

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

In the matter of the application of

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

Petitioner,

for judicial instructions under CPLR Article
77.

Index No. 656028/2021
Hon. Andrew S. Borrok

**ANSWER OF POETIC HOLDINGS TO
FIRST AMENDED PETITION**

Poetic Holdings 8 LP, Poetic Holdings IX LP, and Poetic Holdings VII LLC (together
“Poetic Holdings”) hereby file their Answer to the First Amended Petition of U.S. Bank National
Association (the “Petitioner”).

NOTICE OF INTENTION TO APPEAR

1. Poetic Holdings 8 LP holds ownership interests in the following Subject Trusts:¹
BSMFT 2006-SL6, BSABS 2005-EC1, BSABS 2006-HE2, BSABS 2007-AQ1, BSABS 2007-
HE3, SACO I 2006-5, SACO I 2006-9. Based on its interests in those Subject Trusts, Poetic
Holdings 8 LP notifies the Court and parties that it intends to appear in this proceeding.

2. Poetic Holdings IX LP holds ownership interests in the following Subject Trusts:
BSABS 2005-AQ2, BSABS 2005-EC1, BSABS 2005-HE10, BSABS 2005-HE11, BSABS 2006-
HE2, BSABS 2007-AQ1, BSABS 2007-FS1, BSMFT 2006-SL2, BSMFT 2006-SL4, SACO I

¹ Unless otherwise defined in this Answer, capitalized terms are used as defined in the
Governing Agreements or the First Amended Petition.

2006-4, and SACO I 2006-7. Based on its interests in those Subject Trusts, Poetic Holdings IX LP notifies the Court and parties that it intends to appear in this proceeding.

3. Poetic Holdings VII LLC holds ownership interests in the following Subject Trusts: BSABS 2005-HE10, BSABS 2005-HE3, BSABS 2005-HE7, BSABS 2005-HE8, BSABS 2006-HE1, SACO I 2005-9, SACO I 2005-WM2, SACO I 2005-WM3, and SACO I 2006-6. Based on its interests in those Subject Trusts, Poetic Holdings VII LLC notifies the Court and parties that it intends to appear in this proceeding.

STATEMENT OF POSITIONS

4. The First Amended Petition seeks judicial instruction on two primary issues that affect Poetic Holdings' interests in the Subject Trusts. Poetic Holdings states the following positions on those issues. At this time, Poetic Holdings take no positions on any other issues raised in the First Amended Petition but not addressed in this Answer, but reserve the right to be heard on matters including but not limited to all issues raised by the First Amended Petition, as may be amended in the future, or on other filings made by parties in this action.

A. Post-Zero Balance Collections Should Be Distributed Under the Excess Cashflow Waterfall and Are Not Subject to the Retired Class Provision.

5. The first issue asks how the Petitioner should distribute payments to certificate-holders after the Primary Classes' aggregate outstanding principal balances are reduced to zero. In particular, this issue implicates (a) the distribution of Post-Zero Balance Collections under the waterfalls, and (b) the application of the Retired Class Provision. These questions relate to three general features of the Governing Agreements.

6. First, the Governing Agreements provide that payments are distributed to different classes of certificates in a specific order as set forth in three separate waterfalls: (1) the principal waterfall, (2) the interest waterfall, and (3) the Excess Cashflow waterfall. Under the principal and

interest waterfalls, funds are distributed to the Primary Classes in amounts calculated based on the Certificate Principal Balance of each Primary Class. Under the Excess Cashflow waterfall, funds are distributed in a priority position to the Primary Classes to reimburse them for realized losses and interest shortfalls, and any remaining funds are distributed in a subordinate position to the Class C Classes.

7. Second, the Governing Agreements also provide for an overcollateralization structure. The Overcollateralization Amount at any given time is equal to the difference between the stated principal balances of the mortgage loans in the Subject Trusts and the Certificate Principal Balances of the Primary Classes. This overcollateralization was intended as a credit enhancement for the Primary Classes and to protect the Primary Classes from future losses. If the Overcollateralization Amount on any payment date exceeds the Overcollateralization Target Amount, the excess funds would be distributed under the Excess Cashflow waterfall.

