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May 27, 2020

Via NYSCEF

The Honorable Joel M. Cohen
Supreme Court of the State of New York, Commercial Part 3
60 Centre Street, Courtroom 222
New York, NY 10007

Re: Index No. 150738/2019, *In re the Application of The Bank Of New York Mellon, in its Capacity as Trustee for 278 Residential Mortgage-Backed Securitization Trusts, etc.*

Dear Justice Cohen:

We write as counsel for Silian Ventures LLC (“Silian”) in response to letters submitted by the Trustee and the P&I Investors on May 20, 2020 (the “May 20 Letters”). See NYSCEF 115–20. During the May 12 hearing, the Court requested in connection with the Trustee’s course-of-performance arguments that the Trustee and P&I Investors submit a letter identifying where the Trustee had described to investors its methodology for calculating the Pass-Through Rate owed to the IO senior certificates. Specifically, the Court asked for the Trustee and the P&I Investors to identify evidence “in the record” where the so-called dynamic approach was disclosed through “descriptions, you know, in words rather than just gleaning it from numbers.” NYSCEF 121, at 97:5–13; 71:9–15 (May 12, 2020 Tr.). The Court explained the purpose of its request was to determine whether “the course of performance is clear as opposed to what—I am hearing a little bit now which [is] that anybody could reverse engineer and figure it out.” *Id.* at 77:14–17.

The May 20 Letters fail to identify any disclosures of the type that the Court requested. Instead, the Trustee and P&I Investors rely on documents outside the record to argue (ineffectively) that the Trustee’s calculation could be gleaned or reverse engineered from numbers in the Trustee’s reporting or other, third-party sources. The answer to the Court’s actual question is easily understood from the Trustee’s and P&I Investors’ silence: the Trustee’s methodology was never publicly disclosed to potential or current investors before Silian precipitated this dispute.

I. The Trustee’s Loan-Level And Monthly Reports Do Not Disclose The Trustee’s Methodology For Calculating The Pass-Through Rate

Apparently unable to point to evidence in the record, the Trustee submits three new exhibits—two loan-level reports available on its website and the February 2015 monthly report for the 2006-06 CB Trust—to show that interest-rate modifications were disclosed. See NYSCEF 116 (Nov. 25, 2018 Loan-Level Report); NYSCEF 117 (Apr. 25, 2006 Loan-Level Report);

NYSCEF 118 (Feb. 2015 Monthly Report). The P&I Investors point to the monthly report as disclosing (1) interest-rate modifications on a loan-by-loan basis and (2) a summary table reflecting the overall pool-wide reduction of interest rates (grouping Discount and Non-Discount Mortgage Loans together, and accounting for Debt Service Reductions and Relief Act Reductions in addition to modifications). NYSCEF 119, at 2. For its part, the Trustee points to the loan-level reports as disclosing that certain Mortgage Loans were modified and also disclosing the post-modification interest rate of those Mortgage Loans. NYSCEF 115, at 1–2.

Even if the Court were inclined—notwithstanding its directive to the contrary—to consider evidence outside the record, nothing in these new materials shows, or even suggests, that the modified interest rates disclosed in the monthly report and loan-level data are the interest rates used to calculate the Pass-Through Rate for the IO senior certificates. And nothing in the monthly report or loan-level data submitted by the Trustee identifies the modified rate as the “Adjusted Net Mortgage Rate” defined in the PSA. These new materials merely disclose the undisputed fact that certain pre-crisis mortgage loans were modified, often following government guidelines promoting these types of modifications. See U.S. Dep’t of Treasury, *Making Home Affordable: Home Affordable Modification Program (HAMP)* (“HAMP is a voluntary program that supports servicers’ efforts to modify mortgages, while protecting taxpayers’ interests.”).¹ This information concerning interest-rate modifications is relevant to investors because it allows them to understand the total cash flows that the trust can expect to receive from its pool of mortgage loans over time. But the fact that modified rates were disclosed says nothing about what calculations, if any, the Trustee used those modified rates for, let alone whether the Trustee was using the modified rate to calculate the Pass-Through Rate for the IO senior certificates.

