

**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

IAS Part 60

Hon. Marcy S. Friedman

Mot. Seq. 001

SILIAN VENTURES LLC'S OBJECTION TO PETITION

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PRELIMINARY STATEMENT

This case concerns the calculation of interest owed to certain interest-only (“**IO**”) senior certificates issued by the “ratio-strip” trusts covered by the Petition (“**Pet.**”), Doc. No. 1. The Bank of New York Mellon’s (“**BNYM**”) outlier approach to that calculation impermissibly strays from the market-standard approach adopted by its peer trustees in other ratio-strip transactions. BNYM’s approach is irreconcilable with the language of the pooling and servicing agreements (“**PSAs**”) governing the Covered Trusts, and it leads to commercially absurd results that subvert the intended subordination structure of the trusts by allocating losses first to the IO “Senior Certificates” ahead of expressly denominated “Subordinated Certificates.” Certain intervening investors in principal-and-interest certificates (the “**P&I Investors**”) propose an even more strained approach that would exacerbate the absurdity of BNYM’s calculation. Silian Ventures LLC’s (“**Silian**”) approach avoids the unreasonable outcomes of these alternative approaches and honors the plain language of the PSAs.

The dispute centers on the meaning of “**Mortgage Rate**,” and how that term factors into the overall functioning of the PSAs. The PSAs define Mortgage Rate as the “annual rate of interest borne by a Mortgage Note from time to time.” A “**Mortgage Note**” under the PSAs is “[t]he original executed note.” It is Silian’s position—in contrast to both BNYM and the P&I Investors—that the term Mortgage Rate refers to the interest rate appearing in the original mortgage note (the “**Original Rate**”) and not any modified interest rate agreed to by the borrower and the lender after execution of the original mortgage note (the “**Modified Rate**”). If the Court instead adopts BNYM’s flawed approach, it would need to consider a second question regarding whether the Pass-Through Rate is calculated at a pool level (as the P&I Investors contend) or loan level (as BNYM contends). The Court need not reach this second question if it adopts Silian’s approach.

The PSAs' plain language requires the Trustee to use the Original Rate. By contrast, the outlier approaches advanced by BNYM and the P&I Investors would disrupt the coherent functioning of the Covered Trusts. *First*, the definition of Mortgage Rate specifies the Original Rate by referencing the rate appearing in the *original* mortgage note—an adjective that must mean “first in time” (rather than “not a copy”) to avoid rendering other PSA terms superfluous. BNYM's contrary textual arguments rely on provisions that make no mention of modifications and do not support its reading. The phrase “from time to time” adds nothing to the analysis because it just describes how interest is borne or, at best, accommodates pools of floating-rate mortgages. *Second*, BNYM's approach requires using two incompatible meanings for the term Mortgage Rate in violation of the basic canon of contract construction that a single defined term has a single meaning unless context clearly requires otherwise. Though BNYM asks the Court to bless its use of the Modified Rate in the calculation at issue here, it appears to apply the Original Rate every other time the term “Mortgage Rate” is used in the PSAs. *Third*, BNYM's use of the Modified Rate cannot be reconciled with the structure of the Covered Trusts because it subjects the IO “*Senior* Certificates” to credit losses before “*Subordinated* Certificates” that are specifically designed and marketed as absorbing credit losses first. Were there any ambiguity (and there is not), then extrinsic evidence, including the consistent practice of BNYM and its peer trustees in similar ratio-strip trusts, overwhelmingly supports Silian's approach. For all these reasons, the Court should order BNYM to use the Original Rate throughout its calculations and reimburse past underpayments to the IO certificates as required by the clear terms of the PSAs.

BACKGROUND

A. The Structure Of The Covered Trusts

The Covered Trusts are real estate mortgage investment conduits (“**REMICs**”) that are each governed by a pooling and servicing agreement (“**PSA**”). Pet. ¶ 2. They are structured as

“ratio-strip” transactions with three types of senior certificates: principal-and-interest (“**P&I**”) certificates, IO certificates, and principal-only (“**PO**”) certificates. The P&I, IO, and PO certificates work in tandem to standardize, at a defined “**Required Coupon**,” the interest rate payable to the P&I certificates from cash generated by a pool of primarily fixed-rate mortgages with a range of different rates.¹ For mortgage loans with interest rates greater than the Required Coupon, called “**Non-Discount Mortgage Loans**,” the PSAs segregate, or “strip,” the portion of the interest rate above the Required Coupon and define that segregated portion of the interest rate as the rate payable to the IO senior certificates. For mortgage loans with interest rates below the Required Coupon, called “**Discount Mortgage Loans**,” the PSAs strip principal (to increase the effective interest rate on the remaining principal to the Required Coupon) and define the segregated portion of principal as the principal amount payable to the PO senior certificates. The Covered Trusts are commonly referred to as “ratio-strip” transactions because they are designed to maintain a static relationship—or “ratio”—between (a) the portion or “strip” of interest on any given Non-Discount Mortgage Loan allocable to the IO certificates versus the P&I certificates and (b) the strip of principal on any given Discount Mortgage Loan allocable to the PO certificates versus the P&I certificates. Both ratios are fixed at closing for each Mortgage Loan and do not change.

