in circumstances that threatens to defeat or substantially impair *the purpose for which the trust was created*.") (emphasis added). It has never been applied to RMBS or other securitization trusts, and there is no reason to start here.

RMBS trusts are complex instruments negotiated and agreed to by highly sophisticated parties. The fundamental purpose of RMBS is to securitize loans and pass through the cashflows to investors. *See IKB Intl., S.A. v. Wells Fargo Bank, N.A.*, 2023 N.Y. Slip Op. 03302, at *8 (N.Y. June 15, 2023) (Wilson, J. dissenting) ("The concept behind RMBS was that, by creating pools of thousands of home mortgages and selling interests in those pools to investors, the credit market could be loosened"). This case is nothing more than a dispute over the allocation of those cashflows.

New York courts routinely hear allocation disputes just like this one. But they have not used "equitable deviation" in a single case, and this case is no different. Simply because a handful of investors disagree with the allocation of the Trusts' cashflows does not mean that courts have *carte blanche* to rewrite the PSAs. *See In re Rubin*, 4 Misc. 3d 634, 638-39 (Sur. Ct., N.Y. Cnty. 2004) (denying equitable deviation because "the doctrine is sparingly used and its application has, with few exceptions, been limited to the alteration of administrative provisions or to the relaxation of investment strictures that jeopardize the trust principal."); *In re Knapp*, 41 Misc. 3d 1202(A), 2013 N.Y. Slip Op. 51556(U), at *3 & n.4 (Sur. Ct., N.Y. Cnty. 2013) (denying petition that "in effect request[s] relief under the doctrine of equitable deviation" because the requested changes would be "contrary to the Testator's intent"); *accord* Aronoff

Rebuttal Aff. ¶¶ 7-10, 19-22 (explaining that RMBS industry participants expect PSAs to be applied as written).[5]

In sum, since the deferred principal proceeds are not Subsequent Recoveries, there is no reason to rewrite the PSAs to allow Certificate write-ups based on those proceeds.

II. Post-Zero Balance Collections Should Be Distributed Through The Excess Cashflow Waterfall

As HBK explained in its opening brief, after the Primary Classes' balances are reduced to zero, the excess cashflow waterfall is the *only* mechanism in the PSAs through which the Trusts' cashflow can be distributed at that point. HBK Br. at 10-11, 19-21. No party disputes this unremarkable fact, and some respondents even insist on this outcome. Opening Merits Br. of Poetic Holdings 8 LP, et al., NYSCEF No. 230 at 6-7.

Still, several respondents urge that the Court also depart from the PSAs with respect to this question. They argue that if the Primary Classes have suffered substantial losses, the excess cashflow waterfall should not apply, and the Primary Classes should be written up so they can be made whole through the regular principal waterfall. *See* Olifant Br. at 12; PIMCO Br. at 13-18. These contentions lack merit.

A. The Excess Cashflow Waterfall Applies Irrespective Of Whether The Primary Classes Were Reduced By Losses

To begin with, these contentions improperly conflate the post-zero balance collection question with the deferred principal proceeds question. The two questions are entirely separate and concern entirely separate PSA provisions. *See* Aronoff Rebuttal Aff. ¶ 16 ("[I]t is well

[5] Olifant cites no authority for applying equitable deviation to complex and sophisticated structures like RMBS trusts. Rather, it cites cases involving entirely inapposite contexts, such as child custody disputes, charitable trusts, and mass tort litigation, or courts generally citing the Restatement of Trusts for entirely irrelevant purposes. *See* Olifant Br. at 14, nn. 8 & 9.

understood by RMBS market participants that the creation and maintenance of the required credit support structure involve separate and distinct transaction features from those concerning the collection and distribution of funds (like Deferred Principal Proceeds).”). As U.S. Bank explained in the Petition, the excess cashflow waterfall question concerns *all* post-zero balance collections, including excess interest. NYSCEF No. 1 ¶ 10. That deferred principal collections may constitute *some* of the post-zero balance collections is not an open door to rewrite the PSAs. Instead, the PSAs' write-up and waterfall provisions should continue to apply as written, irrespective of certain investors' subjective notions of fairness. *See* Section I.C *supra*.

There is also nothing to suggest that the excess cashflow waterfall should be ignored simply because the Primary Classes may have losses outstanding. To the contrary, the PSAs squarely refute this notion. As shown in HBK's opening brief, the regular waterfalls explicitly apply only until the Primary Classes' balances are “reduced to zero.” HBK Br. at 12-14. There is no exception for the *reason* why they reached zero.

The Primary Class Certificateholders are highly sophisticated. By investing in these PSAs, they accepted the risk that the balances of their Certificates would be reduced to zero even though the underlying loans remain in the Trusts, and that future cashflows from those loans would flow through the excess cashflow waterfall, including to the Class CE Certificates. *See* Aronoff Rebuttal Aff. ¶¶ 19-22. The result Olifant now decries as “unfair” is, in fact, the result of the bargain all parties struck in the PSAs.

