

**Wells Fargo Bank, N.A. v All Respondents for this
Special Proceeding**

2025 NY Slip Op 32758(U)

July 21, 2025

Supreme Court, New York County

Docket Number: Index No. 154984/2021

Judge: Andrew Borrok

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

PRESENT: HON. ANDREW BORROK PART 53
Justice

-----X

WELLS FARGO BANK, NATIONAL ASSOCIATION,
Petitioner,

INDEX NO. 154984/2021

- v -

**POST-TRIAL DECISION
and ORDER**

ALL RESPONDENTS FOR THIS SPECIAL PROCEEDING,
Respondent.

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This case was tried without a jury over the course of 17 days, beginning May 19, 2025, and ending June 11, 2025.

Two issues for trial were presented:

1. Is the payment of previously deferred principal pursuant to a HAMP modification treated as a Realized Loss a Subsequent Recovery such that the petitioner, Wells Fargo Bank, National Association as trustee (**Wells Fargo**) should write-up certificateholder Certificate Principal Balances pursuant to the Subsequent Recovery write-up provisions set forth in the applicable pooling and servicing agreements?

2. If it is not a Subsequent Recovery, how should Wells Fargo treat it?

At trial, Charles Brehm, Barry Akers, Serria Lohmeier, Danielle Johnson-Kutch, Evan Siegert, Steven Hilfer, James Aronoff, Vincent Varca, Phillip R. Burnaman II and Daniel Castro testified.

None of the foregoing witnesses were senior certificateholders, subordinate certificateholders or residual certificateholders.¹

Following trial, the Court makes the following findings of fact and comes to the following conclusions of law:

Background

1. This case involves 34 residential mortgage-backed securitization (**RMBS**) trusts (NYSCEF Doc. No. 873).
2. The RMBS trust assets are the underlying mortgage loans (*tr.* 1764:8-11).
3. The petitioner is Wells Fargo who was the trustee or the securities administrator of the RMBS trusts.
4. The counter-petitioners are Deer Park Road Management Company, LP, STS Master Fund, LTD., Deer Park 1850 Fund, LP, Northern Lights Fund Trust – Deer Park Total Return Credit Fund, One William Street Capital Master Fund, LTD., OWS Credit Opportunity 1, LLC, Baldr Sherwood Fund Inc., OWS ABS Master Fund II, LP and 1WS Credit Income Fund (**Deer Park**).
5. RMBS trusts are governed by certain pooling and servicing agreements which set forth the rights and obligations of the parties (*tr.* 189:12-190:2).

¹ The parties informed the Court that a stipulation had been entered into pursuant to which the senior certificateholders, subordinate certificateholders and HBK Master Fund L.P. (**HBK**) agreed that they would not call each other's clients as witness at trial but that nothing in the stipulation prevented any party from calling their own certificateholders as witness (*tr.* 2434:8-2438:20).

6. Over the years, pooling and servicing agreements underwent various iterations as the industry developed but continued to reflect certain standard practices and general understandings (*tr.* 1059:16-1060:20).
7. Generally, RMBS trusts reflect a subordination structure with senior certificateholders and subordinate certificateholders and, sometimes, multiple classes of each tranche (*e.g.*, A1, A2, A3, and B1, B2 and B3) in the capital structure (*tr.* 499:16-500:6).²
8. The subordination structure typically provides for priority of payment for different classes of bonds and generally protects senior certificateholders from losses (*tr.* 575:8-11) by allocating losses to subordinate certificateholders and reducing their Certificate Principal Balances before reducing senior certificateholder Certificate Principal Balances.
9. In general, senior certificateholders expect more guaranteed funds and a lower risk of losses while subordinate certificateholders hold riskier investments and expect to take on losses prior to senior certificateholders (*tr.* 500:7-14).
10. Residual certificateholders are at the very bottom of the pooling and servicing subordination capital structure and are expected to be paid only “once the other bonds above them, seniors and subs, are made whole. That doesn’t just include interest and principal, it includes loss recoveries” (*tr.* 2767:19-22).
11. Accordingly, residual certificateholders start with zero Certificate Principal Balance.
12. In the event of a loan level default where the trust experiences a realized loss, the pooling and servicing agreements address how those losses should be allocated among different certificateholders (*tr.* 93:24-94:4).

² As discussed below, RMBS trusts can also have residual certificateholders further down in priority in the capital structure.

13. As set forth above, RMBS subordination structures reflected in pooling and servicing agreements are customarily constructed such that realized losses are allocated to subordinate certificateholders first to protect senior certificateholders from taking losses (*tr.* 3072:6-13; VEC Doc. No. 1315 at 2).
14. Pooling and servicing agreements allocate realized losses by providing for the write-down of certificateholder Certificate Principal Balances (*tr.* 3076:15-17).
15. Realized losses are generally understood to have occurred pursuant to a bankruptcy loss or a liquidated mortgage loan or amounts forgiven pursuant to a servicer modification (*see generally*, the At Issue PSAs [hereinafter defined]; VEC Doc. No. 1315 at 10).
16. Liquidate is generally not defined in pooling and servicing agreements, but a liquidated mortgage loan is generally understood to be a loan where there has been a determination that all amounts to be recovered in respect of amounts due have been recovered such that if there is any later payment, it is ***expected to be*** a *de minimis* recovery – *i.e.*, a small amount (*tr.* 2663:12-20).
17. Recovery, principal recovery and subsequent recovery are generally understood to mean the same thing (*tr.* 563:23-25).
18. If there is a subsequent recovery, the general market expectation is that the pooling and servicing agreements ***would provide*** for the write-up of senior certificateholder Certificate Principal Balances and then subordinate certificateholder Certificate Principal Balances (*tr.* 2936:8-16).
19. However, although these are the general market expectations as to what pooling and servicing agreements would ***generally provide***, with respect to what pooling and servicing agreements ***actually provide***, market expectations are informed by what the pooling and

servicing agreements with respect to any particular trust *actually do provide* because market participants are informed by the pooling and servicing agreements that govern the certificates that they own (*tr.* 3462:13-20).³

20. As discussed below, the At Issue PSAs' (hereinafter defined) Subsequent Recovery write-up provisions unambiguously provide for the write-up of subordinate certificateholder Certificate Principal Balances, not senior certificateholder Certificate Principal Balances (*see Wells Fargo Bank v Aegon USA Inv. Mgt., LLC*, 198 AD3d 156, 160-164 [1st Dept 2021]).
21. The different certificateholders who own different classes of trust certificates are entitled to distributions in the specific order provided for in the pooling and servicing agreements referred to as "waterfalls."
22. Pooling and servicing agreements generally provide for three distinct waterfalls that govern distributions: (i) the interest waterfall, (ii) the principal waterfall, and (iii) the excess cashflow waterfall.

The At Issue PSAs

23. The pooling and serving agreements (the **At Issue PSAs**) which govern the trusts (the **At Issue Trusts**) at issue in this case were executed between 2005 and 2007.
24. While not identical, the provisions in the At Issue PSAs are substantially the same with respect to the concepts material to the two issues presented for trial.

³ As Mr. Castro testified, "[e]very experienced investor I know reads the documents, specifically the PSA. They probably read all the other documents as well. They read the PSA, they know exactly what it says. They know if it's – if they're writing up – if the document says – if the PSA says they can write-up the As and the Bs they know that. If it just says they can write-up the Bs, they know that. So their expectation should be given that they've read the documents, whatever the PSA says, that's their expectation" (*tr.* 3276:3-11).

25. Pursuant to the At Issue PSAs, the trustee (Wells Fargo) is responsible for calculating and distributing payments to investor certificateholders from the collections received from the mortgage loan assets held by the RMBS trusts.

26. The At Issue PSAs provide for an adjustment of certificateholder Certificate Principal Balances under certain circumstances consistent with market expectations as such market expectations are informed by the At Issue PSAs.

27. Certificate Principal Balance is defined as

[w]ith respect to any Certificate (other than the Class B-IO Certificates or the Class R Certificates) as of any Distribution Date, the initial principal amount of such Certificate plus in the case of a Subordinate Certificates, any Subsequent Recoveries added to the Certificate Principal Balance of such Certificates pursuant to Section 6.02(b) hereof, minus the sum of (i) all amounts distributed on previous Distribution Dates on such Certificate with respect to principal and (ii) any Applied Realized Loss Amounts allocated to such Certificate on previous Distribution Dates. With respect to any such Class of Certificates, the Certificate Principal Balance thereof will equal the sum of the Certificate Principal Balances of all Certificates in such Class.

(VEC Doc. No. 540 at 4).

28. Section 6.02 “Allocation of Losses; Subsequent Recoveries” of the At Issue PSAs addresses how losses and recoveries should be allocated (*see e.g.*, VEC Doc. No. 540 § 6.02).

29. Consistent with general industry understanding discussed above, the At Issue PSAs reflect the writing down (decreasing) of subordinate certificateholder Certificate Principal Balances before writing down senior certificateholder Certificate Principal Balances.

30. More specifically, Section 6.02 (a) of the At Issue PSAs generally provide that

[o]n or prior to each Determination Date, the Master Servicer shall determine the amount of any Realized Loss in respect of each Mortgage Loan that occurred during the immediately preceding calendar month. Any Realized Losses with respect to the Mortgage Loans shall be applied on each Distribution Date after the distributions provided for in Section 6.01, in reduction of the Certificate Principal

Balance of the Class or Classes of Certificates to the extent provided in the definition of Applied Realized Loss Amount.

(VEC Doc. No. 540 § 6.02 [a]).⁴

31. Realized Loss is defined as

[a]ny (i) Bankruptcy Loss or (ii) as to any Liquidated Mortgage Loan, (x) the Outstanding Principal Balance of such Liquidated Mortgage Loan plus accrued and unpaid interest thereon at the Mortgage Interest Rate through the last day of the month of such liquidation, less (y) the related Net Liquidation Proceeds with respect to such Mortgage Loan and the related Mortgaged Property; provided, however, that in the event the Master Servicer receives Subsequent Recoveries with respect to any Mortgage Loan, the amount of the Realized Loss with respect to that Mortgage Loan will be reduced to the extent such Subsequent Recoveries are applied to reduce the Certificate Principal Balance of any Class of Certificates on any Distribution Date.

(VEC Doc. No. 540 at 22).

32. As discussed above, in the At Issue PSAs that include the defined term “Applied

Realized Loss Amounts,” by way of example, the PSAs provide the following definition:

[w]ith respect to any Distribution Date and a Class of Certificates (other than the Class B-1O Certificates and the Residual Certificates), the sum of the Realized Losses with respect to the Mortgage Loans, which are to be applied in reduction of the Certificate Principal Balance of such Class of Certificates pursuant to this Agreement in an amount equal to the amount, if any, by which, (i) the aggregate Certificate Principal Balance of all of the Certificates (after all distributions of principal on such Distribution Date) exceeds (ii) the aggregate Stated Principal Balance of all of the Mortgage Loans for such Distribution Date. The Applied

⁴ Certain of the At Issue PSAs set forth the allocation of Realized Losses as opposed to having a separate definition of Applied Realized Losses (*see e.g.*, VEC Doc. No. 548 §6.02 [b]). Other versions of the PSAs also reflect the same concept with minor variation in the language used to accomplish the same or similar allocation, including in some instances, *pro rata* allocation of losses among certain classes of certificateholders Certificate Principal Balances. Finally, the Court notes that approximately three of the At Issue PSAs indicate that Realized Losses also include amounts forgiven pursuant to servicer modifications (*see e.g.*, VEC Doc. No. 576). By way of example, in the Pooling and Servicing Agreement BSMF 2007-AR5 dated June 1, 2007 (*id.*), the Realized Loss definition makes clear “to the extent the Servicer receives Subsequent Recoveries with respect to any Mortgage Loan, the amount of the Realized Loss with respect to that Mortgage Loan will be reduced to the extent such recoveries are applied to reduce the Current Principal Amount of any Class of Certificates.” The Subsequent Recovery definition in this PSA indicates that it includes amounts received related to “a Mortgage Loan that has been modified which resulted in a Realized Loss” and Section 6.02 (b) provides for the increase of the “Current Principal Amount of the Class of Subordinate Certificates in the related Loan Group with the highest payment prior to which Applied Realized Loss Amounts have been allocated, but not by more than the amount of Applied Realized Loss Amounts previously allocated to that Class of Subordinate Certificates.”