B. The Relevant PSA Provisions

1. The Distribution Waterfall

The Covered Trusts receive cash flow from a pool of mortgage loans and distribute that cash to certificateholders in accordance with a detailed priority set forth in the PSAs, often referred to as the “distribution waterfall.” The PSAs require BNYM to apply Available Funds—meaning all funds collected by the Trust, including both principal and interest proceeds—*first* to pay interest

¹ The Prospectus Supplement for the 2006-6CB Trust provides a list of underlying Mortgage Loans categorized by Mortgage Rate. See Pickhardt Aff. Ex. B, at S-37–38.

owed to each interest-bearing class of Senior Certificates, including the IO senior certificates. PSA § 4.02(a)(1)(ii). The PSAs then direct BNYM to apply the remaining Available Funds to pay principal owed to the Senior Certificates, followed by interest and principal owed to the Subordinated Certificates. PSA § 4.02(a)(1)(iv). Therefore, interest payments to Senior Certificates are senior in the distribution waterfall to principal payments on all certificates.

2. The Class Optimal Interest Distribution Amount

The IO senior certificates are entitled to payment of the “**Class Optimal Interest Distribution Amount**,” which equals an interest rate, called the “Pass-Through Rate,” multiplied by a dollar amount, called the “Notional Amount.” PSA I-6.²

The “**Pass-Through Rate**” for the IO senior certificates³ equals “the excess of (a) the weighted average of the Adjusted Net Mortgage Rates of the Non-Discount Mortgage Loans . . . , over (b) 5.50%.” PSA 4 n.19. A “**Non-Discount Mortgage Loan**” is “[a]ny Mortgage Loan . . . with an Adjusted Net Mortgage Rate that is greater than or equal to the Required Coupon” PSA I-17. The “**Required Coupon**” is “5.50% per annum.” PSA I-28. As an equation:

$$\text{Pass-Through Rate} = \text{Weighted Avg. Of Adjusted Net Mtg. Rate for Non-Discount Mtg. Loans} - 5.50\%$$

The “**Notional Amount**” equals “the aggregate of the Stated Principal Balances of the Non-Discount Mortgage Loans . . . as of the Due Date in the preceding calendar month” PSA I-18–19. The “**Stated Principal Balance**” is the “unpaid principal balance of such Mortgage Loan[s] as of [the] Due Date,” subject to adjustments not relevant here. PSA I-31. As an equation:

$$\text{Notional Amount} = \text{Stated Principal Balance of Non-Discount Mtg. Loans}$$

² The result of this equation is then divided by twelve to account for monthly Distribution Dates. *See id.*

³ While the CWALT 2006-6CB Trust provides for two classes of IO senior certificates, this response (like the Petition) references the Class 1-X Certificates for illustrative purposes. Pet. 9 n.3. It also ignores the separation of Mortgage Loans into differentiated “Loan Groups,” because the impact of these Loan Groups is not in dispute.

As shown above, the PSAs use the term “Adjusted Net Mortgage Rate” both in identifying Non-Discount Mortgage Loans and calculating the Pass-Through Rate. The “**Adjusted Net Mortgage Rate**” is the “Mortgage Rate” on a Mortgage Loan minus a fixed Trustee Fee Rate and fixed Master Servicing Fee Rate. PSA I-1.⁴ The “**Mortgage Rate**” is “[t]he annual rate of interest borne by a Mortgage Note from time to time” PSA I-17.⁵ And the “**Mortgage Note**” is “[t]he *original* executed note or other evidence of indebtedness evidencing the indebtedness of a Mortgagor under a Mortgage Loan.” *Id.* (emphasis added).

3. Express Treatment Of Two Types Of Interest-Rate Modifications

While generally silent on the impact of modifications, the PSAs specifically address two types of interest-rate modifications: “**Debt Service Reduction**” and “**Relief Act Reduction**.” A Debt Service Reduction is a court-ordered modification reducing the interest owed on a Mortgage Loan. *See* PSA I-9. A Relief Act Reduction is a reduction of interest owed on a Mortgage Loan based on the Servicemembers Civil Relief Act or similar state law. *See* PSA I-26. Under the PSAs, Debt Service and Relief Act Reductions are allocated across interest payable to the IO and P&I certificates based on the certificates’ respective “**Allocable Share**.” PSA § 4.02(d). For Non-Discount Mortgage Loans, the IO certificates’ Allocable Share equals the Adjusted Net Mortgage Rate minus the Required Coupon, divided by the Adjusted Net Mortgage Rate. PSA I-2.⁶ As an equation:

$$\text{IO Certificates' Allocable Share} = \frac{(\text{Adjusted Net Mortgage Rate} - \text{Required Coupon})}{\text{Adjusted Net Mortgage Rate}}$$

The Allocable Share for the P&I certificates comprises the balance of the reductions. *Id.*

⁴ The Trustee Fee Rate is 0.009% and the Master Servicing Fee Rate is 0.25%. PSA I-15, 34. Neither is in dispute.

