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 for 278 Residential Mortgage-Backed Securitization Trusts, Petitioner, For Judicial Instructions Under CPLR Article 77 Concerning the Proper Pass-Through Rate Calculation for CWALT Interest Only Senior Certificates.	:	Index No. 150738/2019 Assigned to: Friedman, J.

OPENING BRIEF OF THE INSTITUTIONAL INVESTORS, AIG PARTIES, FEDERAL HOME LOAN BANK OF SAN FRANCISCO, and TILDEN PARK (in accordance with Revised Stipulation Regarding Briefing Schedule dated June 25, 2019, Dkt. No. 55)

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INTRODUCTION

Following the financial crisis, the interest rates on many thousands of mortgage loans held by the 278 residential mortgage backed-securities trusts in this Article 77 Proceeding (the "Covered Trusts") were modified downward, which reduced the borrowers' monthly payments and avoided costly foreclosures. These modifications were a "win win"—they were good for borrowers, who could better afford their payments and stay in their homes, and they were good for certificateholders, who avoided the substantial losses associated with foreclosures. The core dispute in this case is whether a particular class of certificateholders, who are entitled to excess interest payments on high-interest mortgage loans, are immune from those interest rate reductions and are therefore ***guaranteed*** a stream of interest payments on the basis of the mortgages' initial rates—whether or not those rates were later reduced through modifications.

There are two categories of certificates at issue. The first category is conventional Principal and Interest certificates ("P&I Certificates"), which are held by the undersigned Investor Group in 234 of the 278 Covered Trusts and receive both principal and interest payments on the underlying mortgage loans.[1] The second category is the Interest-Only Certificates ("IO Certificates"), which are held by Och-Ziff (a hedge fund appearing here through Silian Ventures) in 156 of the 278 Covered Trusts. In contrast to the P&I Certificates, the IO Certificates are entitled only to the excess interest, if any, that is left over on high-interest mortgages (known as "Non-Discount Mortgage Loans") above a threshold interest rate (the "Required Coupon").

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[1] The "Investor Group" includes The Institutional Investors, AIG Parties, the Tilden Park Parties, and the Federal Home Loan Bank of San Francisco. The Institutional Investors include BlackRock Financial Management, Inc., the Federal Home Loan Bank of Atlanta, Goldman Sachs Asset Management L.P., Kore Advisors, L.P., and Pacific Investment Management Company LLC. The AIG Parties include American General Life Insurance Company, American Home Assurance Company, American International Reinsurance Company, Ltd., Lexington Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa., the United States Life Insurance Company in the City of New York, and the Variable Annuity Life Insurance Company. The Tilden Park Parties include Tilden Park Investment Master Fund LP, Tilden Park Management I LLC and Tilden Park Capital Management LP.

Under the payment calculations performed over the past decade by the trustee The Bank of New York Mellon ("BNY Mellon" or the "Trustee"), holders of *all* interest-bearing certificates—including the P&I and IO Certificates—have received interest payments based on the mortgage loans' *current* interest rates, not their *initial* rates. In this way, holders of P&I and IO Certificates have both borne the "cost" of interest rate modifications through reduced cash flows following those modifications. The benefits, of course, have also been shared by the P&I Certificates and IO Certificates, because the alternative to modification is often a costly foreclosure that would *eliminate* both principal and interest payments on a given mortgage and thus eliminate any interest payments to both the P&I and IO Certificates.

In approximately December 2017, Och-Ziff purchased all of the IO Certificates for 156 of the 278 Covered Trusts. Shortly thereafter, Och-Ziff began pressuring BNY Mellon to calculate excess interest paid to those IO Certificates based on the mortgage loans' *initial* interest rates, rather than their *current* rates—a change that would substantially increase the excess interest paid to the IO Certificates. As explained below, publicly available data on the trusts' mortgages reveal that the windfall Och-Ziff seeks here easily exceeds a ***quarter of a billion dollars***. Och-Ziff's demand asserts that the IO Certificates *alone* should be immune from interest rate modifications, and that the P&I Certificates *alone* should bear the entire cost of those modifications. After Och-Ziff sued BNY Mellon in federal court in December 2018, BNY Mellon filed this Article 77 Proceeding seeking instructions on how to calculate excess interest paid to the IO Certificates.

The Pooling and Servicing Agreements ("PSAs") ***unambiguously*** require excess interest paid to the IO Certificates to be calculated by the so-called "Dynamic Method,"—*i.e.*, calculating excess interest on the basis of the mortgages' current, post-modification rates. The Dynamic Method is required by the terms "Adjusted Net Mortgage Rate," "Mortgage Rate," and "Mortgage

Note," all of which require the use of the mortgages' *current* rates, not their initial rates.

Och-Ziff's view that it is entitled to a quarter of a billion dollar windfall is not only contrary to the plain text of the PSAs, but would also turn the trusts' structure upside down by converting *excess interest* certificates into ones that would generate a *guaranteed* stream of leftover interest at a fixed, initial rate—even when interest rate modifications reduce, or even eliminate, that leftover interest. That outcome defies both the contracts' text and common sense.

