13-1776-cv(L), 13-1777(xap)

United States Court Of Appeals
for the
Second Circuit

RETIREMENT BOARD OF THE POLICEMEN'S ANNUITY AND BENEFIT FUND OF THE CITY OF CHICAGO, on behalf of itself and similarly situated Certificate Holders, WESTMORELAND COUNTY EMPLOYEE RETIREMENT SYSTEM, CITY OF GRAND RAPIDS GENERAL RETIREMENT SYSTEM, AND CITY OF GRAND RAPIDS POLICE AND FIRE RETIREMENT SYSTEM,

Plaintiffs – Appellant – Cross-Appellee,

v.

THE BANK OF NEW YORK MELLON,
as Trustee under various Pooling & Servicing Agreements,

Defendant – Appellee – Cross-Appellant.

Appeal from an Order of the United States
District Court for the Southern District of New York

William H. Pauley III, District Judge
Case No. 1:11-cv-5459

**REPLY BRIEF FOR APPELLEE –
CROSS-APPELLANT THE BANK OF NEW YORK MELLON**

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Plaintiffs' brief regarding application of the TIA is notable for what it does *not* assert. Plaintiffs acknowledge, or at least do not deny in any serious way, that the SEC has long and consistently taken the position that the TIA does *not* apply to PSA-governed trust certificates; that authoritative scholars and commentators *uniformly* agree with that conclusion; that *everyone* who participated in the trillion-dollar MBS market over a period of decades (including many sophisticated investors like plaintiffs) accepted and acted on that understanding; that applying the TIA to these transactions retroactively would require wrenching and, in some cases, impossible changes to long-settled contractual arrangements; and that Congress, which surely was aware of this uniform understanding of the TIA as it acted to *facilitate* the growth of the MBS market during this period, changed the TIA in *other* ways but took no steps to apply the statute in circumstances like those here.

Against this background, it is unsurprising that the strained arguments plaintiffs do advance lack merit. We showed in our opening brief that the unambiguous language and clear legislative history of the TIA establish that the statute has no application to PSA-governed certificates. Plaintiffs' response both disregards the plain statutory text and rests on novel, legally immaterial distinctions between related categories of trust certificates. Indeed, it is revealing that plaintiffs' principal argument is advanced for the first time in their brief to this Court and, in significant respects, repudiates the analysis they offered below. Plaintiffs' last-minute gyrations cannot save their case; the TIA does not apply to PSA-governed certificates.

ARGUMENT

A. PSA-Governed Securities Are Exempt From The TIA Pursuant To Section 304(a)(2).

In our opening brief, we demonstrated that PSA-governed certificates are exempt from the TIA pursuant to Section 304(a)(2) because they fall within the plain meaning of the exemption's statutory terms: they are (a) "certificates of interest or participation" (b) "in two or more securities" (c) "having substantially different rights and privileges." BNYM Br. 14-24. We also noted that Congress specifically intended to exempt "pass-through" or "fixed-trust" securities, categories that include the Certificates at issue in this case. *Id*. at 24-26. And we showed how the contrary reasoning of the district court was flawed. *Id*. at 19-21.

Plaintiffs effectively concede the bulk of our argument: they recognize that "pass-through" or "fixed-trust" securities are exempt from the TIA (Pls. Reply 27), barely dispute that the multiple mortgages in each trust are securities that have "substantially different rights and privileges," and do not even attempt to defend the reasoning of the district court. The arguments plaintiffs do assert are incorrect.

1. *The Certificates here are "certificates of interest or participation."*

Although plaintiffs contend that the Certificates here are not "certificates of interest or participation" (Pls. Reply 25-26), they do not challenge any aspect of our argument to the contrary. Plaintiffs do not dispute that a "certificate of interest or participation" is an investment "where the payment of dividends" is "contingent upon an apportionment of profits." BNYM Br. 16-18. They do not deny that the Certificates do exactly that by apportioning to certificateholders profits derived from the mortgage loans. *Id*. at 18-19. And they do not dispute that the district court's contrary reasoning was wrong. *Id*. at 19-21.