⁵ The Mortgage Rate is reduced by “any interest premium charged by the mortgagee to obtain or maintain any Primary Insurance Policy.” PSA I-17. Those interest premiums are not in dispute here.

⁶ For Discount Mortgage Loans, the Allocable Share is defined as zero.

The Allocable Share mechanism allocates Debt Service and Relief Act Reductions among the IO and P&I certificates *pro rata* based on the existing ratio of interest on a Non-Discount Mortgage Loan paid to the IO and P&I certificates, respectively, as required by the “ratio-strip” structure. For example, consider a Mortgage Loan with an Adjusted Net Mortgage Rate of 7.5% in a trust with a Required Coupon of 5.0%. The IO senior certificates receive one-third of the interest payments on this Mortgage Loan (2.5%), and the P&I certificates receive two-thirds of those interest payments (5%). If this Mortgage Loan experiences a Debt Service Reduction that reduces its interest rate to 5%, the IO certificates’ Allocable Share—assuming the Adjusted Net Mortgage Rate is the Original Rate⁷—equals one-third (*i.e.*, $(7.5\% - 5.0\%) / 7.5\%$) and the P&I certificates’ Allocable Share equals two-thirds. Because the IO certificates’ and P&I certificates’ respective Allocable Shares equal their preexisting proportional entitlement to interest from the modified loans, the “ratio” of interest payable to the IO certificate versus the P&I certificate from the modified loan does not change. Instead, each certificate simply would receive proportionately less total interest over the life of the Mortgage Loan.

C. The Parties’ Competing Interpretations Of The PSAs

BNYM asks the Court to address two questions. *First*, BNYM asks whether to use the Original Rate or the Modified Rate to calculate the Pass-Through Rate. *See* Pet. ¶¶ 18–20. *Second*, if the Modified Rate applies, BNYM asks whether to determine the Pass-Through Rate by calculating (a) the weighted average of the Adjusted Net Mortgage Rate of *all* Non-Discount Mortgage Loans before subtracting 5.50% (a “**Pool-Level Calculation**”) or (b) the excess of the Adjusted Net Mortgage Rate of *each* Non-Discount Mortgage Loan over 5.50% and taking the weighted average of the loan-by-loan excess (a “**Loan-Level Calculation**”). *See* Doc. No. 44.

⁷ The impact of using the Modified Rate in this calculation is discussed in Section I.B.3 *infra*.

Silian contends that the Mortgage Rate should always be treated as the Original Rate whenever it appears in the PSAs. Under Silian's approach, the Pool-Level Calculation and Loan-Level Calculation achieve the same result, and resolution of the second question is unnecessary.

BNYM, however, contends that the Mortgage Rate should be the Modified Rate when used to calculate the Pass-Through Rate but should be the Modified Rate *at the time of closing* (which is simply a different way of saying the Original Rate) in all other circumstances, including when identifying the Non-Discount Mortgage Loans used to calculate the Notional Amount. BNYM described a Pool-Level Calculation in the Petition, but it actually uses a Loan-Level Calculation, and it asks this Court to approve its Loan-Level Calculation.

The P&I Investors agree with BNYM that the Modified Rate applies when calculating the Pass-Through Rate and the Original Rate applies in all other circumstances, but they argue that the definition of Pass-Through Rate requires a Pool-Level Calculation, like the one BNYM described in the Petition, not the Loan-Level Calculation that BNYM actually uses. The P&I Investors' approach would dramatically accelerate losses to the IO senior certificates by allocating 100 percent of losses caused by interest-rate modifications to the IO senior certificates (and none to Subordinated Certificates or other Senior Certificates) until the IO senior certificates are completely written down. Stated differently, the P&I Investors' approach requires the IO senior certificates to indemnify the P&I certificates against any interest-rate modification that reduces the interest rate on any Non-Discount Mortgage Loan below the Required Rate.

ARGUMENT

I. SILIAN'S INTERPRETATION IS REQUIRED BY THE PSAs' PLAIN TERMS

A. The Mortgage Rate Is The Rate Listed In The Original Mortgage Note

The Mortgage Rate is "[t]he annual rate of interest borne by a *Mortgage Note* from time to time" minus any premium paid for mortgage insurance, where applicable. PSA I-17 (emphasis

added). A Mortgage Note is “[t]he *original* executed note or other evidence of indebtedness evidencing the indebtedness of a Mortgagor under a Mortgage Loan.” *Id.* (emphasis added). The plain meaning of “original” as used in the definition of Mortgage Note means “first in time,” and the annual rate of interest borne by the first-in-time executed note does not change due to interest-rate modifications after that note was executed.

