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 ANSWER TO THE PETITION

HBK Master Fund L.P. ("HBK") respectfully submits this answer to the First Amended Petition, NYSCEF No. 33 ("Petition") filed by U.S. Bank National Association, as trustee ("Trustee") of 77 residential mortgage-backed securitization trusts (the "Trusts"),[1] and alleges as follows:

PRELIMINARY STATEMENT

1. This Article 77 proceeding seeks judicial instruction concerning the proper method of distributing and accounting for certain collections, including collections of deferred principal from modified loans securitized in the Trusts ("Deferred Principal Collections") after the senior classes ("Primary Classes") of the Trusts' Certificates have been reduced to zero. As explained below, after the principal balance of the Primary Classes reaches zero, the Trusts' pooling and servicing agreements (the "PSAs") require that Deferred Principal Collections and other collections be distributed as excess cashflow to the other classes of Certificates through the

[1] Capitalized terms used but not defined herein have the meaning given in the Petition. Although HBK adopts the terminology used in the Petition with respect to the Certificate classes and contract provisions at issue for the sake of simplicity, it is important to note that the Certificate classes at issue in this case have different risk profiles based on the varying structure of distributions and cash flows in the Trusts, but there is no class that is "Primary" or "Secondary" to another class.

excess cashflow waterfall.

2. HBK holds Certificates in 39 of the Trusts (the "HBK Trusts"): BSABS 2004-HE3, BSABS 2004-HE4, BSABS 2005-EC1, BSABS 2005-HE1, BSABS 2005-HE2, BSABS 2005-HE4, BSABS 2005-HE6, BSABS 2005-HE8, BSABS 2005-HE9, BSABS 2005-HE10, BSABS 2005-HE11, BSABS 2006-AQ1, BSABS 2006-EC1, BSABS 2006-EC2, BSABS 2006-HE1, BSABS 2006-HE2, BSABS 2006-HE3, BSABS 2006-HE4, BSABS 2006-HE5, BSABS 2006-HE6, BSABS 2006-HE7, BSABS 2006-HE8, BSABS 2006-HE9, BSABS 2006-HE10, BSABS 2006-PC1, BSABS 2007-AQ1, BSABS 2007-FS1, BSABS 2007-HE1, BSABS 2007-HE2, BSABS 2007-HE3, BSABS 2007-HE4, BSABS 2007-HE5, SACO 2005-6, SACO 2005-WM2, SACO 2006-3, SACO 2006-4, SACO 2006-5, SACO 2006-10, and SACO 2007-2.[2]

3. In the Petition, the Trustee seeks instruction concerning the manner of distributions to be made after the Primary Classes have been reduced to zero and the treatment of Deferred Principal Collections in connection with the Trusts.

4. The PSAs for all of the HBK Trusts provide that after the principal balance of the Primary Classes is reduced to zero, those Classes receive no distributions (nor write-ups, pursuant to the Retired Class Provision), and the remaining Trust funds are distributed as excess cashflow to other Certificates, including the Class CE (defined in some Trusts as Class C) Certificates. Moreover, the PSAs for 38 of the 39 HBK Trusts also provide that Deferred Principal Collections are not Subsequent Recoveries, as that term is defined in the PSAs, and

[2] In addition to the HBK Trusts, HBK also holds an interest in other Trusts through holdings in seven net interest margin trusts ("NIM Trusts"). U.S. Bank National Association ("U.S. Bank") acts as trustee for those NIM Trusts (in such capacity, the "NIM Trustee"), which is separate from its capacity as Trustee of the Trusts at issue in the Petition. At HBK's direction, U.S. Bank, in its capacity as NIM Trustee, is filing a separate Answer to the Petition, joining in HBK's positions set forth herein (the "NIM Answer"). Further information regarding the NIM Trusts and the NIM Trustee's role is set forth in the NIM Answer.

therefore Deferred Principal Collections cannot be used to write up any Certificates. As such, after the Primary Classes in the HBK Trusts are reduced to zero, the Deferred Principal Collections for those 38 HBK Trusts should be distributed as excess cashflow pursuant to the excess cashflow waterfall, without any concomitant write-ups to any Certificates.

5. Based on the Petition, HBK understands that this is how the Trustee has historically treated these issues. Because the Trustee's historical practices are consistent with the language of the PSAs, the Court should instruct the Trustee to continue them.

