

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 pursuant to CPLR Article 77.

Index No. 656028/2021

Hon. Andrew S. Borrok

**ASO ATLANTIC FUND LLC'S
ANSWER TO THE FIRST
AMENDED PETITION**

ASO Atlantic Fund LLC (“ASO”) is an Interested Person, as that term is used in the Order to Show Cause entered on November 16, 2021, in certain of the 77 trusts (the “Subject Trusts”) at issue in the First Amended Petition (the “Petition” or “FAP”) filed by U.S. Bank National Association (“Petitioner”).¹ ASO holds an interest in the following Trusts: BSABS 2006-HE1, BSABS 2006-HE6 and BSABS 2006-HE9. ASO respectfully submits this response to the First Amended Petition.

STATEMENT OF POSITION

The Subject Trusts are residential mortgage-backed securitizations that are each governed by a separate pooling and servicing agreement (the “Governing Agreements”). Petitioner initiated this proceeding seeking a judicial instruction because of the “lack of clarity” in the Governing Agreements regarding:

- 1) The “manner in which the Retired Class Provision should be applied”;

¹ The Trusts are identified in Exhibit A to the First Amended Petition. ([Dkt. No. 33.](#)) Unless otherwise defined herein, capitalized terms have the meaning ascribed to them in the First Amended Petition.

- 2) The “proper allocation and distribution of Post-Zero Balance Collections under the waterfalls”; and
- 3) Whether Deferred Principal Collections should be treated as Subsequent Recoveries.

FAP ¶ 88. As discussed below, ASO requests that the Court instruct Petitioner to: (i) comply with the First Department’s binding interpretation of the Retired Class Provision and write-up and then distribute funds to Primary Classes that have a zero balance as a result of Realized Losses; (ii) distribute future collections pursuant to the interest and principal waterfalls to all written-up Primary Classes; and (iii) correct Petitioner’s prior decision not to treat Deferred Principal Collections as Subsequent Recoveries and treat all future Deferred Principal Collections as Subsequent Recoveries if the Deferred Principal was treated as a Realized Loss.

I. THE FIRST DEPARTMENT HAS ALREADY DETERMINED THE MEANING OF THE RETIRED CLASS PROVISION.

This is not the first time Petitioner has sought judicial instruction regarding the Retired Class Provision. In *In re Wells Fargo Bank et al.*, No. 657387/2017 (Sup. Ct. N.Y. Cnty.) (Friedman, J.) (“JPM II”), Petitioner and other trust representatives sought judicial instruction concerning several issues of contract interpretation, including the meaning of the Retired Class Provision. After extensive briefing and a lengthy hearing, the court held the Governing Agreements require the write-up of zero-balance certificates pursuant to the write-up provisions of the Governing Agreements, and once written up, those certificates are entitled to distributions. JPM II Trial Court Order at 38-39.² The First Department affirmed, explaining:

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

² See *In re Wells Fargo Bank N.A.*, No. 657387/2017, [2020 WL 735683](#) (Sup. Ct. N.Y. Cty. Feb. 13, 2020) ([Dkt. No. 111](#)).

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 8.³ Although the funds at issue in this proceeding are different than the funds at issue in JPM II,⁴ neither Justice Friedman’s nor the First Department’s ruling hinged on the nature of the funds at issue. These rulings were definitive interpretations of the Retired Class Provision that are binding here unless the Court of Appeals elects to hear a further appeal and rules differently.⁵ But unless and until the Court of Appeals changes the law, Petitioner is bound to follow the judicial instruction it sought and received.

As the Petition acknowledges, Petitioner’s practice has been and continues to be to apply the Retired Class Provision to preclude distributions *and* write-ups to zero-balance certificates, contrary to the JPM II rulings. *See* FAP ¶ 116. Correcting that practice would go a long way towards resolving the uncertainty Petitioner raises concerning distribution of Post-Zero Balance Collections. Simply put, if Petitioner had been writing up zero balance certificates, there would be fewer Primary Classes with zero balances, and thus far fewer (if any) Post-Zero Balance Collections. Given that the First Department has already established what the Retired Class

³ *See Wells Fargo Bank v. Aegon USA Inv. Mgmt., LLC*, 2021 N.Y. Slip Op. 04740, [2021 WL 3668441](#) (1st Dep’t Aug. 19, 2021).

⁴ In JPM II, the funds at issue were proceeds from a settlement with JPMorgan of claims for breach of representations and warranties and related claims, which were paid to the settlement trusts (including most if not all of the Subject Trusts) as Subsequent Recoveries. Here, the funds at issue are collections on the loans in the ordinary course of the administration of the Subject Trusts, in particular Deferred Principal Collections.

⁵ As the Petition notes, one certificateholder has sought leave from the Court of Appeals to appeal the First Department’s ruling with respect to the Retired Class Provision.

Provision means—and has always meant—and Petitioner’s practice of precluding write-ups of, and subsequent distributions to Primary Classes with zero balances is contrary to that plain meaning, the Court should instruct Petitioner to: (i) revise Primary Class balances to reflect write-ups that should have occurred in the past; and (ii) amend its practices to comply with the JPM II Appellate Opinion.