Realized Loss Amount shall be allocated first to the Class B-3 Certificates, the Class B-2 Certificates, the Class B-1 Certificates, the Class M-2 Certificates and the Class M-1 Certificates, in that order (so long as their respective Certificate Principal Balances have not been reduced to zero), and thereafter the Applied Realized Loss Amount shall be allocated to the Class A-1 Certificates until the Certificate Principal Balance of such Class has been reduced to zero.

(VEC Doc. No. 540 at 2).

33. As discussed above, pursuant to the Realized Loss definition, Realized Losses are either Bankruptcy Losses, losses from Liquidated Mortgage Loans or amounts forgiven pursuant to a servicer modification.
34. Bankruptcy Losses are defined as “[w]ith respect to any Mortgage Loan, any Deficient Valuation or Debt Service Reduction related to such Mortgage Loan as reported by the Servicer to the Master Servicer” (VEC Doc. No. 541 at 5).⁵
35. In the majority of the At Issue PSAs, Liquidated Mortgage Loan⁶ is “[a]ny defaulted Mortgage Loan as to which the Servicer has determined that all amounts it expects to

⁵ Debt Service Reduction is defined as “with respect to any Mortgage Loan, a reduction by a court of competent jurisdiction in a proceeding under the Bankruptcy Code in the Scheduled Payment for such Mortgage Loan that became final and non-appealable, except such a reduction resulting from a Deficient Valuation or any other reduction that results in a permanent forgiveness of principal” (VEC Doc. No. 550 at 29). Scheduled Payment is defined as “[t]he scheduled monthly payment on a Mortgage Loan due on a Due Date allocable to principal and/or interest on such Mortgage Loan” (*id.* at 63). As discussed below, the Treasury Department’s HAMP modifications changed the scheduled monthly payment in the amortization schedule by deferring principal and extinguishing the obligation to pay interest entirely on such forbore principal. Although not a Bankruptcy Loss because the final determination was from the Treasury Department (the federal government) and not a court of competent jurisdiction in a proceeding under the Bankruptcy Code, treating it as a Realized Loss was consistent with the concept already set forth in the pooling and servicing agreements because the definition was otherwise satisfied.

⁶ Some of the At Issue PSAs use the term “Liquidated Loan” as opposed to “Liquidated Mortgage Loan.” In those PSAs that have a separate definition of Liquidated Loan, by way of example, Liquidated Loan is defined as

[w]ith respect to any Distribution Date, a defaulted Mortgage Loan that has been liquidated through deed-in-lieu of foreclosure, foreclosure sale, trustee’s sale or other realization as provided by applicable law governing the real property subject to the related Mortgage and any security agreements and as to which the Company or the related Servicer has made a Final Recovery Determination with respect thereto.

(VEC Doc. No. 554 at 30-31). Wells Fargo stipulated that “[s]olely for the purposes of this proceeding, Petitioner stipulates that it is not aware of having received *any other document* expressly stating that, as of or around the time of the modification or repayment of any Loan at issue in this proceeding, a “Final Recovery Determination,” as defined in certain relevant PSAs, had been made by any Servicer with respect to such Loan” (VEC Doc. No. 34 at 3

recover from or on account of such Mortgage Loan have been recovered” (VEC Doc. No. 540 at 17).

36. “Liquidate” is not defined in the At Issue PSAs.

37. Black’s Law Dictionary defines “liquidate” as “[t]o settle (an obligation) by payment or other adjustment; to extinguish (a debt)” (LIQUIDATE, Black's Law Dictionary [12th ed. 2024]).

38. The At Issue PSAs also include a definition for Principal Prepayment which states that

[a]ny payment (whether partial or full) or other recovery of principal on a Mortgage Loan which is received in advance of its scheduled Due Date to the extent that it is not accompanied by an amount as to interest representing scheduled interest due on any date or dates in any month or months subsequent to the month of prepayment, including Insurance Proceeds and Repurchase Proceeds, but excluding the principal portion of Net Liquidation Proceeds received at the time a Mortgage Loan becomes a Liquidated Mortgage Loan.

(VEC Doc. No. 573 at 39).

39. As relevant and pursuant to the plain language of this definition, the payment of

previously deferred principal taken as a Realized Loss is not a prepayment of principal.⁷

40. Payments which come in prior to the time due by sale or at maturity are principal

repayments (VEC Doc. No. 573 at 39).

[emphasis added]). Wells Fargo also stipulated that “it is not aware of any instance when, at the point a servicer reported a Realized Loss based on its deferring payment of a portion of the borrower’s outstanding loan balance, the servicer explicitly stated, in a column or field in Loan Level Data or elsewhere, that the underlying Loan was a ‘Liquidated Mortgage Loan’” and that “it is not aware of any instance when, at the point a servicer reported a Realized Loss based on its deferring payment of a portion of the borrower’s outstanding loan balance, the servicer explicitly stated, in a column or other field in Loan Level Data or elsewhere, that it had recovered all amounts it expected to recover in connection with the subject Loan” (VEC Doc. No. 46 at 3). However, as discussed below, Treasury made the determination in promulgating HAMP Guidance and the HAMP Handbook that the servicer should treat the adjusted principal and extinguished interest in respect of such principal as a Realized Loss (*i.e.*, that the servicer should treat it as though the definition of Realized Loss was satisfied) and the servicer in turn reported it to Wells Fargo as a Realized Loss pursuant to the HAMP safe harbor.

⁷ In fact, Interim Position 55, discussed below, addressed this very issue. Wells Fargo’s computer models were incorrectly reading recoveries of prior losses on active loans, *i.e.*, the payment of previously deferred principal on loans modified pursuant to HAMP (hereinafter defined) as “miscellaneous principal prepayments” (VEC Doc. No. 8).

41. Consistent with industry understanding, the At Issue PSAs also provide for writing up (increasing) certificateholder Certificate Principal Balances when there has been a recovery of a prior Realized Loss.
42. General industry understanding is that the only way to write-up the recovery of a prior Realized Loss is as a recovery, principal recovery or subsequent recovery (*tr.* at 563:23-25; VEC Doc. No. 1315 at 7).

The At Issue PSAs only provide for writing up certificate principal amounts that are Subsequent Recoveries

43. The At Issue Trusts are write-up first (not pay first) trusts (*tr.* 2682:14-17).
44. The At Issue PSAs refer to the concept of a recovery of a prior Realized Loss as a Subsequent Recovery.
45. Subsequent Recoveries are defined as

[a]s of any Distribution Date, amounts received during the related Due Period by the Master Servicer (net of any related expenses permitted to be reimbursed pursuant to Section 4.03) or surplus amounts held by the Master Servicer to cover estimated expenses (including, but not limited to, recoveries in respect of the representations and warranties made by the Seller pursuant to the Mortgage Loan Purchase Agreement) in respect of a Liquidated Mortgage Loan or the disposition of an REO Property prior to the related Prepayment Period that resulted in a Realized Loss, after liquidation or disposition of such Mortgage Loan.

(VEC Doc. No. 540 at 31).⁸

⁸ In some of the At Issue PSAs, Subsequent Recoveries are defined as

As of any Distribution Date, amounts received by the Master Servicer or any Servicer (net of any related expenses permitted to be reimbursed pursuant to Section 6.05) or surplus amounts held by the Master Servicer and the related Servicer to cover estimated expenses (including, but not limited to, recoveries in respect of the representations and warranties made by the Seller pursuant to the Mortgage Loan Purchase Agreement) specifically related to a mortgage Loan that was the subject of a liquidation, a Mortgage Loan that has been modified which resulted in a Realized Loss or final disposition of any REO Property as of the end of the prior calendar month.

(VEC Doc. No. 577 at 22).

46. When an At Issue Trust receives a Subsequent Recovery, the prior Realized Loss is reduced and the Certificate Principal Balance is increased (or “written up”) (VEC Doc. No. 572 § 6.02 [b]).
47. Subsequent Recoveries are the “only mechanism” to “write up certificates after a Realized Loss” (*tr.* 906:1-4, 2869:6-22).
48. Wells Fargo testified that the only way to write-up certificateholder Certificate Principal Balances is as a Subsequent Recovery.⁹
49. As Ms. Lohmeier testified, Realized Losses and Subsequent Recoveries “are two sides of the same coin” (*tr.* 1072:19-20), and industry experts Mr. Castro¹⁰ and Mr. Burnaman¹¹ agreed (*tr.* 3278:16-17, 3081:20-3082:17, 3096:20-3097:4, 3232:3-3233:22 [Castro]; *tr.* 2868:16-23 [Burnaman]).
50. According to Ms. Lohmeier,¹² the only way to write-up certificateholder Certificate Principal Balances is pursuant to the subsequent recovery write-up provision: “[i]n my experience reading the PSAs...the only way to write-up certificates after a realized loss is through a subsequent recovery. It’s the only mechanism I know of” (*tr.* at 906:1-4).
51. Although Mr. Varca¹³ testified that he argued that certificateholder Certificate Principal Balances could be written up through the Applied Realized Loss Amount definition and

⁹ As discussed below, US Bank also takes the position in another pending matter that the subsequent recovery provision of the pooling and servicing agreements is the only mechanism in the pooling and servicing agreements for the write-up of certificate principal balances.

¹⁰ Mr. Castro was qualified at trial as an expert in (i) RMBS industry custom and practice, (ii) RMBS structuring and (iii) the RMBS industry’s understanding of HAMP (*tr.* 3035:9-3064:21). Mr. Castro has experience in many aspects of the RMBS industry, including research, issuance, trading, investing and ratings (*tr.* 3002:3-3014:7).

¹¹ Mr. Burnaman was Wells Fargo’s industry expert, and he was qualified at trial as an expert in RMBS industry custom and practice (*tr.* 2862:17-2863:3).

¹² Ms. Lohmeier is a Wells Fargo employee responsible for providing detail, research and analysis for investor inquiries on, among other things, pooling and servicing agreements and remittance reports (*tr.* 907:23-911:19, 990:9-14, 1115:21-1119:5 and 1283:17-1285:9).

¹³ Mr. Varca was qualified as expert in (i) the RMBS industry custom and practice, (ii) the general expectations of RMBS industry participants as to RMBS performance and (iii) the structures, functions and purpose of RMBS transactions (*tr.* 2281:20-2291:25).

through the Unpaid Realized Loss Amount provision in the Excess Cashflow waterfall,¹⁴ the testimony was simply not credible and was otherwise inconsistent with both the structure and language of the At Issue PSAs, other experts' testimony at trial, what other trustees understand and general industry understanding (*tr.* 2749:5-14).

52. For starters, the definition of Certificate Principal Balance indicates that Certificate Principal Balances are **reduced not increased** based on Applied Realized Loss Amounts:

With respect to any Certificate (other than the Class B-IO Certificates or the Class R Certificates) as of any Distribution Date, the initial principal amount of such Certificate plus in the case of a Subordinate Certificates, any Subsequent Recoveries added to the Certificate Principal Balance of such Certificates pursuant to Section 6.02(b) hereof, *minus the sum* of (i) all amounts distributed on previous Distribution Dates on such Certificate with respect to principal and (ii) any Applied Realized Loss Amounts allocated to such Certificate on previous Distribution Dates. With respect to any such Class of Certificates, the Certificate Principal Balance thereof will equal the sum of the Certificate Principal Balances of all Certificates in such Class.

(VEC Doc. No. 540 at 4 [emphasis added]).

53. Additionally, the definition of Applied Realized Loss Amount is referred to in Section 6.02 (a) which is a provision for writing down certificate balances, not writing them up.

54. Thus, the Applied Realized Loss Amount definition does not provide a mechanism structurally or based on the plain language of Applied Realized Losses in the At Issue PSAs for writing up certificateholder Certificate Principal Balances.