6. Accordingly, and as discussed in more detail below, the Court should enter an order with respect to the HBK Trusts instructing the Trustee that, after the principal balance of the Primary Classes has reached zero, the Trustee should distribute the Deferred Principal Collections, as well as other collections and remaining overcollateralization ("OC") amounts, through the excess cashflow waterfall, for the benefit of the Class CE Certificates (together with any Class C Certificates, the "CE Classes") and the other applicable classes, with the clarification that Deferred Principal Collections are not Subsequent Recoveries and should not be used to write up any Certificates for 38 of the 39 HBK Trusts.

DISCUSSION

7. The HBK Trusts are residential mortgage-backed securitization trusts that were created from 2003 to 2007 for the purpose of selling investments secured by residential mortgage loans. The loans were bundled together into pools, each pool was conveyed to the respective Trust, which issued the Certificates, and the Certificates were sold to investors. The Certificates are broken up into different tranches, or classes, each with a different risk profile and payment terms. Certificate classes receive distributions in a specific order of priority set forth in the

PSAs. *See* BSABS 2007-HE3 PSA, NYSCEF No. 43, §§ 5.04(a)(1), 5.04(a)(2), 5.04(a)(3).[3]

8. Like other Trusts, the Certificates in the HBK Trusts generally fall into the Class A, B, and M Certificates, the Class CE or C Certificates, and the interest-only and residual Classes, which typically consist of Class P, Class IO, and Class R Certificates.

9. The Certificate classes have varying degrees of credit support — *i.e.*, security — from the underlying loan collateral. They are also paid differently. The Primary Classes, for example, have a certain level of credit support and outstanding principal balances that determine the amount of interest and principal paid to those Certificates every month. The principal balances are reduced by the payment of principal, as well as by losses realized by — *i.e.*, attributed to — those Classes.

10. The CE Classes have no credit support and receive monthly distributions only after the Primary Classes receive their defined monthly distributions. The CE Classes are paid interest and principal on a monthly basis through the excess cashflow waterfall. The excess cashflow waterfall is a catchall for collections received by the Trusts when there is sufficient credit support and collections for the Primary Classes or when the principal balance of the Primary Class Certificates reaches zero due to losses, payments, or both. The amount of distributions made to the CE Classes is therefore determined on a month-by-month basis, based on the amount of excess cashflow the Trusts collect in a given month, the level of credit support for the Primary Classes, and if, as relevant here, the Primary Classes have been reduced to zero.

11. To the extent the Trusts suffer losses (when, for example, any of the loans in the collateral pool default), the CE Classes are first to be impacted that month. Insofar as the Trusts

[3] The BSABS 2007-HE3 PSA (the "PSA") is used as an exemplar, and unless otherwise noted, the other HBK PSAs are materially similar with respect to the issues addressed in the Petition.

realize losses in any given month, there may be less or no excess collections for the Trusts to distribute to the CE Classes that month. And if the losses are so significant that they reduce the level of credit support below the required level, the CE Classes receive no distributions that month. In other words, while losses do not write down the CE Classes (because their principal balances are calculated differently from the Primary Classes), the losses may delay distributions to the CE Classes for months or even years. By the same token, when the Primary Classes are reduced to zero, there is no longer any purpose to provide credit support to those Classes, and the Trusts' collections are distributed through the excess cashflow waterfall to the CE Classes and other applicable classes.

12. The payment of the Primary Classes and the CE Classes is provided for, in part, through an OC structure. Under the OC structure, the loan collateral balance at the Trusts' inception exceeded the principal balance of the Certificates. This ensured the required level of credit support for the Primary Classes and sufficient excess cashflow to pay the CE Classes and the other applicable classes.

13. In basic terms, the credit support structure works as follows. The PSAs define OC as the amount by which the collateral balance exceeds the aggregate principal balance of the Primary Classes. They also define the target level of collateral (the "OC target amount") that must be reached while the Primary Classes are outstanding before collections are distributed through the excess cashflow waterfall. If the OC target amount is greater than the OC amount, there is not enough credit support for the Primary Classes, and excess cashflow is directed towards building OC.

14. After the Primary Classes are reduced to zero, there is no longer any purpose for credit support for those classes, and the excess collections are distributed through the excess

cashflow waterfall to the CE Classes and the junior classes, as applicable.

15. These mechanics guide the instructions sought in the Petition, and require that after the Primary Classes are reduced to zero, Deferred Principal Collections and other collections are distributed through the excess cashflow waterfall to the CE Classes and the junior classes, as applicable.

I. Principal Collections Should Be Distributed Through The Excess Cashflow Waterfall After The Primary Classes Are Reduced To Zero

16. While they are outstanding, the Primary Classes receive their interest and principal distributions through the interest and principal waterfall provisions in the PSAs, respectively. *See* PSA §§ 5.04(a)(1)-(2). The CE Classes receive their distributions under the excess cashflow waterfall provisions. *See id.* § 5.04(a)(4).