Rather than contest any of these dispositive points, plaintiffs argue that the Certificates have characteristics of debt and that debt instruments categorically *cannot* be certificates of interest or participation. Pls. Reply 25-28. Although plaintiffs' reasoning on this point is obscure, they appear to contend that, because the TIA separately addresses debt instruments and certificates of interest, Sections 304(a)(1) and (a)(2) would be duplicative if certificates of interest in debt instruments were exempted by Section 304(a)(2). But this contention is nonsensical in the context of the TIA. An instrument surely may be a "certificate of interest or participation" even if it has some hallmarks of debt; that is why Section 304(a)(1) expressly applies the TIA *both* to specified debt instruments *and* to certificates of interest *in* those instruments. And when such an instrument is involved, the statutory text states expressly that, if the certificate reflects an interest or participation in *multiple* securities, it is exempt under Section 304(a)(2). The statute is clear and unambiguous on this point: the language of Section 304(a)(2) applies to certificates of interest or participation in two or more "securities," and "security" is broadly defined to include many debt securities. 15 U.S.C. § 77b(a)(1). Indeed, because *all* non-debt securities are exempt under Section 304(a)(1), a contrary interpretation would render Section 304(a)(2) a nullity.[1]

2. That the Certificates make use of tiered pay-out formulas—i.e., "tranches"—has no bearing on the application of the TIA.

Plaintiffs' next and principal argument is that Section 304(a)(2) does not apply because the Certificates at issue in this case do not reflect an in-

[1] Plaintiffs also assert that, because the TIA "expressly regulates debt," the exemption in Section 304(a)(2) "necessarily applies to property interests which share at least some characteristics of equity." Pls. Reply 27. This contention is a non sequitur. In fact, one thing we know for sure is that Section 304(a)(2) is *not* limited to equity instruments, because those instruments are already exempted from the statute's reach by Section 304(a)(1).

terest in multiple securities; instead, plaintiffs insist that they convey an interest "in *a single debt security*, namely their corresponding tranche." Pls. Reply 26; *see id.* at 28. This argument is wrong for several reasons.

a. To begin with, a "tranche" is not a stand-alone security distinct from both the Certificates and the underlying mortgage notes. Plaintiffs' argument—that each PSA-governed trust contains multiple "tranches," each tranche is itself a security, and each Certificate conveys an interest in that single tranche-security—is thus wrong even as a descriptive matter.

For TIA purposes, the controlling definition of "security" is contained in Section 2 of the Securities Act of 1933, 15 U.S.C. § 77b(a)(1). *See* 15 U.S.C. § 77ccc(1). Under this definition, "note[s]" and "certificate[s] of interest or participation"—but *not* "tranches"—qualify as securities. *Id.* § 77b(a)(1). And in a PSA-governed trust, there are two kinds of "security" at issue: (a) the hundreds or thousands of "notes" (the mortgage loans) that are placed in the trust;[2] and (b) the "certificates" that the trust issues,

[2] In a footnote, plaintiffs suggest that mortgage loans are not securities for purposes of Section 304(a)(2). Pls. Reply 28 n.9. The Court should disregard that suggestion; arguments presented solely by footnote are waived. *See Tolbert v. Queens Coll.*, 242 F.3d 58, 75 (2d Cir. 2001); *United States v. Restrepo*, 986 F.2d 1462, 1463 (2d Cir. 1993) ("We do not consider

which entitle a holder to receive proceeds from the underlying mortgage notes.

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an argument mentioned only in a footnote to be adequately raised or preserved for appellate review.").

And unsurprisingly, the contention is meritless. The Securities Act defines "security" to include, "unless the context otherwise requires," "*any* note." 15 U.S.C. § 77b(a)(1) (emphasis added). A mortgage unquestionably is a "note." "The context" of certain anti-fraud provisions indicates that mortgage loans do not qualify as "securities" for purposes of those provisions. *See Reves v. Ernst & Young*, 494 U.S. 56, 65 (1990); *Exch. Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2d Cir. 1976). But the TIA offers a markedly different context from those statutes, aimed principally at defining (in specified circumstances) the obligations of trustees so as to safeguard the interests of persons who purchase or invest in securities held in a trust. In *that* context, the precise nature of the underlying instrument held in trust therefore is immaterial and, "understood against the backdrop of what Congress was attempting to accomplish in enacting" the TIA (*Reves*, 494 U.S. at 63), the context strongly favors the conclusion that mortgage notes are properly considered securities for TIA purposes. Indeed, for the TIA's goal of investor protection, there is no practical difference between *residential* mortgages and *commercial* mortgages; as commercial mortgages are "securities," it would be anomalous if residential and commercial MBS received different treatment under the TIA.