¹⁴ Mr. Varca testified:

Q. Now, outside of these provisions we just discussed, I couldn't find anywhere in this PSA that references increasing the current principal amount of any certificates, senior or subordinate. Can you point to any provision in this PSA that uses that language?

A. Well, I maintain that the definition of current principal balance with the embedded definition of [applied] realized loss amount can be used to increase the balance of the certificates as well as the unpaid realized loss provision within the excess waterfall.

(*tr.* 2749:5-14).

55. Put another way, Mr. Varca argued that pursuant to the Applied Realized Loss Amount definition and its application in the At Issue PSAs, a negative number would result in a positive increase in certificateholder Certificate Principal Balance, but this is antithetical to the purpose and language of the Applied Realized Loss Amount definition.
56. As discussed above, the Applied Realized Loss Amount definition and application in the At Issue PSAs is designed to write down Certificate Principal Balances.¹⁵
57. In fact, other witnesses rejected Mr. Varca's argument about the application of Applied Realized Loss Amounts as a way to increase certificateholder Certificate Principal Balances.
58. By way of example, Mr. Castro testified that the Applied Realized Loss Amount definition is unrelated to write-ups:

Q. Mr. Castro, in your experience structuring deals where, if anywhere, does the applied realized loss definition tell you that certificates can be written up?

A. This definition has nothing to do [with] write-ups, this definition is strictly tied to 6.02(a), which is telling you how to write-down things. There is nothing in this definition that's even remotely related to a write-up. This is strictly about how you applied the realized losses, nothing more.

(tr. 3084:6-13).

59. Ultimately, Mr. Varca effectively conceded that the Subsequent Recovery write-up provision is the only provision in the At Issue PSAs as written that actually specifically provides for increasing certificateholder Certificate Principal Balances:

Q. And can you recall any language in any of the PSAs that you reviewed for this case other than Section 6.02(b) that talks about increasing the current principal amount of a certificate balance?

A. You're talking about specifically increasing the balance of the certificates.

Q. Correct.

...

¹⁵ As such, Mr. Varca's proposal would require the Court to reform substantial sections of the At Issue PSAs, relief that the senior certificateholders in this case have repeatedly forsworn (tr. 962:11-963:1 and 1975:20-1976:8).

A. Actual language, no.

(*tr.* 2750:1-7, 2752:17).

60. As to the use of the Excess Cashflow provision to write-up certificateholder Certificate Principal Balances based on the payment of previously deferred principal payments, this too was not supported by the language or structure of the At Issue PSAs themselves.

61. Excess Cashflow is defined as

[w]ith respect to any Distribution Date, the sum of (i) Remaining Excess Spread for such Distribution Date and (ii) Overcollateralization Release Amount for such Distribution Date; provided, however, that the Excess Cashflow shall include Principal Funds on and after the Distribution Date on which the aggregate Certificate Principal Balance of the Class A-1, Class M-1, Class M-2, Class B-1, Class B-2 and Class B-3 Certificates has been reduced to zero (other than Principal Funds otherwise distributed to the Holders of Class A-1, Class M-1, Class M-2, Class B-1, Class B-2 and Class B-3 Certificates on such Distribution Date).

(VEC Doc. No. 540 at 10).

62. The Subsequent Recovery provision (generally 6.02 [b])¹⁶ and paying off losses in the Excess Cashflow waterfall are different sections of the contract (*tr.* 2682:2-7).

¹⁶ By way of example, the Subsequent Recovery provision can be found in the Bear Stearns ARM Trust 2005-4 PSA, dated June 1, 2005 in Section 6.02(h) which provides:

(h) In addition, in the event that the Master Servicer receives any Subsequent Recoveries from a Servicer, the Master Servicer shall deposit such funds into the Master Servicer Collection Account pursuant to Section 4.02. If, after taking into account such Subsequent Recoveries, the amount of a Realized Loss is reduced, the amount of such Subsequent Recoveries will be applied to increase the Current Principal Amount of the Class of Subordinate Certificates with the highest payment priority to which Realized Losses have been allocated, but not by more than the amount of Realized Losses previously allocated to that Class of Subordinate Certificates pursuant to this Section 6.02. The amount of any remaining Subsequent Recoveries will be applied to sequentially increase the Current Principal Amount of the Subordinate Certificates, beginning with the Class of Subordinate Certificates with the next highest payment priority, up to the amount of such Realized Losses previously allocated to such Class of Certificates pursuant to this Section 6.02. Holders of such Certificates will not be entitled to any payment in respect of current interest on the amount of such increases for any Interest Accrual Period preceding the Distribution Date on which such increase occurs. Any such increases shall be applied to the Current Principal Amount of each Subordinate Certificate of such Class in accordance with its respective Fractional Undivided Interest.

(VEC Doc. No. 548 § 6.02 [h]).

63. Subsequent Recoveries are allocated to write-up bonds before distributions. Distributions of principal and interest then occur pursuant to the regular part of the waterfall. After that, Unpaid Realized Loss Amounts are potentially paid through Excess Cashflow. (*tr.* 2683:10-19).

64. Unpaid Realized Loss Amount is defined as

[w]ith respect to any Distribution Date and a Class of Offered Certificates and the Class B-3 Certificates, is the excess of (i) Applied Realized Loss Amounts allocated to such Class over (ii) the sum of all distributions to such Class in reduction of such Applied Realized Loss Amounts on all previous Distribution Dates.

(VEC Doc. No. 540 at 33).

65. Excess Cashflow comes from remaining Excess Spread and Overcollateralization Release Amounts (*tr.* 2683:20-2684:2).

66. Excess Spread is defined as

[w]ith respect to any Distribution Date, the excess, if any, of (i) the Interest Funds for such Distribution Date over (ii) the sum of the Current Interest on the Offered Certificates and the Class B-3 Certificates and Interest Carry Forward Amounts on the Class A Certificates, in each case for such Distribution Date.

(VEC Doc. No. 540 at 11).

67. Overcollateralization Release Amount is defined as

[w]ith respect to any Distribution Date is the lesser of (x) the sum of the amounts described in clauses (a) through (e) and (g) in the definition of Principal Funds for such Distribution Date and (y) the excess, if any, of (i) the Overcollateralization Amount for such Distribution Date (assuming that 100% of such Principal Funds is applied as a principal payment on such Distribution Date) over (ii) the Overcollateralization Target Amount for such Distribution Date (with the amount pursuant to clause (y) deemed to be \$0 if the Overcollateralization Amount is less than or equal to the Overcollateralization Target Amount on that Distribution Date).

(VEC Doc. No. 540 at 19).

68. For there to be Remaining Excess Spread, there had to have been Excess Spread in the first instance (*tr.* 2686:6-8).
69. Excess Spread first is to pay an extra principal distribution amount which increases overcollateralization by paying down principal balances of the outstanding bonds without reducing the balances of the loans (*tr.* 2686:9-19).
70. What remains is Excess Spread (*tr.* 2686:20-22).
71. Remaining Excess Spread is defined in the PSAs as “[w]ith respect to any Distribution Date, the excess of the related Excess Spread over the related Extra Principal Distribution Amount” (VEC Doc. No. 540 at 23).
72. Overcollateralization protects both senior and subordinate certificateholders (*tr.* 2686:23-2687:1).
73. Remaining Excess Spread (if any) pays into the Excess Cashflow waterfall (*tr.* 2687:2-4).
74. But for there to be any Remaining Excess Spread, the Overcollateralization Target Amount must be reached (*tr.* 2687:5-7).
75. The Overcollateralization Target Amount is defined as
- [w]ith respect to any Distribution Date (a) prior to the Stepdown Date, \$4,471,937, (b) on or after the Stepdown Date and if a Trigger Event is not in effect, the greater of (i) the lesser of (1) \$4,471,937 and (2) 1.10% of the then current aggregate Stated Principal Balance of the Mortgage Loans as of such Distribution Date and (ii) \$4,065,398 and (c) on or after the Stepdown Date and if a Trigger Event is in effect, the Overcollateralization Target Amount for the immediately preceding Distribution Date.
- (VEC Doc. No. 540 at 19).
76. If there is not Excess Spread to pay down as extra principal to create Overcollateralization, there will never be Excess Spread that pays Excess Cashflow.

77. As long as the Overcollateralization Release Amount is below the Overcollateralization Target Amount, there can never be Excess Spread (*tr.* 2687:17-20).
78. Excess Spread comes from interest funds as the difference between the interest from the collateral and the interest due on the bonds less the servicing fee (*tr.* 2687:21-2688:3).
79. The payment of previously deferred principal payments are the payments of principal not interest (*tr.* 2688:5-14).
80. Thus, principal can only be applied through the Excess Cashflow waterfall as an Overcollateralization Release Amount and principal includes Subsequent Recoveries (*tr.* 2688:15-2692:7).
81. These principal amounts pay down Certificate Principal Balances (*tr.* 2692:9-12).
82. The only way that principal can flow into the Excess Cashflow funds is if there is excess overcollateralization (*tr.* 2693:9-15).
83. The Appellate Division held that you can not include unpaid deferred principal balances in the Overcollateralization Amount calculation (*Wells Fargo Bank v Aegon USA Inv. Mgt., LLC*, 198 AD3d 156, 164 [1st Dept 2021]).
84. The Excess Cashflow waterfall can therefore not be used to write-up certificateholder Certificate Principal Balances.
85. Indeed, in a parallel case (Index No. 656028/2021),¹⁷ U.S. Bank National Association (**US Bank**), another trustee, filed papers indicating that it too was of the view that the

¹⁷ In that proceeding, US Bank seeks judicial instruction regarding whether it should continue its practice as to certain trusts where it does not treat the payment of previously deferred principal payments as Subsequent Recoveries. Although the PSAs in that case may provide for write-ups of other classes of certificateholders and not just subordinate certificateholders, upon cursory review of the PSAs at issue in that case, they appear to be substantially similar to the At Issue PSAs and in fact reflect the same conceptual understandings that the experts testified to in this proceeding. As to the PSAs which include servicer modifications in the definition of Subsequent Recoveries, it appears US Bank treats the payment of previously deferred principal in those trusts as Subsequent Recoveries.

only way to write-up Certificate Principal Balances was pursuant to the Subsequent Recovery write-up provision:

17. But, the Governing Agreements for the vast majority of the Subject Trusts do not define Subsequent Recoveries to include amounts collected that relate to Deferred Principal Amounts or previously reported losses resulting from loan modifications. *See id.* And, ***Subsequent Recoveries are the only designated amounts for which write-ups may be applied under the Governing Agreements—i.e., if an amount is not a Subsequent Recovery, there is no express mechanism requiring the application of a write-up for such amount.*** Consistent with these aspects of the Governing Agreements for such Subject Trusts, Petitioners do not treat Deferred Principal Collections as Subsequent Recoveries, and do not apply write-ups to the Primary Classes when Deferred Principal Collections are distributed. There are, however, four Subject Trusts where the Governing Agreements are slightly different with respect to this issue: (i) three of the Subject Trusts have a definition of Subsequent Recoveries that includes “amounts received” with respect to “a Mortgage Loan that has been modified which resulted in a Realized Loss,” and (ii) one Subject Trust has no reference to Subsequent Recoveries. See Exhibit G (Subsequent Recovery Concepts for the Subject Trusts). In total, then, sixty-two of the sixty-six Subject Trusts do not define Subsequent Recoveries to include collections stemming from modification-related realized losses, such as Deferred Principal Collections. *See id.*

(VEC Doc. No. 290 ¶ 17 [emphasis added]).

86. HBK also agrees that the only way to write-up Certificate Principal Balances is pursuant to the subsequent recovery provision (NYSCEF Doc. No. 1112 at 5).

87. Under the At Issue PSAs, a Subsequent Recovery can only be allocated pursuant to amounts received in respect of a Liquidated Mortgage Loan or the disposition of an REO Property.

88. REO Property is defined as “[a] Mortgaged Property acquired in the name of the Trustee, for the benefit of Certificateholders, by foreclosure or deed-in-lieu of foreclosure in connection with a defaulted Mortgage Loan” (VEC Doc. No. 540 at 28).