ARGUMENT

Each of the Covered Trusts is governed by a PSA that instructs the Trustee how to calculate the monthly distributions made to the various classes of certificates.[2] It is undisputed that distributions to the IO Certificates are calculated by applying a "Pass-Through Rate" to the total outstanding principal balance of the Non-Discount Mortgage Loans (the "Notional Amount").

The "Pass-Through Rate" for the IO Certificates is calculated as the "excess of (a) the weighted average of the Adjusted Net Mortgage Rates of the Non-Discount Mortgage Loans . . . over (b) 5.50%."[3] The IO Certificates are thus entitled to the "excess" interest above the Required Coupon (here, 5.50%) generated by the Non-Discount Mortgage Loans. Three definitions determine the Pass-Through Rate for the IO Certificates, which are typically denominated as the "Class X" certificates:

- "***Adjusted Net Mortgage Rate***" is defined, in relevant part, "[a]s to each Mortgage Loan, <u>and at any time</u>, the per annum rate equal to the <u>Mortgage Rate</u> [less certain fixed percentage fees not relevant here]."[4]

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[2] The Investor Group agrees with BNY Mellon and Och-Ziff that the PSA for the CWALT 2006-6CB Trust is representative of the relevant provisions in the PSAs for the other Covered Trusts. So, for ease of reference, we refer and cite to the terms of the CWALT 2006-6CB PSA throughout, which has been filed at NYSCEF Dkt. No. 3.
[3] PSA, p. 4 (Note 19 to Preliminary Statement setting forth Pass-Through Rates for all certificates, including the "Class X" IO Certificates at issue here).
[4] PSA, art. I, I-1 (emphasis added).

- "***Mortgage Rate***" is defined as "[t]he annual rate of interest borne by a Mortgage Note from time to time, net of any interest premium charged by the mortgagee to obtain or maintain any Primary Insurance Policy."[5]

- "***Mortgage Note***" is defined as "[t]he original executed note or other evidence of indebtedness evidencing the indebtedness of a Mortgagor under a Mortgage Loan."[6]

The PSAs unambiguously require the Dynamic Method. Och-Ziff's contrary arguments are meritless.

I. The Plain Text of the PSAs Unambiguously Requires the Dynamic Method.

The plain text of the PSAs unambiguously requires the Dynamic Method in four ways.

A. The Definitions of "Adjusted Net Mortgage Rate" and "Mortgage Rate" Unambiguously Require the Dynamic Method through the Temporal Language "At Any Time" and "From Time to Time."

First, the definitions of "Adjusted Net Mortgage Rate" and "Mortgage Rate" include language that reflect changes over time—i.e., "***at any time***" and "***from time to time***"—and that language would be meaningless if those rates were always *initial* rates.

Adjusted Net Mortgage Rate. The PSAs define "Adjusted Net Mortgage Rate" as equal to "*at any time*, the per annum rate equal to the Mortgage Rate [less certain fixed percentage fees not relevant here]."[7] The phrase "at any time" instructs that the Adjusted Net Mortgage Rate—and in turn the Pass-Through Rate—uses the rate in effect at the point in time when the calculation is made. Ignoring this phrase would violate the canon of construction that courts must give meaning to all words in a contract.[8]

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[5] PSA, art. I, I-17 (emphasis added).
[6] PSA, art. I, I-17 (emphasis added).
[7] PSA, art. I, I-1 (emphasis added).
[8] *See Matter of Viking Pump, Inc.*, 52 N.E.3d 1144, 1154 (N.Y. 2016) (constructions that cause surplusage "cannot be countenanced under our principles of contract interpretation"); *FCI Grp., Inc. v. City of N.Y.*, 54 A.D.3d 171, 177 (1st Dep't 2008) ("[A] court should not adopt an interpretation which will operate to leave a provision of a contract without force and effect.") (internal quotation marks and citation omitted).

Mortgage Rate. The term "Mortgage Rate," which is included in the definition of Adjusted Net Mortgage Rate, also makes clear that mortgage rates will change over time. The PSAs define "Mortgage Rate" as "[t]he annual rate of interest borne by a Mortgage Note *from time to time* . . . ."[9] By specifying that the Mortgage Rate is the interest rate borne by the mortgages "from time to time," this provision contemplates that the Mortgage Rate will change over time, including when interest rates are reduced through modifications. If the mortgage rates were frozen in 2005, 2006, or 2007, this "from time to time" qualification would be meaningless.