Moreover, residential mortgage notes themselves are "securities" in contexts, like here, where they involve rights between parties other than the homeowner, such as in "a transaction between an individual investor and a broker/dealer selling the notes on a mass market basis." *Mercer v. Jaffe, Snider, Raitt & Heuer, P.C.*, 736 F. Supp. 764, 770 (W.D. Mich. 1990) (applying *Reves*). As Judge Friendly put it in *Exchange National*, 544 F.2d at 1138, "courts had better not depart from [the statutory] words without strong support for the conviction that, under the authority vested in them by the 'context' clause, they are doing what Congress wanted when they refuse to do what it said." In the TIA context, departing from the plain statutory text would not be "what Congress wanted."

In this context, "tranche" is an informal term that is used colloquially to refer to a class of certificates; in each class, the certificates have identical and specified rights to the income from the underlying mortgage loans. Plaintiffs' declaration that "each tranche" has "its own unique rights" (Pls. Reply 26) is therefore just another way of saying that each class of *certificates* has particular characteristics. This understanding—that "a single trust issues different levels, or 'tranches,' of certificates" (*Republic Bank & Trust Co. v. Bear Stearns & Co.*, 683 F.3d 239, 244 (6th Cir. 2012))—is ubiquitous.[3] Because a "tranche" is just another name for a class of certificates, it is not itself a "security" in which the certificates participate.

All of this goes to show that plaintiffs' description of certificates and tranches involves a semantic exercise that presents a misleading picture of the relevant instruments. But plaintiffs' argument also is flawed for a

[3] *See In re Lehman Bros. Sec. & Erisa Litig.*, 2013 WL 3989066, at *1 (S.D.N.Y. 2013) ("Multiple classes or 'tranches' of certificates are issued by each trust."); *Capital Ventures Int'l v. UBS Sec. LLC*, 2013 WL 3805131, at *1 (D. Mass. 2013) ("each tranche (or class) of the Certificates"); *Fort Worth Employees' Ret. Fund v. J.P. Morgan Chase & Co.*, 862 F. Supp. 2d 322, 328 (S.D.N.Y. 2012) ("A 'tranche' is a grouping of MBS certificates within a given offering."). Commentators share this understanding of the relationship between tranches and certificates. *See* Talcott Franklin & Thomas Nealon, *Mortgage and Asset Backed Securities Litigation Handbook* § 1:6 (2013) ("[t]he attributes of each type, or tranche, of certificates").

more fundamental reason: their focus on the tranche is simply beside the point so far as application of Section 304(a)(2) is concerned. However one characterizes the relationship between the Certificate and the tranche, plaintiffs agree that *all* payments received by certificateholders are derived from—and *only* from—the underlying mortgage notes. Pls. Reply 7 ("[t]he [trust] obligations are funded by the revenue generated from a pool of mortgages"). Accordingly, no matter how it is sliced, under the TIA's plain terms the Certificates at issue here are ones of interest and participation in two or more securities having substantially different rights and privileges—that is, the mortgage notes. BNYM Br. 21-24.

b. In an evident attempt to escape this conclusion, plaintiffs next contend that, even though certificateholders receive *all* of their income from the principal and interest paid on the underlying mortgage notes—and even though (with minor and immaterial exceptions, BNYM Br. 20-21) certificateholders receive *all* of the principal and interest that is paid on those notes—the PSA-governed Certificates are not ones of interest and participation *in* the notes. In making this counterintuitive argument, plaintiffs acknowledge that what they term "true pass-through certificates," which they define as ones that "pass[] on a *pro rata* share of a trust's income" to each security holder, *are* certificates of interest and participation in the underlying notes within the meaning of Section 304(a)(2). Pls. Reply 27. They also acknowledge that such certificates are closely analogous to the fixed-trust certificates "that the TIA's legislative history indicates [Section 304(a)(2)] was intended to exempt." *Id.*