BNYM’s argument that “original” in the definition of Mortgage Note means “not a copy,” Pet. ¶ 58, is incorrect. Elsewhere, the PSAs contain provisions that expressly state when a copy of a Mortgage Note can be used. PSA § 2.01(c)(i)(B) (requiring a lost note affidavit “stating that the *original Mortgage Note* was lost or destroyed, together with *a copy* of such *Mortgage Note*” (emphases added)). If the term “original” in the definition of Mortgage Note denoted “not a copy,” it would be unnecessary to separately refer to the “original” Mortgage Note when contrasting with a copy of the Mortgage Note. Moreover, in each instance where BNYM cites to the use of “original” in the phrase “original Mortgage Note,” it is clear from the context that the adjective “original” modifying “Mortgage Note” means “not a copy.” *Id.*; *see also id.* § 2.01(c)(i)(A) (“[T]he original Mortgage Note endorsed by manual or facsimile signature . . .”). Under BNYM’s reading, these provisions literally refer to the “original” “original executed note.” To have non-superfluous meaning, the word “original” in the definition of Mortgage Note must therefore mean “first in time,” rather than “not a copy.” *See U.S. Bank Nat’l Ass’n v. GreenPoint Mortg. Funding, Inc.*, 157 A.D.3d 93, 100 (1st Dep’t 2017) (“In interpreting a contract a court should favor an interpretation that gives effect to all the terms of an agreement . . .”).

This interpretation is further supported by Section 2.01(c), which governs the contents of the “Mortgage File” that the Depositor must send to the Trustee for each loan. While Section 2.01(c)(i) requires that the Mortgage File contain the “original Mortgage Note” or a lost note

affidavit, Section 2.01(c)(iv) permits modification agreements to be included as either “the original or copies.” *Id.* § 2.01(c)(iv). If the term Mortgage Note included modifications, the separate requirement for inclusion of modification agreements in the Mortgage File would be superfluous and the permission to document modifications through “copies” would be contradictory.

The definition of “Mortgage Loan Schedule” underscores Silian’s interpretation of the Mortgage Rate as the Original Rate. All Mortgage Loans under the PSAs must be listed on the Mortgage Loan Schedule, which is a “list of Mortgage Loans . . . transferred to the Trustee.” PSA I-16. The Mortgage Loan Schedule must contain certain information about each Mortgage Loan, including the Mortgage Rate. *Id.* The PSAs permit the Mortgage Loan Schedule, and hence the Mortgage Rate, to be amended by the Master Servicer only in specific circumstances. The permitted amendments do not include interest-rate modifications. *Id.* Thus, the Mortgage Loan Schedule contemplates a static Mortgage Rate.

BNYM’s attempt to read into the definition of Mortgage Rate—which makes no mention of modifications—a requirement that modifications reduce the Mortgage Rate is unconvincing. *First*, BNYM argues that the phrase “from time to time” used in the definition of Mortgage Rate “suggests that the rate will change over time,” because the drafters would not have included this phrase if they intended the rates to remain static. Pet. ¶ 46. Not so. “From time to time” means “[o]nce in a while; at intervals.” *Time*, American Heritage Dictionary of the English Language.⁸ In the Mortgage Rate definition, “from time to time” modifies the verb “borne,” meaning that the Mortgage Note bears an annual rate of interest at intervals—typically monthly—when the borrower must make interest payments at an annualized rate. It is simply an accurate description of how mortgage loans work, not some roundabout reference to modifications.

⁸ <https://www.ahdictionary.com/word/search.html?q=time>.

Second, BNYM claims that the phrase “at any time” in the definition of Adjusted Net Mortgage Rate “again suggest[s] that the rate will change over time.” Pet. ¶ 47. This argument is even more tenuous, since the definition of Adjusted Net Mortgage Rate is just a derivative of the Mortgage Rate. *See* PSA I-1 (defining Adjusted Net Mortgage Rate as “*equal to the Mortgage Rate*” less the Trustee and Master Servicing Fee Rates (emphasis added)). If the definition of Mortgage Rate calls for a static rate, the Adjusted Net Mortgage Rate derived from it will also be static, notwithstanding the use of the phrase “at any time.”

Third, even if these references were read as anticipating potential variation in interest rates over time, they properly are read together with the term “original” as reflecting an accommodation of rate changes specified in the original executed note—such as rate changes specified for a floating-rate mortgage loan—and not as an implicit reference to *subsequent* modifications. Such intended flexibility would be unsurprising in the broader context of the CWALT and CWHL shelves where the definitions of Adjusted Net Mortgage Rate and Mortgage Rate are standard. Some trusts on these shelves hold pools of fixed-rate mortgages, others pools of floating-rate mortgages, and still others pools of both fixed- and floating-rate mortgages. *See, e.g.*, Pickhardt Aff. Ex. C, at I-1, I-19 (using identical definitions for two mortgage pools: one pool of fixed-rate mortgages and one pool of floating-rate mortgages). The phrases “at any time” and “from time to time” thus ensure the flexibility to address both fixed- and floating-rate mortgage pools without requiring the drafters of each PSA to tailor these definitions to the particular characteristics of the mortgage pools. The references need not, and should not, be read as contradicting the PSAs’ express requirement that BNYM refer to the “*original executed note*” for the Mortgage Rate.