Tellingly, the PSAs consistently use the phrase "from time to time" when referring to a variety of interest rates that necessarily *change* over time. For example, some certificates receive interest rates tied to LIBOR, a rate that changes daily. With respect to that daily determination of LIBOR, the PSAs state that the Trustee may conclusively rely upon the offered quotations from the LIBOR panel banks "*in effect from time to time*."[10] Similarly, the PSAs define "Prime Rate" as "[t]he prime commercial lending rate of The Bank of New York, as publicly announced to be in effect *from time to time*. The Prime Rate shall be adjusted *automatically, without notice, on the effective date of any change in such prime commercial lending rate*."[11] These "from time to time" qualifiers for both LIBOR and the Prime Rate require the use of *current* rates. The term "Mortgage Rate" is no different—the "from time to time" qualifier refers to *current* rates.

B. Other Provisions of the PSAs Confirm that "Mortgage Rate" is Dynamic.

Second, contrary to Och-Ziff's assertion that Mortgage Rate is a "static" or "constant" rate,[12] the PSAs consistently use the term "Mortgage Rate" to refer to a *dynamic* figure. One

[9] PSA art. I, at I-17 (emphasis added).
[10] PSA, § 4.07, art. IV, IV-11.
[11] PSA, art. I, I-24.
[12] *See* Och-Ziff Answer (NYSCEF Dkt. No. 31) at 9, 13.

provision in particular, which Och-Ziff has glaringly ignored so far, proves this point.

That provision, found in Section 3.11(b) of the PSAs, addresses a particular type of mortgage modification—one in lieu of a refinancing. When market rates fall, the servicer (here, Countrywide) may modify a loan to prevent the borrower from refinancing her loan with another bank. Although the purpose of a modification in lieu of a refinancing thus differs from other loss mitigation modifications, the result is the same: Countrywide modifies the interest rate downward.

Section 3.11(b) of the PSAs expressly permits modifications in lieu of a refinancing if certain conditions are met, including that the *new* "Mortgage Rate" (capital M, capital R) on the modified loan corresponds to *then-prevailing market* interest rates. The use of the defined term "Mortgage Rate" to describe the new, *modified* interest rate on a *modified* mortgage loan confirms that Mortgage Rate is used in a dynamic way throughout the PSAs. Section 3.11(b) states:

> Countrywide may agree to a modification of any Mortgage Loan (the 'Modified Mortgage Loan') if (i) the modification is in lieu of a refinancing and (ii) the Mortgage Rate on the Modified Mortgage Loan is approximately a prevailing market rate for newly-originated mortgage loans having similar terms and (iii) Countrywide purchases the Modified Mortgage Loan from the Trust Fund . . . ."[13]

A borrower would only refinance her mortgage loan if the *new*, *modified* Mortgage Rate—set at "approximately a prevailing market rate"—were *lower* than the initial rate. So, the reference to "Mortgage Rate" must be dynamic, because it necessarily refers to a *then-current* prevailing rate that is *lower* than the initial rate on a given loan.

C. "Mortgage Note" Includes the Mortgage Note and Other Evidence of Indebtedness, Including Mortgage Modification Documentation.

Third, the term "Mortgage Note" includes the "original executed note **or other evidence**

[13] PSA, art. III, III-14 (emphasis added).

of indebtedness."[14] Och-Ziff's Answer ignores the second half of this definition, which makes clear that Mortgage Note encompasses not only the note entered into a decade ago, but also any other "evidence of indebtedness" that reflects the payment terms on the mortgage.

When the Servicer grants an interest rate reduction modification, it executes a written document reflecting the terms of the modification. That modification documentation constitutes "other evidence of indebtedness" contemplated in the definition of Mortgage Note because it "evidence[s]" the new stream of principal and interest payments a borrower owes on the mortgage—*i.e.*, the borrower's "indebtedness." These payments reflect the "annual rate of interest borne by [the] Mortgage Note from time to time," as opposed to the interest rate on the initial executed note, which is no longer borne as an obligation.

Furthermore, the PSAs expressly require the Depositor to deposit any such mortgage modification documentation into the Trust Fund (*i.e.*, the corpus of the trust).[15] When the trusts were created, Section 2.01 of the PSAs required the Depositor to deposit each of the initial mortgage notes into the Trust Fund.[16] But under Section 2.01(c), the Depositor also has a *continuing* obligation to deposit into the Trust Fund "*from time to time*" any "*additional* original documents *evidencing an assumption or modification of a Mortgage Loan*."[17]

The certificates evidence an interest in the Trust Fund.[18] As the Trust Fund changes over

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[14] PSA, art. I, I-17 (emphasis added).
[15] "Trust Fund" is defined as follows: "The corpus of the trust created hereunder consisting of (i) *the Mortgage Loans and all interest and principal received on or with respect thereto* after the Cut-off Date to the extent not applied in computing the Cut-off Date Principal Balance thereof; (ii) the Certificate Account, the Distribution Account, the Pre-funding Account and the Capitalized Interest Account, and all amounts deposited therein pursuant to the applicable provisions of this Agreement; (iii) property that secured a Mortgage Loan and has been acquired by foreclosure, deed-in-lieu of foreclosure or otherwise; and (iv) all proceeds of the conversion, voluntary or involuntary, of any of the foregoing." PSA, art. I, I-34 (emphasis added).
[16] PSA, art. II, II-1.
[17] PSA, art. II, II-3 (emphasis added).
[18] *See* Preliminary Statement ("The Depositor is the owner of the Trust Fund that is hereby conveyed to the Trustee in return for the Certificates."). PSA at 1.

time, the certificates' entitlements change as well. As noted above, the IO Certificates were designed to receive the "excess" interest on high-interest mortgage loans. After the high-interest mortgage loans are *modified*, the Trust Fund is also *modified* to reflect those interest rate reductions. Thus, it would make no economic sense to pay the IO Certificates on the fiction that the Trust Fund *still* contains those high-interest mortgage loans—when in fact, it does not.