But plaintiffs insist that the Certificates at issue here, which plaintiffs label "sequential-pay Certificates" because they "mak[e] payments to the senior tranches first and then in descending order of priority to the subordinate tranches" rather than on a strict *pro rata* basis, are not "pass-through" certificates at all because "the repayment of principal and interest due to any tranche does not correlate to the principal and interest paid on any individual mortgage loan." Pls. Reply 7; *see id.* at 6, 26-27. Therefore, plaintiffs conclude, the Certificates are not ones of interest or participation in the underlying notes. This contention is wrong, for several reasons.

First, plaintiffs are again playing a semantic game. For the reasons we have just explained, "sequential-pay" certificates *are* a form of pass-through security in the most obvious and literal sense because essentially *all* of the note payments are passed through *to* the certificateholders, and all of the payments received by certificateholders have been passed through *from* the persons paying on the mortgage loans. Thus, this Court has repeatedly referred to RMBS securities using tranche structures as "pass-through certificates." *See Police & Fire Ret. Sys. v. IndyMac MBS, Inc.*, 721 F.3d 95, 102 (2d Cir. 2013) ("IndyMac MBS issued securities known as mortgage pass-through certificates"); *Am. Int'l Grp. v. Bank of Am. Corp.*, 712 F.3d 775, 778 & n.2 (2d Cir. 2013) ("mortgage pass-through certificates"). Commentators, too, refer to certificates "in tranched transactions" as "pass-through." Alfred Toennies, *The Securitization of Mortgages*, C426 ALI-ABA 161, 279 (1989).[4]

Thus, the Certificates at issue in this case carry an express "pass-through" label. JA894, JA999. The district court recognized them to be "pass-through" securities. SPA9. Indeed, in earlier stages of this litigation, plaintiffs *themselves* repeatedly termed the instruments at issue here "pass-through certificates." *See* Dkt. 49, at 5; Dkt. 22, at 13-14. Tellingly, it appears that it was not until the filing of their merits brief in *this* Court

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[4] As one commentator explained, REMIC trusts—which plaintiffs identify as the quintessential "sequential-pay" vehicles (Pls. Reply 5-6)—use "mortgage pass-through certificates" in which "the trustee collects regular mortgage payments from the mortgage servicer and makes payments directly to pass-through certificate holders. In a senior/subordinated pass-through structure, payments are made first to 'senior' pass-through certificate holders and then, to the extent sufficient additional funds are available, to 'subordinate' pass-through certificate holders." Thomas Lemke, *Mortgage-Backed Securities* § 10:7 (2013)

that plaintiffs *ever* referred to these instruments as "sequential-pay" certificates.

Second, the distinction plaintiffs would draw has no substance or legal foundation. Plaintiffs posit a difference between pass-through certificates in which certificateholders receive a *pro rata* share of trust income (Pls. Reply 6, 27) on the one hand and, on the other, "sequential-pay" certificates that use a more complex formula to determine the amount of principal and interest received by particular certificateholders. But for present purposes, that distinction is wholly immaterial; plaintiffs do not even attempt to explain *why* the complexity of the payment formula under which income derived from a note is passed through to the ultimate beneficiary has any bearing on whether the beneficiary has an "interest" or "participates" in the note.[5]

[5] Although plaintiffs do not elaborate on the rationale for their distinction, they may mean that it is easier to trace certificateholders' income to specific underlying notes when mortgage payments are allocated on a *pro rata* basis than when certificates use more complex formulas. *See* Pls. Reply 27. But if this is plaintiffs' contention, it has no basis either in logic or in the text of the TIA. Holders of both "pure pass-through" and "sequential-pay" certificates have a legal interest in the *trust* that contains all the mortgage notes; in neither case do they have a right to seek payment from individual mortgage payors. In both cases, it is the certificateholders' interest in the trust holding *all* of the underlying mortgage notes that triggers application of Section 304(a)(2).