89. The At Issue PSAs provide that Subsequent Recoveries must be written up for subordinate certificateholders not senior certificateholders:

(b) In addition, in the event that the Master Servicer receives any Subsequent Recoveries from the Servicer, the Master Servicer shall deposit such funds into the Master Servicer Collection Account pursuant to Section 4.01(c)(ii). If, after taking into account such Subsequent Recoveries, the amount of a Realized Loss is reduced, the amount of such Subsequent Recoveries will be applied to increase the Certificate Principal Balance of the Class of Subordinate Certificates with the highest payment priority to which Applied Realized Loss Amounts have been allocated, but not by more than the amount of Applied Realized Loss Amounts previously allocated to that Class of Subordinate Certificates. The amount of any remaining Subsequent Recoveries will be applied to sequentially increase the Certificate Principal Balance of the Subordinate Certificates, beginning with the Class of Subordinate Certificates with the next highest payment priority, up to the amount of such Applied Realized Loss Amounts previously allocated to such Class or Classes of Certificates. Holders of such Certificates will not be entitled to any payments in respect of Current Interest on the amount of such increases for any Interest Accrual Period preceding the Distribution Date on which such increase occurs. Any such increases shall be applied to the Certificate Principal Balance of each Subordinate Certificate of such Class in accordance with its respective Fractional Undivided Interest.

(VEC Doc. No. 540 § 6.02 [b]).

90. Mr. Varca testified that the writing up of subordinate Certificate Principal Balances protects senior certificateholders from future losses and is consistent with the subordination structure of the deals:

Q. So when the trustee writes up subordinate bonds from subsequent recoveries, it is increasing credit enhancement before it reimburses the senior bonds for the past losses of the excess cash in the waterfall, right, as it is now?

A. I think I do, but would you remind repeating that question.

Q. Yes. So right now, when the trustee is writing up subordinate bonds, it's not paying down seniors past losses through the excess cash flow waterfall necessarily, right?

A. Right.

Q. And so when it does that, it is building credit enhancement before reimbursing seniors from past losses?

...

A. Yeah, I agree that it's building subordination.

That's the last part of that before --

Q. Yeah. So, you -- What you want or what you suggested that should happen is that the seniors should be reimbursed for past losses before subordinates get written up, right?

A. Yes.

Q. Okay. What's happening now is the subordinates are getting written up before the seniors get reimbursed for past losses?

A. That's true, yes.

Q. And I think we established that when subordinates get written up, that builds credit enhancement?

A. It does.

Q. So it necessarily follows them that what Wells Fargo is doing now is building credit enhancement against future losses before it pays down seniors to reimburse past losses?

A. That's what it's doing now, yes.¹⁸

(tr. 2713:24-2715:15).

91. In a case captioned *Wells Fargo Bank v Aegon USA Inv. Mgt., LLC* (the **JPM Action**), the parties stipulated that certain settlement amounts should be treated as a Subsequent Recovery (198 AD3d 156, 161 [1st Dept 2021]).
92. The Appellate Division in the JPM Action held that the Subsequent Recovery write-up provision generally set forth in Section 6.02 (b) is not ambiguous and requires the write-up of subordinate certificateholder Certificate Principal Balances, not senior certificateholder Certificate Principal Balances:

When an investor buys a certificate in an RMBS trust, the investor is in effect acquiring the right to receive some portion of repayment of the principal and interest on the underlying mortgages... The governing agreements also set forth when and how a certificate principal balance may be increased, or "written up," upon receipt of funds other than principal and interest payments, typically when the trust acquires additional funds to offset prior losses... The court correctly found that where the governing agreements provide only for the write up of subordinate certificates—conspicuously excluding senior certificates from the write-up instructions—the plain and unambiguous intent is that only subordinate certificates will be written up... The subordinate write-up provisions, however, are not in fact silent as to senior certificates; by purposefully omitting the write up of senior certificates from these provisions, the drafters clearly intended to express that only subordinate certificates are to be written up... Where the drafters intended the parties to write up senior certificates, the governing agreements expressly so state... The only explanation for the exclusion of such language from the write-up provisions was the parties' intent to limit the write up to subordinate

¹⁸ The subordination *structure of the deals*, including the purpose and intent of the At Issue PSAs to protect senior certificateholders from future losses is advanced by treating HAMP modifications at the time of repayment as a Subsequent Recovery.

certificates...[W]hile the Realized Loss definition provides for the allocation of losses to reduce certificate balances . . . including senior certificates, the definition does not address the write-up of balances of certificates to account for subsequent recoveries...(2020 NY Slip Op 30453[U], *33)...The court was correct not to consider extrinsic evidence because the subordinate write-up provisions unambiguously provide for the write up of only subordinate certificates. Extrinsic evidence of a contract's meaning should only be considered if the contract is ambiguous ...The court correctly found, with respect to the BSABS 2005-AQ2 Trust and, by extension, the HBK Trusts, that the relevant governing agreements require the trustees to apply the write-up-first methodology. Because, by the plain language of the governing agreements, no distributions of principal can be made under the waterfall provisions without reference to the Certificate Principal Balance, and because the Certificate Principal Balance is defined to include subsequent recoveries added to the Certificate Principal Balance pursuant to section 5.04 (b) "as of" any distribution date, the write-up-first order of operations must necessarily apply...The trustees' concern about the potential for the pay-first method to cause trusts with an overcollateralization structure to be temporarily overcollateralized is irrelevant, given the court's ruling that the write-up-first method applies. As even HBK acknowledges, the court's interpretation of the overcollateralization [sic] amount definition is of no consequence to trusts following the write-up-first method.

(*id.* at 160-164).

93. Mr. Castro testified that certificateholders would understand and expect the trustee to apply the At Issue PSAs unambiguous provisions as drafted (*tr.* 3458:4-18).
94. Mr. Castro also testified that certificateholders would look to the At Issue PSAs as to their understanding and expectation for how Certificate Principal Balances would be written up in respect of a prior Realized Loss (*tr.* 3462:13-20).
95. As discussed above, the evidence adduced at trial established that the industry understanding is that recoveries are expected to be *de minimis* amounts.
96. Mr. Varca testified that recoveries are generally understood to be *de minimis* amounts because when a Realized Loss has occurred, per the pooling and servicing agreements, it is pursuant to a Bankruptcy Loss, Liquidated Mortgage Loan or extinguishment of an

obligation to pay interest or principal pursuant to a modification (*tr.* 2372:18-2373:5 and 2663:12-23).¹⁹

97. As Mr. Varca testified:

- Q. So your testimony is that --
Well, prior to HAMP subsequent recovery amounts were de minimis?
- A. Yes.
- Q. So it's your testimony that subsequent recovery provisions didn't matter?
- A. I wouldn't say that they didn't matter. I mean, they mattered, however, it wasn't assumed that they would be big dollar amounts.

(*tr.* 2663:12-20).

98. As Mr. Castro testified, at the time it is determined that there is a Realized Loss, there is no future expectation of receipt of funds in respect of the amounts of such Realized Loss:

- Q. ... In your experience, when a servicer reports a loss, what if anything have they determined regarding whether there is an expectation of recovery of that loss?
- A. When they report the loss initially, their view is that there's no more cash flows coming in on what they have liquidated, so they're not expecting any additional payments.

(*tr.* 3203:6-12).

Financial Crisis

99. In 2007 there was an unanticipated financial crisis that rocked the housing market.

100. There was a substantial number of defaults each month among homeowners on their home mortgage loans (VEC Doc. No. 1515 at 2).

101. In 2008, Chairman of the Federal Deposit Insurance Company (the **FDIC**), Sheila Bair stated in the FDIC's IndyMac Bank (**IndyMac**) loan modification program manual that

¹⁹ In fact, given this view, and as discussed below, the relevant time to view the value of any recovery is at the time of the HAMP (hereinafter defined) modification not at a later date (*i.e.*, not 2022).

6.4 million loans were currently past due or projected to become delinquent by mid-2010 (VEC Doc. No. 1515 at 2).

102. Even after the government responded by promulgating HAMP, in July 2013, the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) reported to Congress that “[w]hile HAMP has helped about 865,000 homeowners avoid foreclosure through permanent mortgage modifications, more than 306,000 homeowners have redefaulted out of the program—often into a less advantageous private sector modification or even worse, into foreclosure” (VEC Doc. No. 1541 at 161).

103. The At Issue PSAs were executed prior to that time period (*i.e.*, from 2005-2007) and as such did not and could not have anticipated this event or any United States Treasury Department (**Treasury**) response.

104. Ultimately, the federal government did respond to try to keep homeowners in their homes.

The Federal Government’s Response in IndyMac

105. During the financial crisis, the government and the RMBS industry as a whole were grappling with how to address the substantial magnitude of mortgage loan defaults occurring at the time.

106. After IndyMac collapsed (*tr.* 517:17-22), the FDIC responded by providing for certain modifications to IndyMac loans (VEC Doc. No. 1515).

107. IndyMac loan modifications included principal forbearance and bifurcation of the loans into an interest portion (at a reduced rate) and a non-interest-bearing portion (VEC Doc. No. 1515).

108. Pursuant to the IndyMac loan modification program, principal forbearance was treated as a write-off and any future payment of the deferred principal was treated as a “recovery.”²⁰

3) Partial Principal Forbearance: Reduce the adjusted UPB for amortization purposes and amortize over a 40 year period at the reduced interest rate (3 percent floor). This process splits the debt into an interest-bearing, amortizing portion and a zero percent, zero payment portion of the loan. The repayment of the "postponed" principal will be due when the loan is paid in full. ***For loans within securitizations, this principal forbearance should be passed as a write-off of principal to the trust, with any future collections at time of pay-off submitted to the trust as a recovery.***

(VEC Doc. No. 1515 at 9 [emphasis added]).

109. As discussed above, recovery means principal recovery and/or Subsequent Recovery.

The Home Affordable Modification Program (HAMP)

110. On April 6, 2009, Treasury promulgated HAMP to help homeowners stay in their homes by reducing the cost of their home loan obligations.

111. Pursuant to a proper HAMP modification, certain principal payments were deferred and removed from the amortization schedule and the obligation to pay interest on such forborne principal was permanently extinguished (VEC Doc. No. 1537 § 6.3.4; *tr.* 1765:21-25 and 3096:4-15). To wit, loans were bifurcated into a non-interest-bearing amount as to the forborne principal which had been removed from the amortization

²⁰ Ms. Lohmeier, Mr. Akers and Mr. Castro testified that “recovery,” “principal recovery” and “subsequent recovery” are all used interchangeably in the industry (*tr.* 1062:12-15, 563:23-25, 757:14-17 and 3071:16-19). Indeed, the June 2009 ASF white paper, discussed below, stated that “[a]lthough definitions vary, a recovery is a fairly universal concept that generally refers to an amount received in respect of principal which has previously been allocated as a realized loss” (VEC 1315 at 7). Mr. Akers is a Wells Fargo/Computershare employee and was a key participant in discussions with industry groups including ASF (hereinafter defined) and Treasury (hereinafter defined) during 2009-2010 on behalf of Wells Fargo (*tr.* 514:23-515:20, 522:17-523:3, 527:5-528:13, 541:15-542:18 and 558:23-559:2). He also helped shape Wells Fargo’s internal policies regarding the treatment of deferred principal (*id.*; *tr.* 602:5-603:10).

schedule and an interest-bearing amount as to amounts of principal which were not deferred under HAMP.

112. The obligation to pay the interest as to the forborne principal was extinguished (*tr.* 1765:21-25 and 3096:4-15).
113. The American Securitization Forum (the **ASF**) was a group of 315 market participants, including institutional investors, primary servicers, master servicers, trustees and securities administrators (*tr.* 3015:10-20).
114. On June 18, 2009, the ASF released a white paper titled “Discussion Paper on the Impact of Forborne Principal on RMBS Transactions” (VEC Doc. No. 597).²¹
115. Although it is not clear which individual organizations were directly included in the views presented and attributed to them in certain documents produced by the ASF, the ASF’s white paper indicated certain general views which were identified and attributed to different classes of certificateholders as to how forborne (adjusted) principal and interest extinguished or settled should be treated and accounted for under HAMP.
116. The position attributed to senior certificateholders was that it should be treated as a Realized Loss so that Certificate Principal Balances of subordinate certificateholders would be written down first pursuant to the pooling and servicing agreements (VEC Doc. No. 597 at 9-11).²²

²¹ According to Mr. Siegert, the principal drafter of the ASF white paper (*tr.* 1817:2-6), the white paper was a comprehensive effort by the leading industry association to address deferred principal in securitizations, distinguishing between areas of consensus and disagreement (*tr.* 1817:4-1819:15).