Finally, as described below in Section II, the only other court to have addressed a similar dispute held that "other evidence of indebtedness" unambiguously encompasses mortgage modification documentation. Accordingly, the Pass-Through Rate reflects the rate of interest set forth in the mortgage modification documentation.

D. "Mortgage Rate" Is Necessarily a Dynamic Rate Because the Cost to Maintain Primary Mortgage Insurance Can Change over Time.

Fourth, contrary to Och-Ziff's assertion that Mortgage Rate is a "static" or "constant" term, the "Mortgage Rate" is expressly "net of" the cost "to obtain or maintain any Primary Insurance Policy"—a cost that varies over time. Hence, on its face, Mortgage Rate necessarily varies over time too.

The term "Mortgage Rate" is defined as "[t]he annual rate of interest borne by a Mortgage Note from time to time, ***net of any interest premium charged by the mortgagee to obtain or maintain any Primary Insurance Policy***."[19] "Primary Insurance Policy" is defined as "[e]ach policy of primary mortgage guaranty insurance or any replacement policy therefor with respect to any Mortgage Loan."[20]

Primary mortgage guaranty insurance is traditionally charged on loans for which the

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[19] PSA, art. I, I-17 (emphasis added).
[20] PSA, art. I, I-24.

borrowers paid less than 20% of the home price as a down payment. In these trusts, too, the PSAs state that each of the loans with a Loan-to-Value ratio greater than 80% "is the subject of a Primary Insurance Policy that insures that portion of the principal balance equal to a specified percentage times the sum of the remaining principal balance of the related Mortgage Loan, the accrued interest thereon and the related foreclosure expenses."[21] Importantly, as the borrower pays down a mortgage loan (especially to a Loan-to-Value ratio lower than 80%), the cost to "maintain" or to "replace" the primary mortgage insurance policy could fall. If that were the case, then the "Mortgage Rate" used to calculate excess interest payable to the IO Certificates—which is *net* of the cost of that insurance—would *increase*.

In short, although Och-Ziff would have this Court believe that the Mortgage Rate on a loan is fixed at origination, the Mortgage Rate necessarily changes over time because of changing insurance costs. That leaves Och-Ziff forced to maintain that the Mortgage Rate is fixed at origination with respect to changes in the interest rate on the loan but *not* fixed at origination with respect to changes in the insurance premium on a loan. Apart from the inconsistency created by this interpretation, Och-Ziff's argument would allow IO Certificates to benefit from the upside chance of a decline in primary mortgage insurance premiums without the downside risk of loan modifications. On its face, Mortgage Rate is a dynamic rate that can change from month-to-month as any of its components change.

II. The Only Court to Address Distributions to IO Certificates Held That the Dynamic Method Is Required.

The only court to confront Och-Ziff's argument rejected it, holding that a *nearly identical* PSA unambiguously called for the application of the Dynamic Rate for the IO certificates. There,

[21] PSA, sch. III-A, S-III-A-4 (Representation No. 26).

the hedge fund LibreMax purchased IO certificates in an RMBS trust called American Home Mortgage Assets Trust 2007-5 and then sought the same relief Och-Ziff seeks here through the administrator, Wells Fargo. Wells Fargo, like BNY Mellon, refused to change its longstanding calculation of excess interest rates using the current, dynamic mortgage rates. Litigation ensued. *See Matter of Am. Home Mortg. Assets Tr. 2007-5*, No. A18-0768, 2019 WL 1431923 (Minn. Ct. App. Apr. 1, 2019) (Ex. 1) (hereafter *American Home Mortgage*). Wells Fargo won.[22]

American Home Mortgage bears a striking resemblance to this case. Applying New York law, the trial court determined that provisions in the governing PSA that also appear in the Covered Trusts' PSAs ***unambiguously*** required the Dynamic Method.[23] The Minnesota Court of Appeals affirmed, holding that the PSA "indicates no intent to exclude loan modifications" from distribution calculations. *Id.* at *6. On that basis, the court instructed Wells Fargo to continue using the current, post-modification mortgage rates to calculate interest owed to the IO certificates.