In fact, it does not. The plain fact is that *every* MBS trust must use some formula (simple or complex) to allocate the income from a set of underlying notes; in *every* trust, all the income received by the certificateholders is derived from those notes; and in *every* trust, essentially all of the income produced by the notes is passed through to certificateholders. Under any ordinary reading of the terms, that structure gives certificateholders an interest (and a right to participate) in the underlying notes. After all, how much (if anything) *any* certificateholder receives depends on the performance of some or all of the notes. And those notes are, as we have shown and as plaintiffs do not seriously deny, "securities having substantially different rights and privileges" within the meaning of Section 304(a)(2). The statutory exception therefore applies here by its plain terms.[6]

3. The SEC's view that PSA-governed certificates are exempt from the TIA under Section 304(a)(2), in which Congress has acquiesced, is due substantial deference.

a. We showed in our opening brief (at 27-31) that this conclusion draws strong support from the SEC's consistent and long-standing guid-

[6] *Oklahoma Police* did not suggest that the certificates have an interest in the *tranche*; plaintiffs themselves inserted that term. Pls. Reply 29. Instead, Judge Koeltl explained that "the certificates participate" in "the underlying evidence of indebtedness, namely the MBS." 291 F.R.D. at 62.

ance that PSA-governed certificates are exempt from the TIA pursuant to Section 304(a)(2). Plaintiffs' attempt to denigrate the views of the expert agency that is entrusted with enforcement of the TIA (Pls. Reply 33-38) misstates both the SEC's position and the deference due that position.

First, plaintiffs plainly are wrong in their half-hearted suggestion that the SEC's guidance is limited to what plaintiffs call "pure pass-through," and not "sequential-pay," certificates. Pls. Reply 36. As we have explained, the distinction between these types of certificate has no legal significance. There can be no doubt that the Commission means its guidance to apply to both.

The SEC is, of course, well aware of the common use of the "sequential-pay" structure in the MBS context, which the Commission itself described as characteristic of private MBS structures just six years after issuing its telephone guidance regarding Section 304(a)(2). *See* JA552-59. Yet the Commission has *never* suggested that this distinction has any implications for the application of the TIA—and has, to the contrary, uniformly (up to the present day) allowed registration of innumerable "sequential-pay" certificates that had not been qualified under the TIA. This course of conduct must be understood to reflect a considered decision by the Commission that the TIA has no application to PSA-governed certificates. *See FDIC v. Philadelphia Gear Corp.*, 476 U.S. 426, 439 (1986) (consistent failure to act "clearly demonstrates" agency's view). In this context, plaintiffs assume their conclusion when they say that the SEC's reference to certificates "'representing a beneficial ownership interest in a trust'" must mean that the Commission limited its Section 304(a)(2) guidance to *pro rata* pass-through certificates (Pls. Reply 35-36). In fact, the Commission's failure to distinguish in its actions between "true pass-through" and "sequential-pay" certificates makes obvious that its meaning was the converse—that is, that it understood *all* pass-through certificates, including "sequential-pay," *to* represent such a beneficial ownership interest.

Second, plaintiffs dismiss the persuasive force of agency no-action letters, which they quote this Court to describe as "'bind[ing] no one.'" Pls. Reply 33. Plaintiffs fail to note, however, that the Court *also* said that it "would treat [a] no-action letter as persuasive." *New York City Employees' Ret. Sys. v. SEC*, 45 F.3d 7, 13 (2d Cir. 1995). And, of course, more than such an individual letter is at play here; the SEC staff has published general, albeit informal, guidance on the application of Section 304(a)(2) that has remained in force without modification for almost fifteen years. As we showed in our opening brief (at 29), the Court has described this sort of informal agency opinion as "persuasive authority." *Vincent v. Money Store*, 736 F.3d 88, 101 n.12 (2d Cir. 2013).