Fourth, BNYM blatantly misquotes the PSAs as “provid[ing] that IO certificateholders are ‘entitled to interest accruals on each Non-Discount Mortgage Loan in excess of [the] Adjusted Net

Mortgage Rate” and argues that the reference to “interest accruals” as opposed to “scheduled interest” supports its position that the Mortgage Rate is the Modified Rate. Pet. ¶ 48. The quoted language (conspicuously uncited by BNYM) is completely inapposite. It appears in the definition of the Interest Rate applicable to certain *Lower-Tier REMIC Interests* in some, but not all, of the Covered Trusts. PSA 6 nn.4–5. That Interest Rate is not referenced in the calculation of the Pass-Through Rate for the IO senior certificates, which are issued at the *Master REMIC*, not the Lower-Tier REMIC, and thus has no application here.

B. BNYM’s Inconsistent Use Of “Mortgage Rate” Violates A Basic Canon Of Contract Interpretation

BNYM’s interpretation must also be rejected because it would require the Court to ignore the well-established presumption that a defined term is given consistent meaning throughout an agreement unless context clearly demands otherwise. *See State v. R.J. Reynolds Tobacco Co.*, 304 A.D.2d 379, 379–80 (1st Dep’t 2003) (the same phrase used in two sections of the contract “should presumptively be given the same meaning” unless “contexts . . . warrant different interpretations”). While BNYM asks the Court to apply the Modified Rate in calculating one component of the Pass-Through Rate, it seemingly admits the Original Rate applies in all other circumstances.

1. Identification Of Non-Discount Mortgage Loans

“Adjusted Net Mortgage Rate” appears twice in the calculation of Pass-Through Rate: *first*, in identifying Non-Discount Mortgage Loans and, *second*, in taking the weighted average Adjusted Net Mortgage Rate of those Non-Discount Mortgage Loans. *See supra* p. 5. BNYM proposes using the Modified Rate *at the time of closing*—*i.e.*, the Original Rate—to identify the Non-Discount Mortgage Loans, Pet. ¶ 60, but then using the Modified Rate *at present* to calculate the weighted average Adjusted Net Mortgage Rate of those Non-Discount Mortgage Loans, Pet.

¶ 63. This interpretation, which applies the same term in two completely different ways, is presumptively incorrect, and BNYM's acrobatic attempts to overcome that presumption do not withstand scrutiny.

First, BNYM argues that determining the Adjusted Net Mortgage Rate as of different points in time is justified because the "classification of a mortgage loan as a Non-Discount Mortgage Loan or a Discount Mortgage Loan is a one-time determination made at the closing of the transaction." Pet. ¶ 60. This *ipse dixit* argument is so untethered from the text of the PSAs that BNYM does not even hazard a cite to support it. In fact, the definition of "Non-Discount Mortgage Loan" is irreconcilable with BNYM's position. To support BNYM's argument, the definition would need to be rewritten as follows:

"Non-Discount Mortgage Loan: Any Mortgage Loan in a Loan Group with an Adjusted Net Mortgage Rate that ~~is was~~ greater than or equal to the Required Coupon for such Loan Group at the time of closing."

New York law prohibits rewriting contracts "under the guise of interpreting the writing." *Vt. Teddy Bear Co. v. 538 Madison Realty Co.*, 1 N.Y.3d 470, 475 (2004).

Second, BNYM erects a straw man by contending that its one-time determination argument is supported by terms like "Certificate Balance," "Denomination," and "Substitute Mortgage Loan." Pet. ¶ 61. At most, these provisions demonstrate something on which both BNYM and Silian agree: the PSAs anticipate that the universe of Non-Discount Mortgage Loans will remain the same each month. Under Silian's interpretation, however, this conclusion flows naturally from the plain meaning of Non-Discount Mortgage Loan, which is based on a static Adjusted Net Mortgage Rate derived from the Original Rate. By contrast, BNYM proposes a completely *unnatural* reading of Non-Discount Mortgage Loan as a one-time determination. Thus, if anything, BNYM's efforts to justify its "one-time" calculation approach with resort to other PSA provisions only buttresses Silian's interpretation, not BNYM's.

2. Calculation Of The PO Percentage

BNYM separately applies the Original Rate to calculate the PO Percentage used to allocate Available Funds and Subsequent Recoveries among the PO and P&I certificates. Under the distribution waterfall, after interest payments to the Senior Certificates, Available Funds are allocated as principal among the P&I and PO certificates based on the PO Percentage (for PO certificates) and Non-PO Percentage (for P&I certificates). PSA I-17–18, I-22–23 (defining PO Formula Principal Amount and Non-PO Formula Principal Amount). The PO Percentage for Discount Mortgage Loans is defined as:

[A] fraction (expressed as a percentage) the numerator of which is the excess of the Required Coupon . . . over the Adjusted Net Mortgage Rate of such Discount Mortgage Loan and the denominator of which is such Required Coupon. . . .