Moreover, if the Court were inclined to consider evidence outside the record, then Silian would want the opportunity itself to present additional evidence demonstrating that disclosure of data regarding modifications did not equate to notice that modified rates were being used to calculate payments to the IO senior certificates. For example, Silian would seek to present evidence that the Trustee disclosed the *exact same* type of information regarding modifications for other ratio-strip RMBS shelves where it used the *original* rate—not the *modified* rate—for calculating payments to IO senior certificates. See, e.g., Ex. A, at S24 (remittance report issued by Trustee for Chase Mortgage Finance Trust 2007-S6 (“CMFT 07-S6”) listing loan modifications notwithstanding that Trustee used the *original* rate to calculate payments to Class IAX and IIAX IO senior certificates); Ex. B, at 1 (Column G), 7 (Column BJ) (loan-level report for CMFT 07-S6 listing “Current Note Rate” and “Net Interest Rate” even though Trustee used the *original* rate to calculate the payments to Class IAX and IIAX IO senior certificates).

II. Bloomberg Does Not Disclose The Trustee’s Methodology For Calculating The Pass-Through Rate

Straying even further afield from the Court’s request, the P&I Investors submit screenshots from Bloomberg that show the existence of interest-rate modifications and the reduction of the Pass-Through Rate from 2007 to 2020 on one cherry-picked example of the 278 trusts at issue in

¹ <https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/mha/Pages/hamp.aspx>

this action.² Neither of these points is in dispute. *First*, as noted above, there is no dispute that certain loans held by the trusts at issue were modified. And, indeed, Bloomberg disclosed the exact same type of information regarding loan modifications for ratio-strip RMBS trusts where the Trustee uses the *original* rate to calculate payments to the IO senior certificates. So the existence of these disclosures on Bloomberg says nothing about how calculations are performed. *See* Ex. C, at 1 (Bloomberg screenshot showing loan modifications for CMFT 07-S6). *Second*, investors would also have understood that the Pass-Through Rate paid to the IO senior certificates decreased over time. But the Bloomberg screenshots do not purport to explain either *why* or *how* the Pass-Through Rate being paid to the IO senior certificates decreased over time. This is important since the Pass-Through Rate is something that is expected to decrease over time regardless of interest-rate modifications, because higher interest-rate loans often prepay or default faster than lower interest-rate loans. The P&I Investors' Bloomberg screenshots merely confirm this expectation. They do not, however, in any way disclose or describe the Trustee's methodology for calculating the Pass-Through Rate, or the Trustee's use of the modified rate in performing that calculation.

Unable to identify any disclosure of the Trustee's methodology for calculating the Pass-Through Rate, the P&I Investors ask the Court to infer, without any citation or evidentiary support, that "[t]he declines in the coupon rate for the IO certificate in [the CWHL 2007-20] trust" from 2007 to 2020 "[are] so severe ... that investors would understand that a drop of that magnitude would not be due solely to adjustments from prepayments or re-weighting of the interest rates among the Non-Discount Mortgage Loans." NYSCEF 119, at 4. There is absolutely no basis in the record for crediting this *ipse dixit* conclusion even as to the P&I Investors' single cherry-picked example, let alone the 277 other trusts at issue in the proceeding.

Moreover, even if the inferences proposed by the P&I Investors related to the declining Pass-Through Rate between 2007 and 2020³ were properly presented to the Court based on an established evidentiary record, these inferences still would not amount to disclosure of the Trustee's calculation methodology. The P&I Investors seem to suggest that the decline in the Pass-Through Rate disclosed that modifications must be playing some unspecified role in determining the Pass-Through Rate for the IO senior certificates. But it does no such thing. Applying the modified rates with the pool-level approach that the P&I Investors argue is expressly required by the PSA would have wiped out *all* payments to the IO senior certificates in their entirety for most of the CWALT and CWHL trusts years earlier. That has not happened. Instead, the IO senior certificates have continued to receive interest payments—an outcome that would not be expected under the modified-rate approach according to the P&I Investors. Thus, the decline in the Pass-Through Rate would not have provided a clear indication to investors that the Trustee was implementing the modified-rate approach but rather, at best, may have left IO investors guessing what approach the Trustee was implementing. That is a far cry from the type of express explanatory disclosure that the Court was inquiring about at the May 12 hearing.