Moreover, the SEC's guidance here has particular characteristics that entitle it to substantial deference. It was issued in a highly technical area where the agency is expert, concerning the meaning of a statute that the SEC is charged to administer. *See Aluminum Co. v. Cent. Lincoln Peoples' Util. Dist.*, 467 U.S. 380, 390 (1984) (deference has "particular force" where "[t]he subject under regulation is technical and complex"). The Commission's view also has been utterly consistent, for a period of some thirty years (BNYM Br. 27-29), which is a significant "factor in assessing the weight that position is due." *Good Samaritan Hosp. v. Shalala*, 508 U.S. 402, 417 (1993).[7] In such circumstances, and especially where those

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[7] Although plaintiffs insist that the circumstances addressed in *Marion Bass Securities, Inc.*, SEC No-Action Letter, 1984 WL 45531 (1984), differed from those here (Pls. Reply 34), they were in fact identical in material respects: in *Marion Bass*, like here, "[t]he return on the Certificateholders' investment will consist of payments of principal and interest" made on mortgage bonds, and "each Certificateholder [was to] be treated as the owner of an undivided interest in the income and corpus attributable to the Pool." *Id.* at *2. But even apart from the no-action letters, the SEC's "failure" to take action barring registration of PSA-governed certificates, notwithstanding the statutory requirement that the SEC deny registration to securities that are subject to the TIA but not accompanied by a TIA-qualifying indenture (BNYM Br. 41), "clearly demonstrates that the [Commission] never considered" such certificates subject to the TIA. *Philadelphia Gear*, 476 U.S. at 439. Against this background, "[a]lthough

subject to regulation relied for many years without question on the SEC's published position, the SEC's thumb places a heavy weight in its side of the scale, "given the 'specialized experience and broader investigations and information' available to the agency … and given the value of uniformity in its administrative and judicial understandings of what a national law requires." *United States v. Mead Corp.*, 533 U.S. 218, 234 (2001).

b. We also showed in our opening brief (at 30-31) that Congress must be understood to have acquiesced in the SEC's view, as it repeatedly amended the TIA in *other* respects after the Commission issued first its initial no-action letter and then its staff guidance on the scope of Section 304(a)(2)—but took no steps to set aside the SEC's position. Plaintiffs' principal response is its evident contention that Congress may have been unaware of the SEC's view. Pls. Reply 40-41. But that suggestion is, to say the least, implausible.

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the [agency's] interpretation of the relevant statute has not been reduced to a specific regulation," the consistent agency "practice and belief" regarding the scope of Section 304(a)(2) "are entitled in the circumstances of this case to the 'considerable weight [that] should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer.'" *Id.*

As *amici* SIFMA and The Clearing House demonstrate (SIFMA Br. 8-12), Congress acted repeatedly, often at the SEC's prompting or with its close assistance, to facilitate the development or improve the regulation of the trillion-dollar MBS market, both before and after the market crisis that prompted this litigation. In these circumstances, it is simply inconceivable that Congress would have been unaware of something as significant as the SEC's views regarding application of the TIA to a substantial portion of this market. Indeed, we can be sure that Congress *was* aware of the state of the law because, as we showed in our opening brief (at 26-27), Senator Brown acted on that understanding when he unsuccessfully proposed amending the TIA so that it *would* apply to PSA-governed certificates. This is, accordingly, a clear case for application of the principle that, where Congress "has not sought to alter [an agency's] interpretation although it has amended the statute in other respects, then presumably the legislative intent has been correctly discerned.'" *N. Haven Bd. of Educ. v. Bell*, 456 U.S. 512, 535 (1982).

B. PSA-Governed Securities Are Exempt From The TIA Pursuant To Section 304(a)(1).

We also explained in our opening brief (at 31-34) that PSA-governed Certificates, if they are not "certificates of interest or participation" within the meaning of Section 304(a)(2), are exempt from the TIA under Section

304(a)(1) because they are not debt instruments—a point that has been uniformly endorsed by commentators and practitioners (*id.* at 34 & n.11). Here, at least, there is an area of common ground between the parties in this case: both agree that the hallmark of debt "is an unqualified obligation to pay a sum certain at a reasonably close fixed maturity date … regardless of the debtor's income or lack thereof." *Gilbert v. Comm'r*, 248 F.2d 399, 402 (2d Cir. 1957). Equity, by contrast, makes the investor a co-venturer; there is no sum certain due. Pls. Reply 15-16; BNYM Br. 31-32. Where plaintiffs go wrong is in the application of that test to the Certificates at issue here.[8]