17. When the Primary Classes are reduced to zero, the interest and principal collections that previously had been distributed to the Primary Classes should be distributed to through the excess cashflow waterfall.

18. Specifically, when the aggregate principal balance of the Primary Classes is reduced to zero, there are no interest distributions to be made under the interest waterfall because interest due to the Primary Classes is calculated by multiplying the respective principal balances of those Certificates by their respective interest rate (called the pass-through rate). *See* PSA § 1.01 (Current Interest); Pet. ¶¶ 53, 90. When the respective principal balances of those Certificates reach zero, the interest due to those Certificates is also zero. Pet. ¶¶ 53, 90.

19. The same is generally true of the principal distributions. Under the PSAs, the principal collections are distributed to the Primary Classes until the principal balances of each of the Primary Classes "is reduced to zero." PSA § 5.04(a)(2). The principal balance of those Certificates is reduced to zero by principal distributions to and losses realized by those

Certificates. *See* PSA § 1.01 (Certificate Principal Balance). The principal balance is written up only by "Subsequent Recoveries." *Id.* The principal balance of each of the Primary Classes dictates the amount of principal distributions due to those Certificates. *See*, *e.g.*, PSA § 1.01 (Class A Principal Distribution Amount); (Class M Principal Distribution Amount). So when the principal balance of those Certificates reaches zero, the principal distribution amounts to those Certificates likewise are reduced to zero.

20. At that point, the remaining interest and principal collections are distributed through the excess cashflow waterfall. *See* PSA § 5.04(a)(4); PSA § 5.04(a)(1) (directing that interest funds in excess of any amount necessary to reduce the Primary Classes to zero "shall be applied as Excess Cashflow").

21. The excess cashflow waterfall first provides for certain distributions to any Primary Classes with principal balances, to compensate them in certain circumstances for realized losses and interest shortfalls, among other things. *Id.* § 5.04(a)(4)(A)-(B). After those distributions, the excess cashflow waterfall provides for distributions to the CE Classes in the amount of the Class CE Distribution Amount. *Id.* § 5.04(a)(4)(G). The Class CE Distribution Amount includes principal and interest payable to the CE Classes, including excess collections:

> Class CE Distribution Amount: With respect to any Distribution Date, the sum of (i) the Current Interest for the Class CE Interest for such Distribution Date, (ii) any Overcollateralization Release Amount for such Distribution Date and (iii) without duplication, any Subsequent Recoveries not distributed to the Class A Certificates and Class M Certificates on such Distribution Date; provided, however, ***on any Distribution Date after the Distribution Date on which the Certificate Principal Balances of the Class A Certificates and Class M Certificates have been reduced to zero, the Class CE Distribution Amount shall include the Overcollateralization Amount***.

See PSA § 1.01 (Class CE Distribution Amount) (emphasis added). As reflected by the highlighted clause above, when the principal balance of the Primary Classes reaches zero, distributions to the CE Classes include the entire OC amount — *i.e.*, all of the remaining collateral.

22. This amount necessarily has to include the Trusts' collections and other amounts due on the collateral. Since those amounts due include Deferred Principal Collections, this means that Deferred Principal Collections should be distributed to the CE Classes after the Primary Classes are reduced to zero.

23. In the Petition, the Trustee suggests that there is a tension between the Class CE Distribution Amount and the definition of Excess Cashflow. Pet. ¶ 10, 96-98. This is a reference to the fact that under the PSAs, the term "Excess Cashflow" is defined to consist of both, interest collections (defined as "Excess Spread") and either (a) principal collections or (b) the amount by which actual OC exceeds the OC target amount (defined as "the Overcollateralization Release Amount"):

> With respect to any Distribution Date, an amount, if any, equal to the sum of (a) the Remaining Excess Spread for such Distribution Date and (b) the Overcollateralization Release Amount for such Distribution Date.

See PSA § 1.01 (Excess Cashflow).

24. According to the Petition, because the OC target amount has been (and is expected in the foreseeable future to be) greater than the OC amount, the Excess Cashflow presently does not include any of the principal collections received by the Trusts. Pet. ¶ 98. In other words, the tension identified by the Trustee is the inconsistency between the amount of collections *due* to the CE Classes under the excess cashflow waterfall (the definition of Class CE Distribution Amount) and the amount of collections ostensibly *distributed* pursuant to the excess cashflow waterfall (the definition of Excess Cashflow).

25. This appears to be a product of inartful drafting of the PSAs. As the Petition recognizes, the use of "Overcollateralization Amount" in the definition of Class CE Distribution Amount is indeed a "catchall." Pet. ¶ 98. It reflects the unremarkable fact that the CE Classes

should receive — through the excess cashflow waterfall — the collateral and related proceeds remaining after the Primary Classes are reduced to zero.