²² “Their view stems partly from the fact that, because forborne principal does not accrue interest and is not scheduled to be repaid until the loan’s maturity date, its net economic value to the trust is extremely low, similar to principal forgiveness. The interest cash flow on the forborne principal have been liquidated permanently, and the principal balance has been converted from an amortizing payment stream to an uncertain potential recovery at the maturity of the loan...” (VEC Doc. No. 597 at 9).

117. The ASF white paper indicates that certain subordinate certificateholders were of a different view (*id.* at 11) presumably because they did not want losses allocated to them as their Certificate Principal Balances could be entirely wiped out.
118. On December 19, 2009, the ASF wrote to Treasury recommending the senior certificateholders' view that Treasury should enable the industry to allocate forborne principal under HAMP as a Realized Loss in securitization trusts (VEC Doc. No. 1337).
119. Treasury ultimately adopted the view attributed to senior certificateholders in the ASF white paper and promulgated in HAMP that deferred principal and the extinguished obligation to pay interest in respect of such forborne principal should be treated as a Realized Loss by servicers.
120. To address industry concern over potential lawsuit exposure in following HAMP, Treasury promulgated certain HAMP guidance in the form of Supplemental Directives and responses to Frequently Asked Questions (FAQs) and created a legal safe harbor and new industry standard.²³
121. Supplemental Directive 10-05 (SD 10-05) was one of those supplemental directives. SD 10-05 provides, in relevant part:
- when a mortgage loan within a securitization vehicle is modified under HAMP, the following parties will take the respective actions:
- (i) the servicer must report to the trustee or securities administrator any forborne principal as a realized loss;
 - (ii) the trustee or securities administrator must allocate any such reported forborne principal as a realized loss to the trust; and
 - (iii) the servicer must act consistent with the presumption that such allocation has occurred, and may conclusively rely that it has
- (VEC Doc. No. 1516 at 10).

²³ Mr. Akers testified that he did not believe Wells Fargo thought a safe harbor was necessary to apply deferred principal as a Subsequent Recovery once it had been applied as a Realized Loss (*tr.* 825:13-16).

122. SD 10-05 Footnote 2 provides:

The reported forbore principal should be allocated as a realized loss such that, for purposes of calculating distributions to securityholders, such forbore amount is no longer outstanding under the amortization schedule applicable to the related mortgage loan.

(*id.*).

123. Although Ms. Johnson-Kutch²⁴ indicated that she did not rely on ASF in her role at Treasury in her role in drafting SD 10-05, the language appears to be substantially similar if not identical to the ASF letter language:

- (i) the primary servicer shall report to the securities administrator any forbore principal as a realized loss
 - (ii) the securities administrator shall allocate any such reported forbore principal as a realized loss to the trust
- [T]he primary servicer shall presumptively rely that such allocation has occurred

(VEC Doc. No. 1337 at 2).

124. Q26 was one of the FAQs. It provides:

Q26. Does the earlier FDIC guidance on accounting treatment of principal forbearance apply under HAMP?

Yes. For loans within securitizations, principal forbearance should be passed through as a write-off of principal to the securitization trust, unless directed otherwise by the applicable pooling and servicing agreement or trust agreement, with any future collections at the time of pay-off submitted to the trust as a principal recovery.

(VEC Doc. No. 1517 at 8).

125. Q32 was another FAQ. It provides:

Q32. If a borrower with principal forbearance makes a substantial principal curtailment that is greater than or equal to the interest-bearing unpaid principal balance (UPB), should the curtailment be applied to the interest bearing principal or the principal forbearance portion?

²⁴ Ms. Johnson-Kutch was a Treasury policy analyst from 2009-2012 and the “secondary” drafter of SD 10-05 (*tr.* 1733:6-14). She left Treasury in 2012 and returned in a more senior role in 2013 (*tr.* 1535:10-1538:14).

The curtailment should be applied to the principal forbearance portion. This policy eliminates the possibility of a curtailment paying off (and satisfying) the interest-bearing portion of the UPB (the entire loan would become due and payable at that point), thereby forcing the borrower to pay off the principal forbearance portion of the loan balance. In those instances, to avoid that negative result, the curtailment must be applied to the principal forbearance amount. Any remaining funds would be applied to the interest-bearing UPB.

(VEC Doc. No. 225 at 9).

126. Q33 revised Q26 and provides:

Q33. REVISED Does the earlier FDIC guidance on accounting treatment of principal forbearance apply under HAMP?

Yes. For loans within securitizations, servicers, securities administrators and other transaction parties should treat HAMP principal forbearance amounts as realized losses as of the applicable loan modification dates under any applicable securitization pooling or trust agreement. The only exception to that principle is that servicers and securities administrators are permitted not to treat HAMP principal forbearance amounts as realized losses if, and only if, (i) the applicable securitization pooling or trust agreement specifically addresses principal forbearance in the HAMP context (*i.e.*, it includes the permanent forgiveness of interest and postponement of principal repayment for a long period, as described below) and (ii) such agreement explicitly and affirmatively directs that such forborne principal not be treated as a realized loss.

For the avoidance of doubt, “principal forbearance” in the context of HAMP is non-interest bearing and non-amortizing. Securitization pooling or trust agreements often use the term “principal forbearance” in a context which only requires delaying of the date on which certain payments of principal are due for short periods; interest typically continues to accrue and is required to be capitalized. For HAMP, not only must principal forbearance delay the date in which such forborne principal is due to maturity sale or payoff, but no interest may accrue on such forborne amounts.

(VEC Doc. No. 225 at 9).

127. Ultimately the Supplemental Directives and FAQs were compiled and subsumed in a handbook (the **HAMP Handbook**; VEC Doc. No. 1537).

128. Pursuant to HAMP guidance, Treasury directed the industry to treat forbore principal as a Realized Loss and created a safe harbor such that if trustees and servicers followed the guidance, they would be compliant with standard industry practice.²⁵

129. The HAMP safe harbor provides:

HFSTHA also states that qualified loss mitigation plan guidelines issued by Treasury under the Emergency Economic Stabilization Act of 2008 (EESA) shall constitute standard industry practice for purposes of all Federal and State laws. The qualified loss mitigation plan guidelines issued by Treasury under EESA include this Handbook. Accordingly, actions described in clauses (i) through (iii) above, when taken by a servicer pursuant to this Handbook, shall constitute “standard industry practice” within the meaning of the Servicer Safe Harbor, and, when taken by any other person pursuant to this Handbook, including a trustee or securities administrator under a securitization pooling or trust agreement, shall constitute “cooperation of such person with a servicer when such cooperation is necessary for the servicer to implement a qualified loss mitigation plan” within the meaning of the Servicer Safe Harbor.

(VEC Doc. No. 1209 § 6.6.2).

130. As discussed above, pooling and servicing agreements provide that a Realized Loss is pursuant to a Liquidated Mortgage Loan, Bankruptcy Loss or an extinguishment of an obligation to pay interest or principal pursuant to a servicer modification.

131. Having directed that the servicer and trustee treat HAMP modifications as a Realized Loss, Treasury indicated that the definitional requirements of Realized Loss set forth in pooling and servicing agreements for what constitutes a Realized Loss was satisfied.

132. HAMP guidance did not erase prior industry custom or guidance, including the IndyMac program guidance discussed above.

²⁵ The 2019 HAMP Handbook indicates that “Treasury is not providing guidance on how funds are to be passed through to security holders of securitization trusts” (VEC Doc. No. 1209 at 154).

133. HAMP did not directly address whether the payment of previously deferred principal and the extinguished interest in respect of such previously deferred principal should be treated as a Subsequent Recovery (*tr.* 1775:11-15 and 1775:20-1776:9).

134. As Ms. Johnson-Kutch testified, HAMP did not seek to replace previous guidance as to the payment of forbore principal later received except that it did not supersede prior custom and practice and other directives as to the treatment of the receipt of forbore principal. This, according to Ms. Johnson-Kutch would be covered by industry practice:

- Q. Okay. Now, and I believe, this should not be controversial, but I just want to be very clear, this guidance does not direct how the borrowers' payments of forbore principal should be applied when that forbore principal is repaid, right?
- A. So although not stated in the guidance, industry practice would -- would -- is implied through the rest of the guidance that says to the extent we don't address it, follow industry practice.
- Q. But the language does not direct how the borrowers' payments should be applied when the forbearance is repaid, correct?
- A. No, because it's not part of this section.
- Q. It does not direct or it does direct? Your no is confusing to me.
- A. So that language, it's not part of this guidance. It's not stated in here because we did not feel that we needed to go that extra step to say how it needed to be done. So there was an understanding that there was an industry practice that related to this that HAMP did not intend to disrupt.

(*tr.* 1775:11-15, 1775:20-1776:9).

135. As discussed above, prior guidance under the FDIC IndyMac program was to treat the recovery of previously deferred principal as a "recovery" (VEC Doc. No. 1515 at 9).

136. As discussed above, recovery means Subsequent Recovery (*tr.* 1062:12-15, 563:23-25, 757:14-17 and 3071:16-19; VEC Doc. No. 1315 at 7).

137. This made sense because at the time of the HAMP modification and consistent with industry understanding, future defaults were anticipated and the value of the deferred

principal was estimated to be approximately 12-13 cents on the dollar – *i.e., de minimis* (*tr.* 616:22-617:1).²⁶

Treasury’s determination that HAMP Modifications resulted in a Realized Loss was consistent with Market Expectations and otherwise made sense because the modified Loans were partially liquidated.

138. As discussed above, Realized Losses under the At Issue PSAs are either Bankruptcy Losses, losses from Liquidated Mortgage Loans or amounts forgiven pursuant to a servicing modification.

139. Although homeowners remained contractually obligated to pay the deferred principal (*tr.* 2980:23-2981:23), the time at which the loans would be paid could be extended for significant periods of time (up to 40 years) (*tr.* 1706:19-23).

140. The obligation to pay interest in respect of the forbore principal during this lengthy extension was entirely extinguished, and the industry understanding was that the forbore principal was worth pennies on the dollar as massive defaults were occurring and were

²⁶ Previously, the Appellate Division found ambiguity as to whether deferred principal and extinguished interest in respect of that deferred principal was a Subsequent Recovery. As such, the term is subject to more than one reasonable interpretation (*RM Realty Holdings Corp. v Moore*, 64 AD3d 434, 436 [1st Dept 2009] [“A written agreement is ambiguous only if it is *reasonably* susceptible of more than one interpretation”]; *Alexander & Alexander Services, Inc. v These Certain Underwriters at Lloyd’s, London, England*, 136 F3d 82, 86 [2d Cir 1998] [“Ambiguity with respect to the meaning of contract terms can arise either from the language itself or from inferences that can be drawn from this language.”]). As discussed above, the At Issue PSAs do not define “liquidated” or “liquidation” such that their ordinary meaning should be considered (*Consol. Rest. Operations, Inc. v Westport Ins. Corp.*, 205 AD3d 76, 81 [1st Dept 2022]). Liquidate means to settle, adjust or extinguish an obligation or debt. This is precisely what a HAMP modification did. It deferred principal and extinguished the interest obligation in respect of the deferred principal thus adjusting and settling that debt obligation. In fact, several of the At Issue PSAs expressly refer to “complete and partial liquidations” in the definition of Liquidation Proceeds (*see e.g.*, VEC Doc. Nos. 1110, 550 and 577) and the Subsequent Recovery definition simply says “after liquidation” which necessarily includes both complete and partial liquidations.

expected to reoccur at very high rates (46% for 2009 modifications and 38% for 2010 modifications) (VEC Doc. No. 1541 [SIGTARP] at 3).²⁷

141. As Mr. Brehm²⁸ confirmed, when servicers reported the extinguished interest and deferred principal as a Realized Loss, they did not expect repayment (*tr.* 173:2-6).