First, the logical implication of plaintiffs' position is that *all* MBS certificates are debt because the hallmark of debt is the obligation to pay a sum certain at a fixed date and, in plaintiffs' view, MBS certificates "re-

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[8] Plaintiffs devote considerable space to contending that this Court and the SEC have used language generally characterizing mortgage-backed securities as similar to bonds. Pls. Reply 12-15. And to be sure, *some* MBS securities have characteristics of debt. But this Court has never suggested, let alone held, that *all* MBS securities are debt, and neither it nor the SEC has ever had occasion to distinguish between equity and debt in this context. *See, e.g.*, *Pension Ben. Guar. Corp. v. Morgan Stanley Inv. Mgmt.*, 712 F.3d 705, 713 (2d Cir. 2013). Plaintiffs also cite an SEC study that they assert distinguishes between "pass-through" and "sequential-pay" trusts (Pls. Reply 22), but that study is purely descriptive and does not even remotely suggest that this distinction is relevant to the debt/equity determination—or for any other legal purpose. JA 551-59.

flect an obligation to pay a sum certain—'principal' and 'interest' at a specified rate stated on the face of the Certificate on fixed distribution dates each month—and nothing more." Pls. Reply 16. That description is just as true (indeed, even more true) of plaintiffs' "true pass-through" certificates as it is of "sequential-pay" certificates. But plaintiffs' implication must be wrong: it is universally recognized that MBS securities may be structured as *either* debt *or* equity. *See* 17 C.F.R. § 230.415(a)(1)(vii) ("[m]ortgage related securities" include both "mortgage backed debt and mortgage participation or pass through certificates"). Thus, an oft-cited MBS treatise authored by an attorney who frequently represents plaintiff-investors explains that "MBS transactions regularly utilize both debt and equity structures depending upon whether notes or certificates are issued by a particular trust." Talcott Franklin & Thomas Nealon, *Mortgage and Asset Backed Securities Litigation Handbook* § 1:37 (2013).

Second, plaintiffs' central contention that PSA-governed Certificates *do* "reflect an obligation to pay a sum certain" is wrong. Instead, as we explained in detail in our opening brief (at 31-33), the Certificates entitle holders to their share of *whatever* proceeds the trust collects, an amount that *never* is "certain" and may be zero. Thus, the legal entitlement is defined as a share of collections, not a sum certain. Tellingly, in making their argument, plaintiffs do not cite to the PSAs at all, presumably because those documents do not state any obligation on the trust's part to pay certificateholders any particular sum. In saying this, we of course do not contend that there is no "obligation" here (Pls. Reply 16-17); *all* securities create obligations of some sort. Instead, the critical distinction between debt and equity is the obligation to pay a *sum certain*. There is no such obligation here.

Third, plaintiffs are wrong to suggest that the PSA-governed securities may not qualify as equity because their "upside" is capped. Doubtless, there is a hypothetical "maximum" amount that any certificateholder may obtain. But many other equity structures similarly have finite "upsides." To offer just one example, "callable preferred stock" is "stock that may be repurchased by the issuing corporation at a prestated price." Stock, Black's Law Dictionary (9th ed. 2009). Although the "appreciation" of callable stock is effectively "capped," this remains an "equity stake." Callable Common Stock, Investing Answers, http://tiny.cc/7ycqex. And like the tranche payment structure used here, "waterfall" payment formulas are used in many settings to distribute proceeds to equity investors; a capped upside, without an entitlement to any minimum payout, cannot transform an investment into debt. *See* Albert Hudec, *Negotiating Private Equity Fund Terms*, 19-Jun Bus. L. Today 45, 45-46, (2010).