26. This makes sense. The Trusts started out with more collateral than outstanding Certificates. And the OC target amount was designed to provide credit support for the Primary Classes by blocking excess cashflow distributions to the CE Classes while the Primary Classes are outstanding. Once the Primary Classes are gone, there is no need for credit support for those Certificates, and thus no reason for the OC target amount to block excess cashflow distributions to the CE Classes. Otherwise, cash would become trapped in the Trusts.

27. The trapped cash wouldn't just hurt the CE Classes; it would also hurt the Primary Classes while those classes are outstanding. As noted above, before the Primary Classes' principal balances are reduced to zero, the excess cashflow waterfall sends excess cashflow to some of those classes to compensate them for realized losses and interest shortfalls in the HBK Trusts, before distributing the excess cashflow to the CE Classes and other applicable classes. *See* PSA § 5.04(a)(4)(A). Failing to allow excess cash to flow through the excess cashflow waterfall would therefore upend an integral part of the payment mechanism of *all* Certificates in the HBK Trusts. This would make no sense.

28. The same is true of other "issue" identified in the Petition. The Petition points out that the term "Overcollateralization Amount" in the Class CE Distribution Amount represents excess collateral rather than excess collections. Pet. ¶ 98. But this is a distinction without a difference. Excess collateral necessarily includes collections from such collateral.

29. This concept is reflected in the fact that the same terms guide the distributions of the Extra Principal Distribution Amount — *i.e.*, excess collections — to the Primary Classes through the principal waterfall, before such collections are distributed through the excess

cashflow waterfall. *See* PSA § 5.04(a)(1)-(2); *see also* *id.* § 1.01 (defining "Extra Principal Distribution Amount" to include "the excess" of the OC target amount over the OC amount). So while some of these terms may be inartfully drafted, reading them to preclude distributions of excess collections to the *CE Classes* would also potentially bar distributions of excess collections to the *Primary Classes* while the latter Classes are outstanding. This would also make no sense.

30. Accordingly, the Court should instruct the Trustee that collections received by the HBK Trusts after the Primary Classes are reduced to zero should be distributed via the excess cashflow waterfall, including to the CE Classes and the junior classes, as applicable.

II. Deferred Principal Collections Are Not Subsequent Recoveries

31. The Petition also seeks instruction as to whether Deferred Principal Collections — collections received from modified loans — constitute Subsequent Recoveries within the meaning of the PSAs. For the vast majority of the HBK Trusts, they do not.

32. The PSAs for 38 of the 39 HBK Trusts define Subsequent Recoveries to only include amounts received in connection with mortgage loans that were liquidated or disposed of at a loss:

> As of any Distribution Date, amounts received . . . specifically related to a Mortgage Loan that was the subject of a liquidation or final disposition of any REO Property prior to the related calendar monthly that resulted in a Realized Loss.

PSA § 1.01 (Subsequent Recoveries).

33. The Deferred Principal Collections at issue here, however, are payments made by borrowers in respect of amounts deferred under modification agreements with the loan servicer. Pet. ¶¶ 12-14. Because the Deferred Principal Collections came from modified loans, rather than from loans that were liquidated or from proceeds of foreclosing upon and selling mortgaged

properties from a Trust, Deferred Principal Collections are not Subsequent Recoveries.[4]

34. This is not changed by the fact that some or all of the modifications underlying the Deferred Principal Collections had resulted in a Realized Loss. The Realized Loss is only one part of the Subsequent Recoveries definition. Since the other requirement — that the loan was either liquidated or the underlying property was sold from the Trusts — was not satisfied, the Trustee has correctly treated Deferred Principal Collections as principal collections that are not Subsequent Recoveries.

35. The Court should therefore instruct the Trustee to continue its historical treatment.

III. Once The Primary Classes Are Reduced To Zero, They Are Not Written Up By Deferred Principal Collections

36. The Petition also seeks instruction as to whether Deferred Principal Collections and other collections received after the Primary Classes have been reduced to zero can nevertheless cause a write-up of those Certificates. For the HBK Trusts, the answer is no.

37. To begin, as described in the Petition, Subsequent Recoveries are indeed "the only express mechanism for applying write-ups" to the Certificates. Pet. ¶ 94.