142. As discussed above, this bifurcation between an interest-bearing portion of the loan and a non-interest-bearing portion of the loan (*i.e.*, the obligation to pay interest in respect of such forbore amount entirely extinguished) which included an expectation that the deferred principal amounts were worth pennies on the dollar resulted in a partial liquidation of the loan.²⁹

²⁷ Although Mr. Hilfer, who was qualified as an expert at trial in (i) quantitative analysis of RMBS reporting data and (ii) valuation of mortgage loans (*tr.* 1862:16-1882:21), provided a valuation as of 2022, he did not provide any analysis of the value or expected value of the time of the HAMP modification – *i.e.*, the time when Treasury determined that the HAMP modification of the deferred principal and extinguished obligation to pay interest in respect of such forbore principal should be treated as a Realized Loss. His valuation indicated that despite evidence that contemporaneous expectation was that the payments to be received would be *de minimis*, in actuality and based on other unanticipated events including an increase in home values in later years, that amounts received exceeded expectations from the time in which Treasury indicated that servicers and trustees should treat these amounts as Realized Losses. Put another way, the determination as to whether something qualifies as a Realized Loss requires judgment that any monies received in a subsequent period is expected to be of *de minimis* value. This is when the Certificate Principal Balance is written down. Thus, the relevant time period for determining whether money that might be received would be a Subsequent Recovery is at the time when the Realized Loss determination is made and allocated to reduce the Certificate Principal Balance. The fact that in later periods and based on unseen and unanticipated events, monies received or “recoveries” turn out to beat prior expectations made at the time of the Realized Loss determination does not change the character of that money from being a Subsequent Recovery.

²⁸ Mr. Brehm is a Wells Fargo/Computershare employee who served as Wells Fargo’s corporate representative during discovery.

²⁹ As discussed above, it is entirely irrelevant that the previously drafted At Issue PSAs do not include a definition of partial liquidation because as discussed above Treasury made the determination that the definition of Realized Loss was satisfied and directed trustees and servicers to treat HAMP modified amounts as Realized Losses. Although Mr. Aronoff testified that there must be a transfer of property for a liquidation to occur, this was not credible because, among other things, the sole document he cited, contradicted his position (*tr.* 2237:14-2240:20; VEC Doc. No. 73 [Fannie Mae Servicing Guide] at 692). Additionally, Mr. Castro disagreed with Mr. Aronoff’s view:

Q Are you familiar that Mr. Aronoff testified that in order to have a liquidation, there needed to be a transfer of the property?

A Yes.

Q And do you agree with him?

A No. He is wrong.

Q Why do you believe he is wrong?

A Well, there’s a lot of ways you can have a liquidation. I mean I don’t know if I can go through all of them. You can have a foreclosure; you can have a deed in lieu foreclosure;

you can have a short sale; you can have a bankruptcy; *you could have something called a charge-off. And sometimes it gets charged off and the property stays with the owner.* And I know the next question is, well, why would they do that? Well, if the property was damaged or if they had to spend a lot of money to fix the property up to resell it, I have seen plenty of times where they just said, you know, we're not going to do that. We're just writing it off. So sometimes they write it off and there is no transfer of ownership. That can happen. It does happen.

(tr. 3203:17-3204:13 [emphasis added]). Additionally, on August 13, 2009, The Investor Committee of ASF, which Mr. Castro was a member of which he testified included membership from senior investors, including PIMCO and a smaller group of subordinate investors, released a white paper titled "Mortgage Investors Endorse Treasury Department's Guidance on Accounting Treatment of Forborne Principal" (VEC Doc. No. 597 at WF-00014132). Notably, the paper states:

Because the interest cashflows on forborne amounts have been liquidated, the Investor Committee believes that forborne principal should be treated as a partial liquidation of the mortgage loan. In pooling and servicing agreements ("PSAs"), the term "realized loss" is generally defined by reference to a "liquidated mortgage loan". The definition of "liquidated mortgage loan" is open to interpretation because the terms "liquidate," "liquidated" and "liquidation," which are used in the definition, are generally not defined in the PSAs. *The Investor Committee believes that the absence of definitions for these terms means that the realized loss definitions contained in PSAs can and should be construed to include forborne principal.* The following definitions of "liquidate," "liquidated" contained in Black's Law Dictionary support this proposition: "[t]o settle (an obligation) by payment or other adjustment; to extinguish (a debt)," "[t]o ascertain the precise amount of (debt, damages, etc.) by litigation or agreement," "to adjust or settle a debt," "[o]f an amount of debt) settled or determined, esp. by agreement" and "the act or process of settling or making clear, fixed, and determinate that which before was uncertain or unascertained." *This approach is consistent with the purpose underlying the concept of subordination in securitization (i.e. that losses are allocated from the bottom up to protect senior holders).*

(id. at WF-00014133 [emphasis added]). As Mr. Akers testified, "Q. And why did you believe that they were partially liquidated? A. The concept of realized loss ties directly to a liquidated loan. The servicer is making that determination on the principal forbearance amount to treat it as a realized loss. **Realized loss ties to liquidation so that those two are tied together**" (tr. 598:10-16 [emphasis added]). Ms. Lohmeier also agreed with this view:

- Q. More specifically, it refers to, "A mortgage loan as to which the servicer has determined that all amounts it expects to recover from or on amount of such mortgage loan have been recovered." Right?
- A. Yes, but if you consider the portion of the definition that says the servicer has determined all amounts that it expects to recover have been recovered; that's consistent with the servicer reporting a realized loss on the deferred portion of the loan. So it wouldn't have been treated as a loss if the servicer expected to recover it.

(tr. 1388:8-17).

- Q. ... Am I correct in understanding you to be saying that you understood that when Wells Fargo treated deferred principal amounts as a realized loss, it necessarily was treating the loan as having been liquidated?
- A. Yes.

(tr. 1165:7-11). As Mr. Castro testified:

143. A 2010 Congressional Oversight Panel April Oversight Report provides that

Most borrowers who proceed through HAMP will face a precarious future, but their resources will be severely constrained. *With a majority of their income still tied up in debt payments, a small disruption in income or increase in expenses could make repayment almost impossible.* Many will have no equity in their homes and are likely to question whether it makes sense to struggle so hard and for so long to make payments on homes that could remain below water for years. Many borrowers will eventually redefault and face foreclosure. Others may make payments for five years under a so-called “permanent modification,” only to see their payments rise again when the modification period ends. The redefaults signal the worst form of failure of the HAMP program: billions of taxpayer dollars will have been spent to delay rather than prevent foreclosures.

(VEC Doc. No. 1025 [emphasis added]).

144. The rating agencies released certain documents addressing HAMP forbearance that indicated that HAMP principal modified/deferred amounts should be treated as “forgiven” even though borrowers technically remained responsible for the obligation to repay such deferred principal which obligation could be deferred for as long as 40 years and where the interest obligation in respect of such forborne amounts was forgiven and that the repayment of such amounts would be a subsequent recovery.

145. On July 23, 2009, Standard & Poor’s (S&P) released an article describing its rating methodology for RMBS transactions with underlying loan modifications that include interest and/or principal forbearance plans (VEC Doc. No. 154).

146. Under “scope of criteria,” S&P indicated:

2. These criteria apply to all U.S. RMBS issued since the original publication date on July 23, 2009, and to any proposed amendments on transactions issued after 2008. This article clarifies Standard & Poor’s criteria for loan modifications that include forbearance plans. The clarification focuses on our view that:

-
- Q. ... In your experience, when a servicer reports a loss, what if anything have they determined regarding whether there is an expectation of recovery of that loss?
- A. When they report the loss initially, their view is that there's no more cash flows coming in on what they have liquidated, so they're not expecting any additional payments.

(tr. 3203:6-12). In fact, as Mr. Castro testified, the concept of a partial liquidation predates HAMP (tr. 3192:13-22).

- *Principal forbearance should be treated similarly to principal forgiveness* in our ratings analysis; and
- Interest forbearance should be treated similarly to interest forgiveness in our ratings analysis.

...

8. In addition, we will consider whether the transaction documents treat any amounts received with respect to the forbearance plans similarly to subsequent recoveries. Thus, if write-downs occurred as a result of loss recognition, we will look to see whether amounts received in subsequent periods with respect to the forbearance plan are treated as a *subsequent recovery*. We would expect the most senior class that experienced a write-down to be written back up by the amount received with respect to the forbearance plan (if multiple loan groups exist, the senior most class associated with that particular loan group would be written back up). Additionally, if recoveries related to forbearance exceed the amount written up for the most senior class, we would expect classes that were previously written down to zero to be written back up based on payment priority.

(VEC Doc. No. 154 at 2-4 [emphasis added]).³⁰

147. On June 16, 2010, Fitch released an article titled “Re-Defaulted U.S. RMBS to Stay High Despite HAMP Progress”:

Fitch Ratings-New York-16 June 2010: Though both Home Affordable Modification Program (HAMP) and servicer-specific loan modifications continue to increase, a sizeable amount of these loans will default again within a year, according to Fitch Ratings in a new report.

Since HAMP was launched early last year, servicers have been making slow but steady progress with modifications under the program. By balance, approximately 15% of all RMBS loans have received either a HAMP or non-HAMP loan modification through May 2010 (up from 10% in September 2009). Additionally, almost 35% of RMBS subprime loans have received at least one modification compared to 25% through the same time period.

³⁰ Mr. Varca’s rebuttal testimony was also not credible because he relied (*tr.* 2516:15-21) on a segment of the July 9, 2009 S&P communication indicating that an expectation that pooling and servicing agreements would provide for a write-up of seniors certificateholder Certificate Principal Balances, but ignored the rest of the communication which indicated that the deferred amounts should be treated as forgiven – *i.e.*, such that the deferred amounts when repaid would in fact be a Subsequent Recovery and written up as such, thus undermining his position. Indeed, the very section of the communication on which he relies, indicates that the rating agencies position was that the write-up would be as a Subsequent Recovery. Put another way, he just focuses on the fact that the rating agency guidance indicates an expectation for write-ups in favor of seniors. As discussed above, this does not take into account market expectations as informed by the At Issue PSAs which unambiguously provide for write-ups in favor of subordinate certificateholders Certificate Principal Balances.

However, the results are falling far short of HAMP's completed modification goals thus far. In addition, Treasury-imposed changes to HAMP will continue to impact future progress, according to Managing Director Diane Pendley. 'With servicers now required by HAMP to re-analyze and re-work borrowers, final determination of the program's ultimate effectiveness will continue to be delayed,' said Pendley.

As a result, Fitch maintains its projection that 65%-75% subprime and Alt-A loans that have been modified will default again within a year. The prognosis is slightly lower for prime increased gradually since the middle of last year, with half taking place in California. While this strategy has benefits for both borrower and the investor, 'Assets in short sale are in competition with other distressed properties and will result in a borrower losing their home,' said Pendley.

Looking forward, guidelines and programs continue to change, while potential new moratoriums are threatened and mandated mediations are becoming more widely required. As such, 'Many distressed mortgage loans, including modified loans, will not see a final resolution until well into 2012,' said Pendley.

(VEC Doc. No. 1027).

148. On June 10, 2013, Fitch released an article titled "Fitch Reviews Realized Losses in RMBS Trusts Previously Serviced by Homeward Residential" (VEC Doc. No. 621).