II. AFTER PRIMARY CLASSES ARE WRITTEN UP, DISTRIBUTIONS SHOULD BE MADE UNDER THE INTEREST AND PRINCIPAL WATERFALLS.

Petitioner requests instruction concerning which waterfall to follow in distributing Post-Zero Balance Collections. FAP ¶¶ 89-120. Once Primary Classes with zero balances are written up, distributions should occur through the standard interest and principal waterfalls. This necessarily follows from the fact that written up certificates would no longer have a zero balance, and thus are owed interest on the outstanding certificate balance and principal payments for the outstanding principal balance.

III. DEFERRED PRINCIPAL COLLECTIONS ARE PROPERLY TREATED AS SUBSEQUENT RECOVERIES.

Finally, Petitioner requests instruction concerning its treatment of Deferred Principal Collections for 73 of the Subject Trusts. FAP ¶¶ 121-134. Although Petitioner acknowledges that the Realized Loss definition for twenty Subject Trusts “expressly requires amounts related to modifications to be treated as losses” and the definition for fifty-three Subject Trusts do not, it has consistently treated Deferred Principal as a Realized Loss for all of the Subject Trusts. FAP ¶ 124. In contrast, Deferred Principal Collections have been treated inconsistently and only treated as Subsequent Recoveries where the Subsequent Recoveries definition expressly references modifications. This inconsistent treatment of Deferred Principal and Deferred Principal Collections results in Primary Class certificates incurring losses with no hope of recouping those losses—even when the Subject Trust actually recoups the Deferred Principal that created the loss

in the first place. As the Petition explains, the looming consequence of this practice is that the Class C Certificates will be paid from overcollateralization before the Primary Classes, which were actually written down when principal amounts were deferred, are paid in full. *See* FAP ¶¶ 127-131. This outcome is commercially unreasonable because the Class C Certificates represent the “equity” portion of the Subject Trusts, and are only supposed to be paid if the Primary Classes (the debt portion of the Subject Trusts) receive full payment each month (and there remain sufficient funds to trigger the Excess Cashflow Waterfall and reach the Class C Certificates’ priority level in that waterfall). Petitioner’s current practice will, if not reversed, lead to a windfall for the Class C Certificates, to the detriment of Primary Class certificateholders, that was never contemplated—let alone required—by the Governing Agreements.

To the contrary, even the Governing Agreements that Petitioner characterizes as “narrowly” defining Subsequent Recoveries (FAP ¶ 124(b)) require Deferred Principal Collections to be treated as Subsequent Recoveries when the Deferred Principal was treated as a Realized Loss. In those Governing Agreements, Subsequent Recoveries are any “amounts received by the Master Servicer . . . specifically related to a Mortgage Loan that was the subject of a liquidation or final disposition of any REO Property prior to the related Prepayment Period that resulted in a Realized Loss.” *E.g.*, BSABS 2006-HE1 Pooling and Servicing Agreement § 1.01 (definition of “Subsequent Recoveries”).⁶ “Liquidation” is an undefined term that, pursuant to standard industry practice, allows for partial liquidation of a mortgage loan. Indeed, the Governing Agreements expressly contemplate partial liquidations. “Liquidation Proceeds” are “[a]mounts, other than Insurance Proceeds, received in connection with the partial or complete liquidation of a Mortgage

⁶ The BSABS 2006-HE1 Pooling and Servicing Agreement is available at *available at* https://www.sec.gov/Archives/edgar/data/1349160/000088237706000465/d422821_ex4-1.htm.

Loan.” BSABS 2006-HE1 Pooling and Servicing Agreement § 1.01 (definition of “Liquidation Proceeds”). Liquidation Proceeds are amounts the servicer recovers during a liquidation—partial or complete. Subsequent Recoveries are amounts the servicer recovers after a liquidation—partial or complete. By treating Deferred Principal as a Realized Loss, the servicer is treating the modification as a partial liquidation of the mortgage loan. Consequently, given that Deferred Principal has been treated as a partial liquidation, when the Deferred Principal Collections are recovered, they are “amounts . . . specifically related to a Mortgage Loan that was the subject of a liquidation” and must be treated as a Subsequent Recovery.

IV. REQUEST FOR ADDITIONAL MERITS BRIEING

Given the complexity of the issues addressed herein, and the number of Subject Trusts, ASO respectfully requests full merits briefing. ASO reserves the right to respond to additional arguments from other Interested Persons or Petitioner.

CONCLUSION

For the foregoing reasons, as well as those to be presented in additional briefing and oral argument before the Court, ASO respectfully request that the Court instruct Petitioner to: (i) follow the First Department’s ruling that the Retired Class Provision does not prevent either the write-up of Primary Class certificates that have applied losses and interest shortfalls or distributions after write-ups have been applied; (ii) reverse any and all previous decisions not to write-up Primary Class certificates as a result of the misapplication of the Retired Class Provision; and (iii) treat Deferred Principal Collections as Subsequent Recoveries if the Deferred Principal was treated as a Realized Loss.⁷

⁷ If the Court were to conclude that Deferred Principal Collections are not Subsequent Recoveries, then ASO would request that the Court instruct Petitioner to correct its past treatment of Deferred Principal as Realized Losses.

Dated: New York, New York
January 18, 2022

MCKOOL SMITH, P.C.

By: /s/ Robert W. Scheef

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