The contractual bargain is underscored by the Retired Class Provision, which bars distributions to the Primary Classes when their balances reach zero. PSA § 5.04(a). While the First Department has ruled that the Retired Class Provision does not prohibit write-ups, the PSAs are clear that no Class of Certificates will be “entitled to distributions” after it “has been reduced

to zero." *Id.* In other words, there still needs to be an independent basis for write-ups of zero-balance Certificates somewhere in the PSAs. *See* JPM Appellate Order at 162-163. Absent such basis — which, as shown above, does not exist with respect to the deferred principal proceeds — the PSAs provide that zero-balance Certificates receive no distributions of any kind and the Trusts' cashflow is distributed through the excess cashflow waterfall.[6]

B. The Excess Cashflow Waterfall Distributes All Cashflow Previously Used For Overcollateralization While The Primary Classes Were Outstanding

As shown in HBK's opening brief, there is no need for overcollateralization once the Primary Class balances are reduced to zero. HBK Br. 19-24. At that point, the PSAs distribute through the excess cashflow waterfall all cashflow that was previously used for overcollateralization. *Id.* at 20. This unremarkable notion is further underscored by the marketing materials sent to potential investors at the outset of these deals, which describe the excess cashflow as simply the amount remaining after the principal and interest waterfalls. *See* Itkin Rebuttal Aff. Ex. 17, Bear Stearns, New Issue Marketing Materials (Apr. 10, 2007), HBKUS_0006704-HBKUS_0006767, at 0006727 (defining "Net Monthly Excess Cashflow" as "the available distribution amount remaining after distribution of the Interest Remittance Amount and the Group I and Group II Principal Distribution Amount").

This is indeed the only sensible reading of the PSAs. While Olifant and PIMCO argue that the excess cashflow waterfall can only be utilized when overcollateralization exceeds a

[6] Significantly, the PSAs provide that there are no distributions of any kind to any zero-balance Primary Class Certificates under any waterfall, including on account of interest or basis risk shortfalls or carry forward amounts. *See* PSA § 5.04(a) ("[O]n any Distribution Date after the Distribution Date on which the Certificate Principal Balance of a Class of Class A Certificates or Class M Certificates has been reduced to zero, that Class of Certificates will be retired and will no longer be entitled to distributions, including distributions in respect of Prepayment Interest Shortfalls or Basis Risk Shortfall Carry Forward Amounts").

specific target amount, PIMCO Br. at 16-17; Olifant Br. at 11-12, 17, they cannot dispute that there is no need for overcollateralization or overcollateralization targets once the Primary Classes reach zero. At that point, the PSAs explicitly provide that the entire overcollateralization amount is distributed through the Class CE Distribution Amount. And since the excess cashflow waterfall is the only mechanism for distributing the Class CE Distribution Amount, post-zero balance collections must necessarily be distributed through the excess cashflow waterfall.

Taken to their logical conclusion, Olifant's and PIMCO's contentions would actually lead to absurd results. As U.S. Bank explained in the Petition, the overcollateralization targets will never be less than the minimum threshold amounts — ranging in the millions of dollars — and most of these Trusts will never reach those targets. NYSCEF No. 1 ¶ 49. So if Olifant and PIMCO were correct that overcollateralization cannot *never* be released until those targets are satisfied, the Trusts would *never* release millions of dollars of cashflow. Such a cash trap would certainly be absurd and commercially unreasonable. It is plainly *not* what drafters intended.

The Court should therefore instruct U.S. Bank to distribute Post-Zero Balance Collections through the excess cashflow waterfall in accordance with the PSAs.

III. The Retired Class Provision Prohibits Distributions to Zero-Balance Primary Classes

The Retired Class Provision only confirms the answers to the two questions above. Even under the First Department's ruling, the Provision's plain language makes clear that there can be no distributions to zero-balance Primary Class Certificates without prior write-ups. *See* JPM Appellate Order, at 163, 165 (affirming lower Court ruling that zero balance classes "may be written up" by RMBS settlement payment mutually agreed to be treated as a subsequent recovery and "may receive distributions of that amount"). Thus, after the Primary Classes' balances reach

zero, the Trusts' cashflow should be distributed through the excess cashflow waterfall, and only to Certificates with outstanding balances.

CONCLUSION

For all of these reasons, HBK respectfully requests that the Court enter an order instructing the Trustee to (i) continue distributing deferred principal proceeds as regular principal, rather than Subsequent Recoveries, without any write-ups; (ii) distribute all cashflow through the excess cashflow waterfall once the Primary Classes are reduced to zero; and (iii) continue not making distributions to any Primary Class Certificates reduced to zero and not otherwise written up.

Dated: June 21, 2023
New York, New York

Respectfully submitted,

AKIN GUMP STRAUSS HAUER & FELD LLP

By: */s/ Uri A. Itkin*
Uri A. Itkin
Richard D'Amato
Andrew A. McWhorter

One Bryant Park
New York, NY 10036
Tel: (212) 872-1027

Attorneys for HBK Master Fund L.P.

CERTIFICATE OF COMPLIANCE

This brief complies with this Court's so-ordered 8,500-word limit because it contains 4,884 words (using the "word count" function of Microsoft Word), excluding the parts of the brief exempted by Rule 17 of the New York Commercial Division Rules.

Dated: June 21, 2023
New York, New York

/s/ Uri A. Itkin
Uri A. Itkin