The key terms in the *American Home Mortgage* PSAs are virtually identical to those in the PSAs at issue here. Under both PSAs, the Pass-Through Rate for IO Certificates is calculated by reference to the "Net Mortgage Rate" (in the *American Home Mortgage* PSA) or the "Adjusted Net Mortgage Rate" (in the Covered Trusts' PSAs). Under both, these terms' definitions specify that the net interest rate can change over time. *Compare American Home Mortgage*, 2019 WL 1431923, at *2 (defining "Net Mortgage Rate" as "the *then-applicable* Mortgage Rate"), *with*

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[22] Notably, Och-Ziff was well along the way in pursuing the same relief here when then the *American Home Mortgage* decisions came down.

[23] The Minnesota courts did not stop at the plain language of the PSA only because, unlike the PSAs for the Covered Trusts, the PSA at issue in that case incorporated a separate Servicing Agreement. That Servicing Agreement contained a provision that *expressly excluded servicing modifications from the calculation of the Pass-Through Rate*. *Id.* at *3. Although the PSA unambiguously required the Dynamic Method, this language in the Servicing Agreement created a conflict that had to be resolved via a trial. *See American Home Mortgage* at *6. Here, there is no Servicing Agreement and there is no language in any governing document of the Covered Trusts that excludes loan modifications from the calculation of the Pass-Through Rate, so the case for the Dynamic Method is even stronger here than it was in the *American Home Mortgage* case.

Covered Trust PSA, art. I, I-1 (defining "Adjusted Net Mortgage Rate" as "*at any time*, the per annum rate equal to the Mortgage Rate").

In both, the definitions of Mortgage Rate also make clear that the rate can change "*from time to time*." *Compare American Home Mortgage*, 2019 WL 1431923, at *2 (defining "Mortgage Rate" as "the annual rate at which interest accrues on such Mortgage Loan, as adjusted *from time to time* in accordance with the provisions of the Mortgage Note"), *with* Covered Trust PSA, art. I, I-17 (defining "Mortgage Rate" as "[t]he annual rate of interest borne by a Mortgage Note *from time to time*, net of any interest premium charged by the mortgagee to obtain or maintain any Primary Insurance Policy"). And, in both, the definition of Mortgage Note includes both the original note and "other evidence" of indebtedness. *Compare American Home Mortgage*, 2019 WL 1431923, at *2, *5 (defining "Mortgage Note" as "the note *or other evidence of the indebtedness* of a Mortgagor under a Mortgage Loan"), *with* Covered Trust PSA, art. I, I-17 (defining "Mortgage Note" as "[t]he original executed note *or other evidence of indebtedness* evidencing the indebtedness of a Mortgagor under a Mortgage Loan"). Faced with arguments virtually identical to Och-Ziff's, the Minnesota courts found that these terms unambiguously required the Dynamic Method.

American Home Mortgage also determined that the structure of the PSAs requires the Trustee to use the Dynamic Method. There, as here, an investor purchased IO certificates, a standard type of RMBS certificate that the market would expect to operate in fundamentally predictable ways. As the Minnesota courts held, these instruments place the risk of interest rate modifications on the holders of interest-bearing certificates by calculating monthly distributions using the mortgages' then-current rates. Having made that same bet here by investing in well-understood IO certificates with a well-established risk profile, Och-Ziff must not be allowed to

receive a windfall it did not pay for.

III. A Dynamic Rate Is Consistent with the Reasonable Expectations of the Parties and the Structure of the Covered Trusts.

The Dynamic Rate is not only required by the text of the PSAs, it is consistent with the intent and structure of the Covered Trusts. In contrast, the use of the initial mortgage rates to determine excess interest payments to the IO Certificates would lead to absurd results.[24] For instance, Och-Ziff's reading of the PSAs would provide the IO Certificates a ***guaranteed*** excess interest rate—frozen in time when the mortgage loans were issued over a decade ago. Under Och-Ziff's theory, the IO Certificates, unlike the other interest-bearing certificates, would be uniquely immune to widespread defaults, foreclosures, and the mortgage modifications designed to avoid those foreclosures. That result would turn the structure of the trusts upside down.

The IO Certificates were purchased by investors willing to bet that the Non-Discount Mortgage Loans would continue to generate "excess" interest over time, such that there would be leftover interest to pay the IO Certificates. But this result was in no way guaranteed.

For example, if the Non-Discount Mortgage Loans were refinanced at lower rates, prepaid, or foreclosed upon, they would no longer create the "excess" interest above the Required Coupon they once did. In either case, the loans would be removed from the trust, and the IO Certificates would not receive any excess interest payments from them. In fact, this was the point: If the Non-Discount Mortgage Loans stopped *creating excess* interest, the IO Certificates stopped *receiving excess* interest—a risk that the holders of the IO Certificates took from the beginning. The Prospectus Supplements speak directly to this very risk:

> [T]he pass-through rates of the [IO Certificates] <u>in effect from time to time are</u>

[24] *See, e.g.*, *Matter of Lipper Holdings v. Trident Holdings*, 1 A.D.3d 170, 171 (1st Dep't 2003) (a "contract should not be interpreted to produce a result that is absurd, commercially unreasonable or contrary to the reasonable expectations of the parties").