149. In the article, Fitch noted that

[a]dditionally, the Home Affordable Mortgage Modification Program (HAMP) introduced in 2009 also did not initially provide guidance to servicers on how to report forbearance modifications. This was later clarified by the Treasury Department in June 2010 by directing servicers to report HAMP forbearance amounts as losses and trustees to allocate forborne principal as realized losses at the time of the modification. ***Any repaid forborne principal will be distributed to investors as a subsequent recovery***

(*id.* at 3 [emphasis added]).³¹

150. Thus, the market as informed by rating agency communications were that HAMP modified loans were partially liquidated and any payments on deferred principal would

³¹ Mr. Varca's rebuttal testimony was also not credible because he relied on a segment of the July 9, 2009 S&P indicating that an expectation that pooling and servicing agreements would provide for a write-up of seniors, but ignored the rest of the communication which indicated that the deferred amounts should be treated as forgiven – *i.e.*, such that the deferred amounts when repaid would in fact be a Subsequent Recovery and thus undermining his position.

be *de minimis* and treated as a Subsequent Recovery, just as they had been under the FDIC's IndyMac program.

151. Consistent with industry practice, Wells Fargo treated deferred principal payments, *i.e.*, recovery of the Realized Loss as a Subsequent Recovery.

Certain of the Senior and Certain Subordinate Certificateholders Understood that Wells Fargo was writing up Certificate Principal Balances of deferred principal as a Subsequent Recovery

152. Prior to, and for some time after the Appellate Division issued its decision in the JPM Action, Wells Fargo treated the payment of HAMP previously deferred principal and as a Subsequent Recovery and applied the Subsequent Recovery provision in the At Issue PSAs incorrectly to write up senior certificateholders Certificate Principal Balances and not subordinate certificateholders Certificate Principal Balances.

153. This was understood and no certificateholder testified otherwise at trial.

154. In fact, in the JPM Action, DW Partners LP, Ellington Management Group, L.L.C., AEGON USA Investment Management, LLC, BlackRock Financial Management, Inc., Cascade Investment, LLC, Federal Home Loan Bank of Atlanta, Federal Home Loan Mortgage Corp., Federal National Mortgage Association, Goldman Sachs Asset Mgmt L.P., Voya Investment Mgmt LLC, Invesco Advisers, Inc., Kore Advisors, L.P., Metropolitan Life Ins. Co., Pacific Investment Mgmt Company LLC (PIMCO), Teachers Ins. and Annuity Assoc. of America, TCW Group, Inc., Thrivent Financial for Lutherans, Western Asset Mgmt. Co., American General Life Insurance Company, American Home Assurance Company, 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 stipulated for the purpose of the lawsuit that certain settlement amounts were Subsequent Recoveries and that based on Wells Fargo's practice of applying Subsequent Recoveries to write-up senior certificateholder Certificate Principal Balances, the Appellate Division should hold that Subsequent Recoveries should be written up in favor of senior certificateholders:

In this regard, the IAS Court did not explain how any party could have conceivably expected that, upon the receipt of Subsequent Recoveries, the Subject Exhibit E Trusts' senior-most certificates would continue to suffer from past Realized Losses, while the Subordinate Certificates' losses would be reversed. The allocation of losses between senior and subordinate certificates is central to the Trusts' mechanics, and the IAS Court's reasoning turns it upside down.

(VEC Doc. No. 1054 at 24).

155. In that case, Daniel Margolis, General Counsel of respondent Ellington Management Group, L.L.C. submitted an affidavit in support of the position taken by the briefs submitted on behalf of and adopted by the senior certificateholders in that case that stated, in relevant part:

3. In August 2018, a Subsequent Recovery in the SAMI 2006-AR5 Trust was applied to write up the principal balance of the 1-A-2 certificates, one of the senior classes in the trust. Attached as Exhibit A are true and correct copies of relevant excerpts from the August 2018 remittance report for the SAMI 2006-AR5 Trust.

4. In July 2018, a Subsequent Recovery in the GPMF 2005-AR4 Trust was applied to write up the principal balance of the IV-A-2 certificates, one of the senior classes in the trust. Attached as Exhibit B is a true and correct copy of the relevant excerpt from the July 2018 remittance report for the GPMF 2005-AR4 Trust.

5. In May 2018, a Subsequent Recovery in the BALTA 2006-3 Trust was applied to write up the principal balance of the I-A-1 certificates, one of the senior classes in the trusts. Attached as Exhibit C is a true and correct copy of the relevant excerpt from the May 2018 remittance report for the BALTA 2006-3 Trust.

6. In May 2018, a Subsequent Recovery in the BSARM 2005-3 Trust was applied to write up the principal balance of the I-A-1, II-A-1, and II-A-2 certificates,

which are all senior classes. Attached as Exhibit D is a true and correct copy of the relevant excerpt from the May 2018 remittance report for BSARM 2005-3 Trust.

7. In December 2017, a Subsequent Recovery in the BSMF 2006-AR5 Trust was applied to write up the principal balance of the I-A-2 and II-A-2 certificates, which are all senior classes. Attached as Exhibit D is a true and correct copy of the relevant excerpt from the May 2018 remittance report for BSARM 2005-3 Trust.

(VEC Doc. No. 1406 ¶¶ 3-7).

156. Mr. Margolis supported the arguments made in the JPM Action in his affidavit by demonstrating his understanding that remittance reports fully disclosed that the payment of deferred principal was being treated as a Subsequent Recovery in writing up Certificate Principal Balances (VEC Doc. No. 1407).³²

157. As discussed above, in the JPM Action, the Appellate Division held that Subsequent Recovery Provision is not ambiguous and provides for the write-ups of subordinate certificateholders Certificate Principal Balances, not senior certificate holder Certificate Principal Balances (*JPM*, 198 AD3d at 160-164).

³² These are admissions as to only the parties that filed those papers, but they are properly considered as evidence that the remittance reports disclosed Wells Fargo's practice of writing up certificate balances based on treating them as subsequent recoveries. Additionally, although true that lawyers can take different positions over the course of litigation, this misses the point entirely. The point is simply that it was understood and disclosed on remittance reports that Wells Fargo was treating the payment of previously deferred principal which had been allocated as a Realized Loss as a Subsequent Recovery and any suggestion to the contrary, *i.e.*, that those parties did not understand this, is plainly false. It is also true that their articulated understanding was based on the remittance reports and how the payment of previously deferred principal was used to write-up Certificate Principal Balances in the remittance reports. The position taken was not "don't treat it as a Subsequent Recovery," the position was "do treat it as a Subsequent Recovery," as this is what Wells Fargo has been doing and because they have been writing up Subsequent Recoveries in favor of senior certificateholder Certificate Principal Balances they should continue to do so (*Silian Ventures*, 68 Misc 3d 1206[A], *aff'd* 202 AD3d at 466). This position taken in the JPM Action was rejected by the Appellate Division in holding that the Subsequent Recovery write-up provision is not ambiguous and requires Subsequent Recoveries to be written up in favor of subordinate certificateholder Certificate Principal Balances only as it pertains to the At Issue PSAs.

158. As such, no extrinsic evidence is appropriate for consideration as to how to apply this unambiguous provision (*cf. Matter of Bank of New York Mellon*, 68 Misc 3d 1206[A] [Sup Ct 2020], *affd* 202 AD3d 465 [1st Dept 2022] [**Silian Ventures**]).
159. This is a different issue than if deferred principal payments are in fact Subsequent Recoveries.
160. As to this issue, the Appellate Division held that it is ambiguous and the consideration of extrinsic evidence to resolve ambiguity is appropriate (*Wells Fargo*, 227 AD3d at 597-598):
- [i]ssues of fact preclude summary determination of whether the Deferred Principal Payments are Subsequent Recoveries under the operative Pooling and Servicing Agreements (PSAs)...The PSAs are ambiguous with respect to whether Deferred Principal Payments constitute Subsequent Recoveries, and guidance issued by the United States Department of the Treasury (Treasury) did not definitively resolve this ambiguity. Furthermore, the extrinsic evidence of the parties' course of performance is not conclusive...We reject counter-petitioners' argument that unpaid deferred principal balances should be included in the contractual Overcollateralization Amount—specifically, as part of the aggregate mortgage loan balance. Treasury guidance requires treating the deferred principal as a Realized Loss “such that, for purposes of calculating distributions to securityholders, such forborne amount is no longer outstanding.”
- (*Wells Fargo Bank, N.A. v All Respondents for this Special Proceeding*, 227 AD3d 597, 597-598 [1st Dept 2024]).
161. But as discussed above, and as set forth in the briefing of the JPM Action, certain of the senior certificateholders understood that Wells Fargo was writing up Certificate Principal Balances (albeit incorrectly) based on treating them as Subsequent Recoveries pursuant to the Subsequent Recovery provisions of the pooling and servicing agreements.
162. As discussed above, Wells Fargo did in fact treat the payment of previously deferred principal payments as a Subsequent Recovery.
163. Internal documents created by Wells Fargo confirm this practice.

164. To wit, Wells Fargo had certain modeling in place, and it had to address and modify the computer modeling to account for the extinguishment of interest on the deferred principal and for the deferred principal itself.
165. One of these documents was Interim Position 55. Interim Position 55 provided, in relevant part that “[i]n the absence of explicit language in the governing documents stating otherwise, recoveries of prior losses on active loans identified by an exception in the standard bond process should be treated in the same manner as subsequent recoveries on previously liquidated loans by manipulating the DAT and XAG files in accordance with the recovery of prior loss on active loan procedure” (VEC Doc. No. 8).
166. Interim Position 55 confirms that Wells Fargo consistently treated deferred principal payments as Subsequent Recoveries.
167. As Ms. Lohmeier testified, Interim Position 55 stated that Wells Fargo’s cashflow-modeling software incorrectly read recoveries of prior losses on active loans as “miscellaneous principal prepayments” (*tr.* 1176:23-1177:9) and corrected that error and directed that “recoveries of prior losses on active loans...should be treated in the same manner as subsequent recoveries on previously liquidated loans” (VEC Doc. No. 8).
168. As Ms. Lohmeier testified:
- Q. In your own words, I would appreciate you explaining what the purpose of Interim Position 55 was as you understand it.
- A. When deferred principal was repaid, there was a portion of the loan that was still active, that still had a balance. And Wells Fargo uses the [Intex] software to process payments monthly... It wasn’t treating it as a subsequent recovery. We thought that was a problem, so we were exploring ways to updated the programming, to fix the process so that we could treat them as subsequent recoveries.
- (*tr.* 1176:23-1177:13).

169. Another document was Modeling Standard 3. Modeling Standard 3 provided, in relevant part that

Wells Fargo received legal advice on this issue during a conference call with Alston & Bird and Locke Lord on June 19, 2013. According to this advice, we are permitted to write up bonds for subsequent recoveries, unless the documents explicitly prohibit doing so. This applies to both situations described above – when there is no mention of write-ups at all, and when the write-ups are mentioned with regard to subordinate certificates only. In both of these cases, we will be writing up all certificates, senior and subordinate, unless specifically prohibited by the governing documents.

(VEC Doc. No. 808).

170. As discussed above, the only understood methodology for writing up of Certificate Principal Balances was as a Subsequent Recovery.

171. Indeed, Treasury expected this. As Ms. Johnson-Kutch testified:

- Q. So when you were talking about modifications and the accounting treatment as a realized loss, what did you anticipate would happen to certificate balances at the time of modification?
- A. I don't know that I have an opinion about the certificate balances.
- Q. I'm not sure I understand your answer.
- When you said it was an accounting convention as a loss, and HAMP says that, are you saying that you didn't anticipate that there would be a write-down of the certificate balance at that time in the amount of the deferred principal amount; Is that what you're saying to me?
- A. At the time of modification, yes, they would recognize that as a realized loss for their accounting treatment.
- Q. Is that in your understanding as to what would happen, would there be a write-down certificate balance is my question?
- A. Yes.
- Q. Okay. And when the money comes in, do you have an understanding of what was supposed to happen to the certificate balance when the money came in in the future?
- A. My understanding is that that accounting treatment would have been applied, and so you would write that back up.
- Q. It would be a write-up?
- A. Correct.

(tr. 1653:4-1655:1).

172. Ms. Johnson-Kutch also testified that her understanding was that the industry standard was that pooling and servicing agreements would generally provide that when deferred principal payments came in, they would go to seniors:

THE WITNESS: My understanding in this scenario and having engaged with Fannie Mae and Freddie Mac and where they are as investors, as seniors, my understanding was that the proceeds would go to them; they would not take a loss on the principal forbearance amount. But I'm not an expert in that part -- in that section of it.