38. This is reflected in the definition of Certificate Principal Balance, which provides that the principal balance of the Primary Classes is increased only by "Subsequent Recoveries":

> Certificate Principal Balance: As to any Certificate (other than any Class CE Certificates and any Class R Certificates) and as of any Distribution Date, the Initial Certificate Principal Balance of such Certificate plus, in the case of a Class A Certificate and Class M Certificate, any Subsequent Recoveries added to the Certificate Principal Balance of such Certificate pursuant to Section 5.04(b), less the sum of (i) all amounts distributed with respect to such Certificate in reduction of the Certificate Principal Balance thereof on previous Distribution Dates

[4] The PSA for one of the HBK Trusts defines Subsequent Recoveries to include amounts received from modified loans — *i.e.*, "a Mortgage Loan that has been modified which resulted in a Realized Loss." BSABS 2007-HE5 PSA, § 1.01 (Subsequent Recoveries). While the Deferred Principal Collections may be Subsequent Recoveries under that particular definition, this only underscores that Deferred Principal Collections for the other 38 HBK Trusts, which do not include amounts received from a "modified" loan, are not Subsequent Recoveries.

> pursuant to Section 5.04, and (ii) any Applied Realized Loss Amounts allocated to such Certificate on previous Distribution Dates. As to the Class CE Certificates and as of any Distribution Date, an amount equal to the Uncertificated Principal Balance of the Class CE Interest.

PSA § 1.01 (Certificate Principal Balance). It is also reflected in the PSA's waterfall provisions:

> [T]he amount of such Subsequent Recoveries will be applied to increase the Certificate Principal Balance of the Class of Certificates with the highest payment priority to which Realized Losses have been allocated, but not by more than the amount of Realized Losses previously allocated to that Class of Certificates pursuant to Section 5.05 . . . .

Id. § 5.04(b).

39. Because Deferred Principal Collections are not Subsequent Recoveries for 38 of the 39 HBK Trusts, they do not result in any write-ups under the PSA. The Trustee has therefore correctly interpreted the PSAs with respect to Deferred Principal Collections for those HBK Trusts. The Court should instruct the Trustee to continue doing so.

IV. The Retired Class Provision Prohibits Reviving Certificates Reduced To Zero

40. Moreover, as the Trustee also points out in the Petition, the PSAs for the HBK Trusts contain a provision that prohibits the Primary Classes from receiving any distributions after they are reduced to zero. *See* PSA § 5.04(a). The Petition refers to this provision as the "Retired Class Provision." Pet. ¶ 11.

41. In relevant part, the Retired Class Provision provides that the Primary Classes are no longer entitled to distributions after their principal balance is reduced to zero:

> [N]otwithstanding the foregoing, on 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.

See PSA § 5.04(a) at p. 149 (emphasis added).

42. This provision means what it says and makes no exception. Once the Primary

Classes are reduced to zero (through either losses or pay-downs), they are not entitled to any distributions going forward, irrespective of whether those distributions are a result of write-ups or made pursuant to the excess cashflow waterfall. Not surprisingly, the Trustee generally has applied the Retired Class Provision in this manner. Pet. ¶ 114.

43. In the Petition, however, the Trustee states that certain parties have disputed its general application of the Retired Class Provision as a result of the First Department's ruling referred to in the Petition as the "JPM II Appellate Opinion." Pet. ¶ 25. But that ruling is inapplicable here for a number of reasons, including because it concerned a one-time, *sui generis* settlement payment, rather than routine distributions of collections in the ordinary course. JPM II Appellate Opinion at 2. Indeed, that case dealt with the interplay between the applicable PSAs and a settlement agreement with respect to the recovery of losses suffered by hundreds of RMBS trusts due to pervasive representation and warranty violations. JPM II Trial Court Order at 7. That is not the case here, and moreover that case is still being appealed.

44. Accordingly, the Court should instruct the Trustee to continue not writing up and not distributing proceeds to the Primary Classes of Certificates in the HBK Trusts on the basis of Deferred Principal Collections and other collections received after the principal balances of those Certificates are reduced to zero.

CONCLUSION

For all of these reasons, HBK respectfully requests that the Court enter an order instructing the Trustee to distribute Deferred Principal Collections and all other collections through the excess cashflow waterfall, for the benefit of Class CE Certificates and other applicable classes, when the Primary Classes are reduced to zero, and to continue not treating Deferred Principal Collections as Subsequent Recoveries and abiding by the Retired Class Provision for routine distributions in the ordinary course.

Dated: New York, New York
January 18, 2022

Respectfully submitted,

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CERTIFICATION OF WORD COUNT

The undersigned hereby certifies that the foregoing HBK Master Fund L.P.'s Answer To the Petition contains 4,081 words according to the word processing software used to prepare this Answer, excluding the caption and signature block.

By: /s/ *Uri A. Itkin*
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