² The P&I Investors provide no explanation why they chose to highlight the CWHL 2007-20 trust. Silian does not believe that the reduction in the Pass-Through Rate in CWHL 2007-20 is representative of the other trusts at issue here.

³ The P&I Investors' use of the Pass-Through Rate in 2020 inappropriately exaggerates the reduction in Pass-Through Rate. The relevant inquiry under the Trustee's course-of-performance argument is whether there was an openly disclosed course of performance in the years leading up to 2017, when Silian raised the calculation error to the Trustee and asked that it be corrected.

III. Third-Party Research After Filing Of This Litigation Does Not Disclose The Trustee's Methodology For Calculating The Pass-Through Rate

Oddly, the P&I Investors also identify two third-party-research sources published *after* the filing of this lawsuit in response to the Court's request for a disclosure of the Trustee's calculation methodology. Neither source shows such a disclosure.

The notation added to Intex after this lawsuit was filed, which added the "option to use unmodified rates when calculating IO coupon," says nothing about whether the calculation methodology used by the Trustee was disclosed prior to this litigation. Indeed, Intex's apparent *silence* on whether its calculation used the original rate or modified rate before this litigation is compelling evidence that the market was not fully aware of the Trustee's approach. If the trusts at issue here—unlike virtually every other shelf of ratio-strip IO certificates on the market—were using the modified rate rather than the original rate, one would expect Intex to have flagged that anomaly for investors. It did not. Likewise, the Nomura report, which parrots the Trustee's description of its calculation methodology from the Petition, obviously does not show that the Trustee's approach was openly disclosed prior to the Petition. Once again, the absence of pre-suit reporting about the Trustee's anomalous approach to calculating the Pass-Through Rate is itself evidence the approach was not open and notorious.

* * *

Despite reaching outside the record, the Trustee and P&I Investors still have not identified any evidence showing that the Trustee had ever, in any way, publicly described its calculation methodology prior to this dispute. This is significant for two reasons. *First*, it is significant because investors—and, particularly, buy-and-hold investors that acquired the IO senior certificates at inception—would not have been properly notified of the Trustee's approach. *Second*, it is significant because it supports Silian's assertion—evidenced by the Trustee's quotation from incorrect provisions of the PSA and its use of a loan-level calculation—that the Trustee has been mistakenly implementing an incorrect provision of the PSA when calculating the Pass-Through Rate for the IO senior certificates. Specifically, as Silian has explained, the Trustee appears to have been mistakenly using the calculation for the Interest Rate on the LTR-X-1 Interests to calculate the Pass-Through Rate, which would be an unambiguously incorrect interpretation of the PSA under settled First Department precedent. *See U.S. Bank, N.A. v. SBMC Holdings LLC*, 177 A.D.3d 443, 444 (1st Dept. 2019) (“[T]he provisions of the PSA that apply to Real Estate Mortgage Investment Conduit (REMIC) I [*i.e.*, the equivalent of the lower-tier REMIC here] (which was an internal trust vehicle, as was REMIC II) ... have no application to REMIC III [*i.e.*, the equivalent to the Master REMIC here] ...”). Perhaps tellingly, the Trustee has never denied that it was mistakenly applying the wrong provision when it established its methodology to calculate the Pass-Through Rate. An unquestionably mistaken interpretation of the PSA is not probative course-of-performance evidence for how to perform the Pass-Through Rate calculation under the correct provision. *See 5 Corbin on Contracts § 24.16* (2019) (“The parties’ mistaken interpretation of their contract does not constitute a course of performance which can assist the court in interpreting a disputed term.”).

Because the Trustee and P&I Investors cannot identify any clear disclosure of the Trustee's calculation methodology in the record (or in their new submissions), and for the other reasons stated above and in Silian's briefing in this matter, the Court should decline to consider the

Trustee's course-of-performance argument at this juncture and allow for appropriate discovery to "explore all that may be offered to show what is the proper interpretation of the disputed language." *LDIR, LLC v. DB Structured Prods., Inc.*, 172 A.D.3d 1, 5 (1st Dep't 2019) (alterations omitted).

We thank the Court for its consideration of this matter.

Respectfully submitted,

A handwritten signature in blue ink that reads "Jonathan E. Pickhardt". The signature is written in a cursive style with a large initial "J" and "P".

Jonathan E. Pickhardt