8. Third, the Governing Agreements provide that the Primary Classes' Certificate Principal Balances can be reduced—and thereby the funds to which each Principal Class is entitled under the principal waterfall also is reduced—in two ways. A Certificate Principal Balance is reduced when the Primary Class receives a distribution of principal. In addition, a Certificate Principal Balance is reduced when the Primary Class is allocated realized losses, which are allocated under the priority established in the Governing Agreements when loan-level losses exceed current overcollateralization.

9. Because of losses on the mortgage loans in the Subject Trusts, the Primary Classes have incurred substantial realized losses. Over time, these realized losses not only eroded the Overcollateralization Amount in the Subject Trusts, but also reduced the Certificate Principal Balances of the Primary Classes. The Certificate Principal Balances of certain Primary Classes

will eventually be or already have been reduced to zero. Due to these losses, certain Primary Classes have unreimbursed realized losses or interest shortfalls when they are reduced to zero.

10. Turning to the waterfall question in dispute, payments are often still received by the trust—or may be expected by the trust—after the Certificate Principal Balance of all Primary Classes has been reduced to zero. While these collections would normally be distributed to the Primary Classes under the interest or principal waterfall, the amount to be distributed to a Primary Class is zero when its balance is zero. The Petitioner seeks judicial instruction on whether, under the Governing Agreements, these Post-Zero Balance Collections should be distributed under the principal waterfall or the Excess Cashflow Waterfall.

11. The Court should conclude that the Governing Agreements require the Petitioner to distribute Post-Zero Balance Collections under the Excess Cashflow waterfall. The reason is simple: *the Excess Cashflow waterfall is the only possible waterfall that could apply*. The principal waterfall could not apply because it expressly distributes principal payments “based on the respective Certificate Principal Balances . . . until the Certificate Principal Balance thereof is reduced to zero.” PSA § 5.04(a)(2).² Nor could the interest waterfall apply because it distributes “Interest Funds,” which definitionally do not accrue on principal balances of zero. *Id.* §§ 1.01 (definition of Interest Funds), 5.04(a)(1). This leaves a final waterfall: the Excess Cashflow waterfall. The Excess Cashflow waterfall is intended to operate when Primary Class balances have been reduced to zero and reimburses interest shortfalls or realized losses incurred by the Primary Classes before distributing remaining residuals to Class C Classes. Given that Post-Zero Balance

² “PSA” refers to the Pooling and Servicing Agreement for the SACO I 2006-4 trust, which is attached to the First Amended Petition as Exhibit C. Poetic Holdings cites to this PSA because its language is illustrative of and not materially different than the language of the PSAs governing all of the Subject Trusts in which Poetic Holdings owns certificates.

Collections must be distributed under one of the three waterfalls expressly provided in the Governing Agreements, the Excess Cashflow waterfall applies because it is the only operable waterfall and the only one that makes sense in the full context of the Governing Agreements.

12. As for the Retired Class Provision, the provision has already been interpreted in JPM II by both the Supreme Court and the Appellate Division. In JPM II, the trial court held that the Retired Class Provision allows for the Primary Classes' Certificate Principal Balances to be written up after they are reduced to zero and allows "post-write-up distributions." JPM II Trial Court Order at 37-39. This ruling paved the way for settlement funds to be distributed to the Primary Classes following the application of write-ups. On appeal, the Appellate Division affirmed and further substantiated the trial court's interpretation of the Retired Class Provision:

The retired class provisions merely provide that once a certificate has been paid in full and formally retired, it is no longer entitled to receive distributions that it might have otherwise received under the waterfall. The zero-balance certificates here have neither been fully repaid nor withdrawn from the market pursuant to the procedures set forth in the relevant governing agreements; rather, they have outstanding losses and are still actively traded. The provisions make clear that certificates are only considered "retired" when the trustee has undertaken certain affirmative steps to accomplish that end—e.g., paying off the certificates and withdrawing them from circulation; the mere reduction of the certificate balances to zero is insufficient.

JPM II Appellate Opinion at 8.