(tr. 1630:11-25).

173. As discussed above, Wells Fargo's treatment of deferred principal payments as Subsequent Recoveries was not a secret.

174. In fact, and as discussed above, there simply was not credible evidence adduced at trial that any certificateholder did not understand that the payment of previously deferred principal was being treated as a Subsequent Recovery by Wells Fargo.

175. Discussions were related to why Subsequent Recoveries were being written up in favor of one class of certificateholder as opposed to another but not whether they were Subsequent Recoveries.

176. As discussed above, Wells Fargo disclosed their practice to investors in monthly remittance reports.

177. Page 1 of each remittance report includes a column for "Current Realized Loss."

178. The remittance reports also include "Gains & Subsequent Recoveries (Realized Losses)"

179. Ms. Lohmeier's testimony was that Wells Fargo's treatment of deferred principal payments was clearly disclosed, and her testimony was compelling.

180. She competently testified as to the interplay between summary pages, loan level detail, and NIB tables, and she was able to tie each number of deferred principal payments as a Realized Loss to its effect on Certificate Principal Balances and to show how and where those Certificate Principal Balances were written up as a Subsequent Recovery. In fact, she was able to do this as to *any* line-item question she received on cross examination in the tens of thousands of pages of remittance reports adduced at trial.

181. The Supplemental Reporting section of the remits includes:

Wells Fargo's practice, as master servicer, securities administrator or trustee, is to report and allocate principal forborne in connection with mortgage loan modifications ("Forborne Principal") as losses or non-losses, including mortgage loan modifications made pursuant to the Home Affordability Modification Program, as explicitly and clearly reported to Wells Fargo by the servicer of the modified loan. From time to time, Wells Fargo may receive information from a servicer that revises or clarifies the servicer's intent about its treatment of Forborne Principal ("Supplemental Servicer Reporting"). If this occurs, Wells Fargo's practice is to revise its reporting of Forborne Principal to conform to the Supplemental Servicer Reporting. This may result in the recognition and allocation of Forborne Principal as a loss after the modification date of a mortgage loan by the servicer or the reversal of a prior recognition and allocation of Forborne Principal as a loss.

(VEC 1149 at 251).³³

182. Certain senior certificateholders understood this.

183. By way of example, in a letter dated May 13, 2021, Samuel J. Lieberman, counsel to

Deer Park demanded that Wells Fargo "immediately revert to the write-up methodology

³³ The remittance report recorded the HAMP modification as a partial liquidation by indicating that the loan was active but with an asterisk reflecting the bifurcation of the loan into an interest-bearing component and a non-interest-bearing component where certain principal had been deferred and the obligation to pay such interest in respect of such deferred amount entirely extinguished pursuant to the HAMP modification. It is entirely irrelevant that the magic words "partial liquidation" do not appear because of general market information including Rating Agency releases, the At Issue PSAs themselves providing for the write-up of Certificate Principal Balances only as Subsequent Recoveries and the fact that the Remittance Reports disclosed the write-up of Certificate Principal Balances of prior Realized Losses. The senior certificateholders filings in the JPM Action corroborate this conclusion.

of crediting Senior Certificates, which the Trustee had used prior to the April 26, 2021 Certificate Holder distribution” (VEC Doc. No. 1382 at WF-00020726).³⁴

184. Mr. Lieberman referred to these write-up amounts as “subsequent recoveries:”

Between February 12 and April 7, 2021, the Certificate Holders bought significant amounts of BSMF-2007-AR3-I-A-2, BSMF-AR3-II-A-2, and BSMF-AR3-II-2A-1 Senior Certificates. The Certificate Holders relied on the default method reported in Intex of writing up Senior Certificates for *subsequent recoveries* - with no benefit to Subordinates.

But on April 26, 2021, the Trustee reversed course. It authorized write-ups for the Subordinated Certificates I-B-1 (\$165,696.59) and II-B-1 (\$34,300), both of which previously had \$0 Beginning Certificate Balances. And it provided no write-up to any Senior Certificates.

(*id.* [emphasis added]).³⁵

185. In fact, the only thing the senior certificateholders who filed papers in this case did not appreciate or understand is that the At Issue PSAs required writing up of subordinate certificateholder Certificate Principal Balances not senior certificateholder Certificate Principal Balances (*Silian Ventures*, 68 Misc 3d 1206[A], *affd* 202 AD3d at 466 [“where

³⁴ The brief filed in the JPM Action is an admission of all those on behalf of whom it was filed, *i.e.*, those who signed or adopted it. It is also evidence that the remittance reports were not an incomprehensible map requiring additional key or information to find sunken treasure in parts unknown. Quite the contrary, the remittance reports were an adequate disclosure of Wells Fargo’s practice of treating deferred principal itself as a Realized Loss at the time of modification and as a Subsequent Recovery at the time of payment. No further information was required to disclose this and neither the “Supplemental Reporting” at the end of the remittance report (*see e.g.*, VEC Doc. No. 1456 at 28) nor the item “Gains & Subsequent Recoveries (Realized Losses)” in the summary of the remittance reports (*id.* at 6) obscured this. Putting aside that Ms. Lohmeier was able to trace the treatment through tens of thousands of pages of remittance reports picked by the senior certificateholder counter petitioners without notice on cross examination without meaningful hesitation or error and explain each line item credibly and how they relate to one another and the provisions of the applicable At Issue PSA, the filings and letters including the letter sent on behalf of Deer Park also demonstrate that one did not need to be Ms. Lohmeier or any other person who put together the remittance reports or supervised the putting together of the remittance reports in order to do that. No credible evidence was adduced which suggested otherwise particularly because a prior Realized Loss can only be used to write up a Certificate Principal Balance as a Subsequent Recovery. Ms. Lohmeier demonstrated this in her testimony about the remittance reports and filings in JPM Action and the letter sent on behalf of Deer Park demonstrates that this was understood by others too.

³⁵ Even, in his summary chart, Mr. Hilfer identified the deferred principal payments as write ups “Total Senior Write-Ups” (VEC Doc. No. 1385). But the remittance reports don’t use the word “write-up.” Mr. Hilfer doesn’t use terms like “negative realized loss” in his chart. He did not use the term “overcollateralization” or any other term. He referred to them “write-ups,” and write-ups under the At Issue PSAs can only occur as a Subsequent Recovery.

a contract is clear and unambiguous, a party's course of conduct could not change its meaning...[b]ut where, as here, a contract is ambiguous, a court may determine that the contract terms are, in fact, congruent with the parties' consistent course of conduct, even where another interpretation is possible under the contract terms”] [internal citations omitted]).³⁶ But as the Appellate Division held this provision is unambiguous and requires write-ups in favor of subordinate certificateholder Certificate Principal Balances, not senior certificateholder Certificate Principal Balances.

186. Indeed, although true that not every counter petitioner was a party to JPM such that the papers filed in that action is an admission by them and Mr. Lieberman does not represent every counter petitioner party such that his letters can be attributed to those clients, none of the other counter petitioner parties or senior certificateholders called a single witness or introduced any documentary evidence to support their argument that investors were unaware of Wells Fargo's treatment of the payment of deferred principal as a Subsequent Recoveries.³⁷

187. Therefore, deferred principal payments are Subsequent Recoveries.

Even if it is not a Subsequent Recovery, the Trustee should treat the payment of previously deferred principal as a Subsequent Recovery

³⁶ *Silian Ventures* is inapposite to the position advances by the Senior certificateholders because the historical practice of writing up senior certificateholder Certificate Principal Balances was addressed by the Appellate Division when it held that Subsequent Recoveries write-up provision was unambiguous and required the write-up of subordinate certificateholder Certificate Principal Balances.

³⁷ Thus, Wells Fargo's *course of performance* was to treat HAMP modifications as a Realized Loss at the time of modification and as a Subsequent Recovery on payment, *i.e.*, conduct by Wells Fargo and knowledge and acquiescence by senior certificateholders to treat this money as a Subsequent Recovery. No objection was ever made to treating it as a Subsequent Recovery, the only objection was that Subsequent Recoveries should be written up in favor of senior certificateholder Certificate Principal Balances. Subordinate certificateholders also understood that it was being treated as a Subsequent Recovery and acquiesced to that treatment, *i.e.*, treatment as a Subsequent Recovery. What they ultimately did not acquiesce to after the decision in the JPM Action was the write-up of Subsequent Recoveries in favor of senior certificateholder Certificate Principal Balances.

188. Treasury made the determination that HAMP modifications were to be treated as Realized Losses under pooling and servicing agreements.
189. Servicers reported to the Trustee based on Treasury guidance that the deferred principal and extinguished interest under HAMP was a Realized Loss.
190. As discussed above, given industry understanding and market expectation that any recovery received would be *de minimis* at the modification was made, the industry, Rating Agencies and professionally organizations understood that any received payments would be Subsequent Recoveries.
191. The failure to write-up certificate balances could cause residual certificateholders to be paid before senior and subordinate certificateholders have been paid. This is contrary to both market expectations and the subordination structure.
192. As discussed above, industry understanding and the At Issues only provide for the write-up Certificate Principal Balances is through the Subsequent Recovery provision.
193. As discussed above, application through the excess waterfall is not appropriate.
194. The industry and certificateholders understood that Wells Fargo was writing up deferred principal as a Subsequent Recovery (albeit incorrectly) prior to the Appellate Division decision in the JPM Action.
195. Thus, consistent with *Silian Ventures* and Wells Fargo's practice since HAMP of writing up Certificate Principal Balances based on the Subsequent Recovery provision, industry understanding, rating agency guidance, the FDIC's IndyMac program, the payment of deferred principal should be treated as a Subsequent Recovery.
196. Any other treatment would create an absurd result.

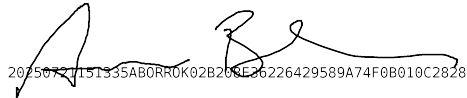
197. As discussed above, the payment of previously deferred principal taken as a Realized Loss is not a prepayment of principal.
198. As discussed above, payments which come in prior to the time due by sale or at maturity are principal repayments.
199. Prepayments of principal are not used to write-up Certificate Principal Balances. Prepayments are applied through the waterfall.
200. As discussed above, even if Wells Fargo were to treat deferred principal payments as something other than Subsequent Recoveries, there would be no basis in the At Issue PSAs to write-up senior Certificate Principal Balances.
201. If prior Realized Losses used to write-down Certificate Principal Balances were not used to write-up Certificate Principal Balances, they could result in payment through the waterfall to Residuals before the other bonds above them, seniors and subordinates, are made whole.
202. This would cause an absurd result.³⁸
203. As discussed extensively above, thus, even if not a Subsequent Recovery, treating the payment of prior Realized Losses as a Subsequent Recovery on HAMP modified loans is consistent with (i) the course of performance, meaning conduct by one party coupled with knowledge and acquiescence by others, (ii) the structure of the deals, including the overarching purpose and intent of the At Issue PSAs and (iii) commercial reasonableness, including the avoidance of absurd outcomes.

Therefore, it is hereby

³⁸ As discussed above, this is inconsistent with the subordination structure set forth in the At Issue PSAs.

ORDERED and ADJUDGED that the payment of previously deferred principal pursuant to a HAMP modification treated as a Realized Loss is a Subsequent Recovery such that Wells Fargo should write-up certificateholder Certificate Principal Balances pursuant to the Subsequent Recovery write-up provisions set forth in the applicable At Issue PSAs; and it is further

ORDERED and ADJUDGED that even if the payment of previously deferred principal pursuant to a HAMP modification treated as a Realized Loss is not a Subsequent Recovery, it should be treated as a Subsequent Recovery such that Wells Fargo should write up certificateholder Certificate Principal Balances pursuant to the Subsequent Recovery write-up provisions set forth in the applicable At Issue PSAs.


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DATE: 07/21/2025

ANDREW BORROK, JSC

Check One:

Case Disposed

Non-Final Disposition

Check if Appropriate:

Other (Specify _____)