> calculated by reference to the net mortgage rates of the Non-Discount mortgage loans in the related loan group. The Non-Discount mortgage loans in the related loan group will have higher net mortgage rates (and higher mortgage rates) than the other mortgage loans in that loan group. In general, mortgage loans with higher mortgage rates tend to prepay at higher rates than mortgage loans with relatively lower mortgage rates in response to a given change in market interest rates. As a result, the Non-Discount mortgage loans in a loan group may prepay at higher rates, thereby reducing the related pass-through rate and related notional amount of the [IO Certificates], as applicable.[25]

As the Court well knows, in the years following the issuance of these trusts the underlying mortgage loans began to default at very high rates, leading to significant losses for investors. The governing agreements themselves require the servicer to meet the customary standards of prudent servicing, which include consideration of and entry into mortgage loan modifications designed to prevent costly foreclosures and to mitigate trust losses.[26] These modifications come in many forms, but often reduce the monthly payments through interest rate reductions.

In addition to these servicing standards, the $8.5 billion global Countrywide settlement agreement expressly incentivized specialty sub-servicers to pursue beneficial modifications on tens of thousands of highly delinquent mortgage loans. Many thousands of the Trusts' mortgages have been modified in the years following the financial crisis—including through interest rate reductions.[27] That is a good thing for the trusts and for all certificateholders, because the alternative to a modification is often a costly foreclosure.

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[25] Prospectus Supplement CWALT 2006-CB at S120–21. Och-Ziff stresses that the Prospectuses did not itemize, as a material risk factor for the IO Certificates, the possibility that mass mortgage modifications would materially reduce the excess interest paid to the IO Certificates. This point is meaningless because the Prospectuses did not identify mass modifications as an itemized risk factor for ***any*** certificates—perhaps because few expected the magnitude of the foreclosure crisis—yet Och-Ziff would have the P&I Certificates bear it alone. In any event, the Prospectuses disclosed the definitions of Adjusted Net Mortgage Rate and Mortgage Rate, which require Dynamic Rates.

[26] *See* PSA, art. III, III-1 (§ 3.01) (servicing standards).

[27] The global Countrywide settlement was approved "in all respects." Index No. 651786/2011 (Dkt. No. 1149). The sub-servicer protocol, together with other servicing reforms incentivizing modifications, is set forth in Section 5 of the Countrywide settlement agreement. *See* Index No. 651786/2011 (Dkt. No. 3).

Indeed, with respect to the 156 Covered Trusts in which Och-Ziff has asserted an interest, there were initially approximately 240,000 Non-Discount Mortgage Loans in the trusts, of which approximately 24,000 (10%) have received interest rate reduction modifications.[28] There are now approximately 40,000 Non-Discount Mortgage Loans in the trusts, of which approximately 17,000 (42.5%) have received an interest rate reduction.[29]

The effect of these modifications is substantial, which means the windfall Och-Ziff seeks from this Court is massive. According to the mathematical analysis of public data on the loans in those 156 Covered Trusts by the Investor Group's experts at Ankura Consulting Group[30], the backwards-looking "true-up" payment Och-Ziff seeks would exceed ***$169 million***. Going forward, Och-Ziff would reap another ***$97 million***, for a total windfall exceeding ***$266 million***. This analysis is apparently consistent with Och-Ziff's own model, as confirmed by its counsel's statements in open court.[31] At bottom, Och-Ziff is seeking to shift its share of the cost of modifications—to the tune of ***over a quarter of a billion dollars***—to the P&I Certificates alone.

But as the PSAs make clear, the IO Certificates were designed to receive "excess" interest only to the extent the Non-Discount Mortgage Loans *created* excess interest. Following the financial crisis and the resulting widespread modifications to the mortgage loans' payment terms, that excess interest was diminished, so the excess interest payments to the IO Certificates decreased accordingly. That is what was *supposed* to happen, and simply bears out the interest

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[28] *See* the enclosed Affidavit of John Montgomery, Ph.D, at para. 13.
[29] *Id.*
[30] *See* the enclosed Affidavit of John Montgomery, Ph.D.
[31] Och-Ziff has alleged the current monthly difference between its method and the Trustee's method is $1.5 million per month, which corresponds to the Ankura estimates. *Compare* Transcript of May 9, 2019 Hearing (Dkt. No. 43) at 11:10–14 (stating Och-Ziff's belief that "there's about a million and a half dollars each month . . . that is going to other certificate holders when we believe it should be going to the IO certificate holders") & Transcript of Feb. 1, 2019 Hearing (Dkt. No. 13) at 12:22–13:6 (same), *with* Affidavit of John Montgomery, Ph.D. at para. 19 and Ex. 4 (estimating current monthly difference between the Trustee's method and Silian's is approximately $1.585 million).

rate risk that all investors took (the IO holders and the P&I holders alike) when they bought interest-bearing certificates.