PSA I-23. As an equation:

$$PO \text{ Percentage} = \frac{(Req'd \text{ Coupon} - Adj. \text{ Net Mtg. Rate of Discount Mtg. Loans})}{Req'd \text{ Coupon}}$$

If the Trustee employed the Modified Rate in this calculation, interest-rate modifications on Discount Mortgage Loans would increase the numerator, and therefore increase the PO Percentage. The inverse calculation of the Non-PO Percentage would correspondingly decrease. The resulting distribution would allocate more Available Funds to the PO certificates and less to the P&I certificates—thereby increasing losses to the P&I certificates. See PSA § 4.02(a)(1)(iv)(x), (y). Recognizing this result is untenable, the Trustee uses the Original Rate to determine the PO and Non-PO Percentages.

3. Calculation Of Allocable Share

As illustrated above, *see supra* Background Part B.3., when the Original Rate is used to determine Allocable Share, the Allocable Share mechanism preserves a fixed ratio between interest payable to the IO and P&I certificates from a given Non-Discount Mortgage Loan. Using the

Modified Rate in determining the Allocable Share fails to preserve this ratio, which leads to objectively unreasonable outcomes. For example, consider two identical Mortgage Loans with an Original Rate of 7.5% in a trust with a Required Coupon of 5%. A Debt Service Reduction of 1.5% in one of those Mortgage Loans and 2.5% in the other results in Modified Rates of 6% and 5%, respectively. As described above, using the Original Rates, the IO certificates' Allocable Share of these reductions in either scenario would be 33.3% (*i.e.*, $(7.5\% - 5\%) / 7.5\%$). *Id.* Using the Modified Rates, by comparison, the IO certificates' Allocable Share on the 1.5% reduction would be roughly 16.6% (*i.e.*, $(6\% - 5\%) / 6\%$) while on the *larger* 2.5% reduction, the IO certificates' Allocable Share would be *zero* (*i.e.*, $(5\% - 5\%) / 5\%$). These allocations are entirely divorced from the original one-third ratio of interest allocated to the IO certificates on these Mortgage Loans, and the amount of a Debt Service Reduction allocated to the IO certificates would inexplicably *decrease* as the total amount of the reduction *increases*. Based on this absurd result, we believe the Trustee again uses the Original Rate to determine Allocable Share.

4. Calculation Of Interest To IO Certificates In CWALT 2005-1CB

As explained above, interest payable to the IO senior certificates for most of the Covered Trusts is based on changes to the Pass-Through Rate and Notional Amount. At least one Covered Trust, CWALT 2005-1CB, differs because interest payable to the IO senior certificates is based on changes in the Notional Amount only. The 2005-1CB PSA defines the Notional Amount as equal to “(i) a fraction, the numerator of which is the excess of (a) the weighted average of the Adjusted Net Mortgage Rates of the Non-Discount Mortgage Loans . . . over (b) 6.00% [the ‘Required Coupon’], and the denominator of which is 6.00%,” multiplied by “(ii) the aggregate of the Stated Principal Balances of the Non-Discount Mortgage Loans”⁹ As an equation:

⁹ See Pickhardt Aff. Ex. D, at I-19. While the mechanics of this calculation are slightly different than the other Covered Trusts, the two equations are mathematically equivalent and intended to produce an identical result.

$$\text{Notional Amount} = \frac{(\text{Wtd. Avg. Adj. Net Mtg. Rate of Non-Disc. Mtg. Loans} - \text{Req'd Coupon}) / \text{Req'd Coupon}}{\text{* Stated Principal Balances of Non-Disc. Mtg. Loans}}$$

Notwithstanding that the definitions of Mortgage Rate and Adjusted Net Mortgage Rate are identical to the other Covered Trusts, BNYM calculates and reports the Notional Amount of the IO senior certificates in CWALT 2005-1CB by using the Original Rate for all components of the calculation, including the determination of Mortgage Rate and Adjusted Net Mortgage Rate.

C. BNYM's Approach And The P&I Investors' Approach Lead To Commercially Unreasonable Results

Beyond the plain language of the PSAs, a contract “should not be interpreted to produce a result that is absurd, commercially unreasonable or contrary to the reasonable expectations of the parties.” *Greenwich Capital Fin. Prods., Inc. v. Negrin*, 74 A.D.3d 413, 415 (1st Dep’t 2010). The approaches advanced by BNYM and the P&I Investors (the “**Modified-Rate Approaches**”) produce commercially unreasonable results for multiple reasons, which provide an independent basis for adopting Silian’s approach.