13. The Appellate Division's reasoning applies equally to the monthly payments subject to this present Petition. The Primary Classes may have Certificate Principal Balances of zero, but under the JPM II Appellate Opinion they are not "retired" as long as they have accrued unreimbursed losses or shortfalls. As the Appellate Division made clear, "zero-balance certificates [that] have neither been fully repaid nor withdrawn from the market pursuant to the procedures set forth in the relevant governing documents" are not "retired." *Id.* Petitioner does not allege or otherwise show that the Primary Classes' certificates in the Subject Trusts have been "retired"

under the procedures in the Governing Agreements. Nor does Petitioner distinguish the payments discussed in the First Amended Petition from those discussed in JPM II insofar as allegedly “retired” certificates are concerned. In short, JPM II controls, and the Court should conclude that the Retired Class Provision does not prevent distributions of Post-Zero Balance Collections to Primary Classes.

B. Deferred Principal Collections Require Write-Ups for the Primary Classes.

14. The second issue concerns how Deferred Principal Collections should be treated to write up the Primary Classes’ Certificate Principal Balances.

15. By way of brief background, servicers for the mortgage loans in the Subject Trusts have agreed to modifications that allow borrowers to defer their scheduled principal payments. As an accounting matter and as a result of directions under the U.S. Department of Treasury Home Affordable Modification Program (“HAMP”)—not because of anything contained in the Governing Agreements—servicers report these deferred principal amounts as losses on the mortgage loans to account for the risk that borrowers may not pay back the deferred principal amounts. Many borrowers, however, have made payments on deferred principal, or Deferred Principal Collections. Because of the servicers’ treatment, these loan-level losses resulted in realized losses to the Primary Classes. When a realized loss is applied, the Petitioner reduces, or “writes down,” a Primary Class’s Certificate Principal Balance. But if a Deferred Principal Collection is distributed, the Petitioner’s practice is *not* to reverse the loss on, or “write up,” the Primary Class’s Certificate Principal Balance. This means that the Certificate Principal Balance will be reduced to zero more quickly, which impairs the Primary Class’s ability to receive future distributions under the principal waterfall.

16. According to the Petitioner, the Governing Agreements provide that Subsequent Recoveries require the Petitioner to write up a Primary Class's Certificate Principal Balance to account for a previously applied realized loss arising from liquidation or final disposition. The Petitioner further believes that, because Subsequent Recoveries do not include Deferred Principal Collections, the Petitioner is not required to write up the Certificate Principal Balance when Deferred Principal Collections are distributed.

17. The Court should instruct the Petitioner that Deferred Principal Collections require write-ups of the Primary Classes' Certificate Principal Balances whether or not Deferred Principal Collections are Subsequent Recoveries. The losses due to deferred principal were reported in expectation of potential future losses (under HAMP guidance) rather than in recognition of actual losses (as contemplated by the Governing Agreements), so it is only reasonable that they be reversed when it becomes clear that those balances are paid rather than lost. This would be consistent with the Appellate Division's reasoning in JPM II, which affirmed that Certificate Principal Balances that have been reduced to zero may be written up. *See* JPM II Appellate Opinion at 8.

REQUEST FOR RELIEF

WHEREFORE, Poetic Holdings respectfully requests that the Court enter judgment with respect to Poetic Holdings' interests in the Subject Trusts as follows:

- a. Instruct the Petitioner to distribute Post-Zero Balance Collections under the Excess Cashflow waterfall;
- b. Instruct the Petitioner that the Retired Class Provision does not prevent the distribution of Post-Zero Balance Collections;

- c. Instruct the Petitioner to write up the Primary Classes' Certificate Principal Balances based on Deferred Principal Collections;
- d. Grant the parties leave to file briefing, including memoranda of law, to more fully address the issues presented in the First Amended Petition on the merits; and
- e. Order any other relief that the Court may deem just and proper.

Dated: January 18, 2022

GREENE ESPEL PLLP

/s/ John B. Orenstein

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IX LP*

CERTIFICATE OF SERVICE

I certify that on January 18, 2022, I caused this Answer of Poetic Holdings to First Amended Petition to be served on all parties who have appeared in this action via NYSCEF. I also caused service to be effectuated on all parties who have appeared by overnight mail.

/s/ John B. Orenstein

John B. Orenstein