IV. Och-Ziff's Textual Arguments Are Meritless.

In its Initial Statement, Och-Ziff offered various arguments in support of its position that the Mortgage Rate is fixed at origination. None stands up to scrutiny. Och-Ziff simply ignores or misconstrues provisions that undermine its position, seeks to manufacture conflicts between harmonious PSA provisions, and speculates without evidence about what trustees do on other trusts not before the Court.

A. Och-Ziff's "Original Note" Argument Ignores an Entire Clause of the Definition It Purports to Interpret.

Unable to find anything in the terms "Adjusted Net Mortgage Rate" or "Mortgage Rate," Och-Ziff turns to the definition of "Mortgage Note" for its primary support. The definition of Mortgage Note is indeed crucial in determining the correct method of calculating distributions, but it proves exactly the opposite of Och-Ziff's point: it *supports* the Dynamic Method.

"Mortgage Rate" is defined as "[t]he annual rate of interest borne by a ***Mortgage Note*** from time to time."[32] "Mortgage Note" is defined, in turn, as "[t]he original executed note ***or other evidence of indebtedness*** evidencing the indebtedness of a Mortgagor under a Mortgage Loan."[33] Och-Ziff argues that because the definition of Mortgage Note refers to the "original executed note," the Mortgage Rate must always be the same as in that "original executed note." But, as discussed in Section I.C above, the second half of the definition—which Och-Ziff simply ignores—makes clear that the Dynamic Method is required. The definition of Mortgage Note

[32] PSA, art. I, I-17.
[33] PSA, art. I, I-17.

states that "*other evidence of indebtedness*"—*i.e.*, a loan document *other than* the "original executed note"—is included in the group of documents that together comprise the Mortgage Note. There can be no doubt that a loan-modification agreement constitutes "other evidence of indebtedness" under this catch-all definition of Mortgage Note. Indeed, in the *American Home Mortgage* case, the Minnesota Court of Appeals held that "***a loan-modification agreement is 'other evidence of the indebtedness of a Mortgagor under a Mortgage Loan' within the meaning of the definition of Mortgage Note***."[34]

And because the definition of Mortgage Rate expressly depends on the "annual rate of interest borne by a ***Mortgage Note from time to time***," these two definitions, together, require the Mortgage Rate to be the post-modification rate embodied in a loan-modification agreement. That much was also plain to the Minnesota Court of Appeals, which held that this language in ***"the PSA informs [the Trustee] to consider adjustments in the interest rate due to loan-modifications agreements."***[35] The same reasoning, on the same language, applies here.

B. Och-Ziff's "Inconsistency" Argument Fails Because the PSAs Make Clear That the Pool of Non-Discount Mortgage Loans Is Fixed at Origination.

Bereft of affirmative textual arguments supporting its position, Och-Ziff resorts to claiming that the Dynamic Rate method requires the term "Mortgage Rate" to be used in two different ways throughout the PSAs. Specifically, seizing on the definition of "Non-Discount Mortgage Loans," Och-Ziff argues that the Trustee necessarily uses the *original* Mortgage Rate in determining which loans are Non-Discount Mortgage Loans, but uses a *dynamic* Mortgage Rate to calculate excess interest paid to the IO certificates. Contrary to Och-Ziff's depiction, there is nothing inconsistent

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[34] *American Home Mortgage*, 2019 WL 1431923, at *5 (emphasis added).
[35] *Id.* at *6 (emphasis added).

about the Trustee's use of the term "Mortgage Rate."

First, the definition of Non-Discount Mortgage Loans makes clear that the classification should be performed *once*—at the time the trusts were created. The PSAs define Non-Discount Mortgage Loan as "[a]ny Mortgage Loan in a Loan Group with an Adjusted Net Mortgage Rate that is greater than or equal to the Required Coupon for such Loan Group."[36] Where the PSAs' drafters wanted the Trustee to perform a particular calculation on a periodic basis, in the future, they said so by including temporal language identifying the time period over which the calculation is to be performed. They did not do so in the definition of Non-Discount Mortgage Loans, which shows the categorization was only to be performed once—over a decade ago.

For example, in calculating the amount of "Available Funds" to be distributed to investors, the PSAs make clear that "Available Funds" are calculated "[a]s to any Distribution Date."[37] Likewise, the Class Optimal Interest Distribution Amount is expressly required to be calculated "[w]ith respect to any Distribution Date and interest bearing Class."[38] So, too, with the all-important terms "Adjusted Net Mortgage Rate" and "Mortgage Rate," each of which contains temporal language ("at any time" or "from time to time").[39] That the drafters did not include such periodic, future-oriented language in the definition of Non-Discount Mortgage Loans shows that they intended the pool of Non-Discount loans to be determined once, at the time the Covered Trusts were created.[40]

Second, the definition of Adjusted Net Mortgage Rate requires that once a mortgage loan