First, the Modified-Rate Approaches are commercially unreasonable because they turn IO senior certificates into first-loss certificates on losses caused by interest-rate modifications. BNYM’s approach allocates all losses up to the difference between the Adjusted Net Mortgage Rate and the Required Coupon to the IO senior certificates before allocating any additional loss to other certificates. The P&I Investors’ approach allocates the entire interest reduction caused by a rate modification on any Non-Discount Mortgage Loan to the IO senior certificates—with no loss at all to the Subordinated Certificates, let alone the P&I certificates. In either case, the Modified-Rate Approaches effectively subordinate the IO “Senior Certificates” to expressly denominated “Subordinated Certificates,” which are designed to absorb the first losses incurred by the Trust. The Covered Trusts’ offering documents tell investors that “[t]he rights of the holders of the

subordinated certificates to receive distributions with respect to the mortgage loans will be subordinated to the rights of the holders of the senior certificates” Pickhardt Aff. Ex. B, at S-135. The Modified-Rate Approaches are irreconcilable with this structure. The disconnect is particularly stark under the P&I Investors’ approach, which would have caused nearly half the IO senior certificates held by Silian to be fully written down before the Subordinated Certificates, in many cases by several years.

Second, the Modified-Rate Approaches are commercially unreasonable because they create an unprincipled disparity between the impact of interest losses on unmodified Mortgage Loans and those on modified Mortgage Loans. For unmodified Mortgage Loans, interest losses (other than Debt Service Reductions and Relief Act Reductions, discussed above) are expressly treated as a Realized Loss. *See* PSA I-25–26. And a Realized Loss—including these interest losses on unmodified Mortgage Loans—reduces the *principal* amount owing to the most subordinate certificates outstanding. PSA § 4.04. But for modified Mortgage Loans, the Modified-Rate Approaches transform the same interest losses into a loss for the IO senior certificates. There is no principled basis for treating interest losses differently based solely on whether the Master Servicer agreed to a modification.

Third, the Modified-Rate Approaches are commercially unreasonable because they double count modifications meeting the definition of a Debt Service Reduction and a Relief Act Reduction, which are allocated as a *pro rata* reduction in the interest rate paid to all interest-bearing certificates across the entire trust. *See supra* Background Part B.3. If these specific rate modifications were *also* accounted for by reducing the Pass-Through Rate of the IO senior certificates, as required by the Modified-Rate Approaches, they would be taken out of the distribution to certificateholders *twice*. This double counting would subvert the pass-through

structure of the Covered Trusts by imposing losses on the certificates that are not tied to losses on the underlying Mortgage Loans. Moreover, the PSAs' identification of two specific circumstances when modification losses are addressed by reducing interest paid to all certificates further highlights that interest losses were never intended to be concentrated on the IO senior certificates.

All three of these commercially unreasonable outcomes are eliminated by Silian's interpretation. Because interest losses, regardless of whether they relate to a modified Mortgage Loan or an unmodified Mortgage Loan, are allocated like all other credit losses in accordance with the distribution waterfall, there is no disruption of the Covered Trusts' subordination structure, and interest losses are treated consistently across all Mortgage Loans. And under Silian's approach, modifications tied to Debt Service Reductions and Relief Act Reductions are counted only once, under Section 4.02(d) of the PSAs, and not again under the calculation of the Pass-Through Rate.

II. EXTRINSIC EVIDENCE STRONGLY SUPPORTS SILIAN'S APPROACH

The Court should not consider extrinsic evidence here because the PSAs unambiguously define the Mortgage Rate as the Original Rate. *Greenfield v. Phillies Records, Inc.*, 98 N.Y.2d 562, 569 (2002) ("Extrinsic evidence of the parties' intent may be considered only if the agreement is ambiguous . . ."). If the Court does consider extrinsic evidence, cherry-picked examples of a single party's historical behavior cannot outweigh other evidence. Instead, the Court should permit 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). After proper discovery, the weight of extrinsic evidence will clearly support Silian's approach.

First, as explained in Silian's opening submission, Doc. No. 31, at 16-17 ("**Silian Br.**"), a developed factual record will clearly show that the prevailing approach of BNYM's peer trustees administering IO senior certificates in similar "ratio-strip" structures across numerous RMBS

shelves is to calculate the Pass-Through Rate using Silian's approach. Some of these other shelves, such as the RAST shelf, employ materially identical definitions to those in the Covered Trust PSAs, and the trustees administering those shelves find that the Mortgage Rate means the Original Rate. *Id.* Moreover, it will be established that BNYM itself applies the Original Rate when interpreting materially identical definitions on several other shelves. Under New York law, "[a] contract must be construed according to the custom and use prevailing in a particular trade." *Zurakov v. Register.Com, Inc.*, 304 A.D.2d 176, 179 (1st Dep't 2003). And a decision endorsing BNYM's approach would call into question the prevailing practice on billions of dollars of IO certificates across numerous RMBS trusts, throwing the larger market into turmoil.

Second, as explained in Silian's opening submission, Silian Br. 17, the absence of any risk disclosure that the IO senior certificates would bear the first loss on interest-rate modifications is compelling evidence that this risk was not intended to be borne by the IO senior certificates. If the IO senior certificates were intended to bear the risk of interest-rate modifications, the exclusive focus in the Prospectus Supplements on prepayment risk faced by the IO senior certificates, *see Pickhardt Aff. Ex. B*, at S-120–21, would be grossly inadequate.

In contrast, BNYM's reliance on its own past practice, which will need to be established through discovery, is inadequate to support use of the Modified Rate to calculate the Pass-Through Rate. *First*, there has been no market reliance on BNYM's faulty interpretation in the Petition, Pet. ¶¶ 49–50, because BNYM's actual practice is different, *see supra* p. 7, and BNYM's actual calculations shift arbitrarily between using the Original Rate and the Modified Rate in a way that is untenable and cannot be squared with *any* rational reading of the contract, *see supra* Part I.B. BNYM cannot change the meaning of the PSAs through its own unilateral conduct. *See* PSA § 10.01 (requiring certificateholder consent for amendments that "reduce in any manner the amount

of” payments to any Certificate). That other holders of the IO senior certificates may not have raised concerns earlier—if true—says nothing about whether BNYM’s use of the Modified Rate is correct. Remedying trustee errors can be costly and time consuming and a decision by certain holders of IO senior certificates not to bring a legal challenge to remedy BNYM’s error does not suggest they agreed with BNYM’s approach. Finally, BNYM’s *ipse dixit* contention that the market has somehow relied on BNYM’s error in pricing and trading CWALT and CWHL certificates deserves no weight, particularly because BNYM is not itself an investor in the RMBS market. In fact, BNYM’s conjecture regarding the market’s trading of IO senior certificates bears no resemblance to the actual approach of the sophisticated investors that trade these securities.¹⁰

III. THE PSAs REQUIRE REIMBURSEMENT OF PAST INTEREST SHORTFALLS

On each Distribution Date, BNYM’s miscalculation of the Pass-Through Rate causes an interest-payment shortfall to the IO senior certificates. The PSAs specifically address how to resolve these payment shortfalls. *First*, the PSAs define the amount by which the Class Optimal Interest Distribution Amount “exceeds the amount of interest actually distributed” to a given class of certificates as the “**Class Interest Shortfall.**” PSA I-6. *Second*, the PSAs aggregate these Class Interest Shortfalls into “**Class Unpaid Interest Amounts.**” *See id.* (defining Class Unpaid Interest Amounts as “the amount by which the aggregate Class Interest Shortfalls for such Class on prior Distribution Dates exceeds the amount distributed” through the distribution waterfall). *Third*, the PSAs require that these shortfalls be repaid on the next Distribution Date in the Class Optimal

¹⁰ As explained in Silian’s opening submission, *see* Silian Br. 18–19, the calculation of “Excess Master Servicing Fees” (which BNYM calls “uncertificated IOs” without any explanation) does not support BNYM’s position. Even if the calculation of Excess Master Servicing Fees uses the Modified Rate—a fact that would need to be verified in discovery—that calculation uses entirely different language and an entirely different structure than the interest calculations here. *See, e.g.,* Pickhardt Aff. Ex. E §§ 3.08(b)(vii), 3.14. Moreover, the Excess Master Servicing Fee arises only when loan servicing transfers to a third party, *see id.*, meaning that—contrary to BNYM’s contention, Pet. ¶ 52—the party calculating the extra fee (*i.e.*, the new Master Servicer) has an incentive to minimize rather than maximize the former Master Servicer’s recoveries. More importantly, the new Master Servicer performing these calculations was not involved in the drafting of the PSA and has no insight into the intent of the drafters.

Interest Distribution Amount. *See id.* (defining Class Optimal Interest Distribution Amount to include “any Class Unpaid Interest Amounts for such Class”). The Class Optimal Interest Distribution Amount—which includes the Class Unpaid Interest Amounts—is distributed to each class of Senior Certificates before any principal amounts are distributed. PSA § 4.02(a)(1)(ii).

BNYM’s contrary position that “any . . . changes [in its calculation of the Pass-Through Rate] should be made on a prospective basis only,” Pet. ¶ 70, fails to even mention its contractual obligation to reimburse Class Unpaid Interest Amounts. BNYM’s request for a prospective-only order must therefore be rejected. Additionally, BNYM’s suggestion that current certificateholders are somehow not entitled to contractually required reimbursement because they were not holders when the payment shortfalls began ignores that the PSA provides for reimbursement through payments to current holders as well as New York law providing that claims against the trustee or obligor on certificates transfer with the certificates. *See* General Obligations Law § 13-107(1).

IV. BNYM IS NOT ENTITLED TO AN ORDER ABSOLVING IT OF LIABILITY


BNYM’s interpretation conflicts with the plain language of the PSAs, is internally inconsistent, is inconsistent with its own historical calculations, is inconsistent with the interpretation of similar provisions by its peer trustees, and would lead to absurd results. Thus there are significant fact issues now relating to BNYM’s negligence, which would be compensable with damages. *See* PSA § 8.01. Given these fact issues, BNYM’s request that the Court bar “all parties . . . from asserting claims against the Trustee,” Pet. ¶ 71, should be rejected at this stage.

CONCLUSION

The Court should direct BNYM to use the Original Rate consistently throughout its calculation of the Class Optimal Interest Distribution Amount and to reimburse the IO senior certificates for past shortfalls through distribution of Class Unpaid Interest Amounts.

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