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[36] PSA, art. I, I-17.
[37] PSA, art. I, I-3.
[38] PSA, art. I, I-6.
[39] PSA, art. I, I-17.
[40] Further, as noted above, Och-Ziff simply ignores that the PSAs use Mortgage Rate in a dynamic way when describing the condition that mortgage modifications in lieu of refinancing can only take place if the ***new*** Mortgage Rate is at "approximately a prevailing market rate." *See* Section I.B, above.

is classified as Non-Discount or Discount, that classification sticks even if the loan is replaced with a "Substitute Mortgage Loan" bearing an interest rate lower than the Required Coupon and thus would otherwise be a Discount Loan.[41] If the PSAs' drafters had intended the classification of Discount versus Non-Discount loans to be a month-by-month exercise, this provision would make no sense; the actual interest rate on the substituted mortgage loan would be used. Instead, the PSAs contemplate that the interest rates borne by the loans in the loan pool might change, but also expressly state that the classification as a Discount or Non-Discount loan should not change.

In sum, the PSAs are fully consistent when they direct the Trustee to look to mortgage interest rates at different points in time for different purposes: once, at origination, for determining whether a loan is classified as a Discount Mortgage Loan or a Non Discount Mortgage Loan; and dynamically, at each distribution period, for determining whether a loan is then generating any "excess interest" to pay to the Certificateholders entitled to it.

C. Och-Ziff's "Industry Custom" Argument is Improper and Unsubstantiated.

In its Answer, Och-Ziff speculates about what other trustees do on other trusts not before this Court. But to the knowledge of the Investor Group, the only courts that have decided a comparable issue concerning IO interest calculations were the Minnesota courts that decided *American Home Mortgage*, and they required the use of dynamic, post-modification mortgage rates in calculating excess interest paid to IO certificates. At this stage, the Court should disregard

[41] In full, this part of the definition of Adjusted Net Mortgage Rate provides: "For purposes of determining whether any Substitute Mortgage Loan is a Discount Mortgage Loan or a Non-Discount Mortgage Loan and for purposes of calculating the applicable PO Percentage and the applicable Non-PO Percentage, each Substitute Mortgage Loan shall be deemed to have an Adjusted Net Mortgage Rate equal to the Adjusted Net Mortgage Rate of the Deleted Mortgage Loan for which it is substituted." PSA, art. I, I-1.

Och-Ziff's unsubstantiated speculation.[42]

V. Independent of the Dispute over the Dynamic Method, the Investor Parties Agree That the Trustee Should Employ a Pool-Level Calculation.

Historically, BNY Mellon has calculated the excess interest owed to the IO Certificates on a loan-by-loan basis, by calculating the weighted average of the excess (***if any***) of each individual Non-Discount Mortgage Loan's current interest rate over the Required Coupon.[43] This is referred to as the "loan-level" approach. An alternative approach is to calculate the excess of the weighted average interest rate of all the Non-Discount Mortgage Loans (whether or not their mortgage rates have fallen below the Required Coupon), over the Required Coupon. This calculation is referred to as the "pool-level" approach. Although the pool-level versus loan-level approach is a separate and independent issue from the Dynamic Rate versus initial rate issue, it is properly within the scope of the Court's consideration of the proper calculation of excess interest payable to the IO Certificates and thus squarely at issue in this Article 77. To remove any doubt in that regard, this issue was described in the Supplemental Notice ordered by the Court. On this score, the Investor Group agrees with Och-Ziff that the Court should direct BNY Mellon to employ the pool-level method, independent of how the Court rules on the initial versus Dynamic Rate issue.[44]

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[42] As the Court noted at the initial hearing, "the court should determine from contractual language, without regard to extrinsic evidence, whether there is any ambiguity." *Royal Park Investments, SA/NV v. CIFG Assur. N. Am., Inc.*, 2013 WL 7044889, at *5 (Sup. Ct. N.Y. Co. 2013) (Friedman, J.); *see also Bd. of Managers of 4260 Broadway Condominium*, 2012 WL 3064866, at *3–4 (Sup. Ct. N.Y. Co. 2012) (Friedman, J.) (same).

[43] *See* BNY Mellon's Proposed Suppl. Notice Letter (Dkt. 44) and Ex. A (Dkt. 45) at Section II, May 14, 2019.

[44] The relevant provision states that the Pass-Through Rate on IO Certificates is "the excess of (a) the weighted average of the Adjusted Net Mortgage Rates on the Non-Discount Mortgage Loans in Loan Group 1, weighted on the basis of the Stated Principal Balance thereof as of the Due Date in the preceding calendar month …, over (b) 5.50% [*i.e.*, the Required Coupon]." PSA Preliminary Statement, at 4 n.19. For Och-Ziff's position on the pool-level approach, *see* its Initial Statement (Dkt. No. 31) at 6 ("[T]he PSAs require the calculation of the Pass Through Rate on a portfolio basis (i.e., calculating the weighted average of all Non-Discount Mortgage Loans before subtracting the Required Coupon of 5.50%).").

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