Here, too, plaintiffs rely on a chimerical distinction between "true pass-through" and "sequential-pay" certificates. Plaintiffs appear to concede that what they view as "true pass-through" certificates may be equity instruments (even though, in plaintiffs' view, payment of interest and principal to certificateholders is a sum certain). Pls. Reply 21-22. With respect to "sequential-pay" certificates, however, plaintiffs contend that it is "impossible for a Certificateholder to own an interest in the underlying mortgage loans." *Id*. at 22. This supposed distinction, however, is nonsensical: in *no* case does an investor in a securitization trust have authority to *directly* sue a mortgagee for non-payment. JA554. But *all* investors are, as a general matter, beneficial owners of the whole pool of mortgages, with the Certificates "evidenc[ing] a beneficial interest in the trust." Franklin, *supra*, § 2:11. That ownership interest makes these instruments equity securities.

Fourth, plaintiffs insist that the Certificates must be debt because they are "functionally indistinguishable from" MBS notes that we recognize to be debt instruments. Pls. Reply 18. But that simply is not so. The note indenture agreement specifically provides that, "[n]otwithstanding any other provisions in this Indenture, every Noteholder has an absolute and unconditional right to receive payment" of principal and interest "after their due dates … and to institute suit for the enforcement of any payment." JA330 (Section 5.08); *see* BNYM Br. 33 n.10 (citing indenture payment provisions). This right to pursue a remedy for failure to pay a sum certain on the due date is the hallmark of debt—but no such provision exists with respect to the PSA-governed securities, which provide that certificateholders will receive, not a sum certain, but *whatever* monies (if any) are generated by the underlying mortgage loans each month. BNYM Br. 31-33. Consequently, the PSA-governed certificates are properly characterized as equity—and are exempt from the TIA under Section 304(a)(1).

C. The TIA Does Not Apply Retroactively To Securities That The SEC Permitted To Issue Without TIA Qualification.

The TIA also does not apply to the securities at issue in this case because they were never "qualified" under the statute. BNYM Br. 39-47. The TIA is designed so that all parties know at the outset whether a particular security is in fact within the statutory ambit. When the SEC permits a registered security to issue without requiring it to "qualify" under the TIA, the requirements of the TIA simply do not apply to that instrument. Congress adopted this structure to prevent precisely what plaintiffs seek to do in this case: rewrite the terms of a security years after it issued by imposing significant new legal duties that the parties never envisioned. Plaintiffs thus are wrong in maintaining that BNYM may be held liable because the Certificates should have been, but were not, qualified under the TIA.

1. Plaintiffs first observe that, pursuant to Section 304, "the TIA's provisions 'apply' to all non-exempt securities," which they take to mean that the TIA automatically applies to every security that is non-exempt. Pls. Reply 41 (quoting 15 U.S.C. § 77ddd(a)). But that is not what the statute says. It actually provides that "[t]he provisions of this subchapter shall not apply to any of the following securities," going on to list those that categorically are exempted. 15 U.S.C. § 77ddd(a). It does not state the converse—that is, that every SEC-registered security of a sort not appearing on the exempt list necessarily is subject to the TIA even absent qualification. And that cannot be the meaning of the statutory test, as it would render null the careful provisions of the TIA that control *how* TIA qualification must occur. *See id*. §§ 77eee, 77fff.

2. Next, pointing to Section 309(a)(1), plaintiffs contend that the PSAs are indentures that were "'deemed to have been qualified'" automatically "'when registration [became] effective.'" Pls. Reply 42 (quoting 15 U.S.C. § 77iii(a)(1)). But this argument assumes its conclusion. The stat-

ute actually reads: "The *indenture under which a security has been or is to be issued* shall be deemed to have been qualified … when registration becomes effective as to such security." 15 U.S.C. § 77iii(a)(1) (emphasis added). And here, there *is no indenture*. Thus, the necessary predicate for automatic application of the TIA's provisions under Section 309(a)(1)—the issuance of a security *under an indenture*—never occurred.

In premising their argument to the contrary on the 1990 amendments to the TIA, plaintiffs conflate two distinct questions: whether the TIA applies to a security that has not been qualified; and whether, if the security has been issued in connection with a qualified indenture, the various TIA requirements are "deemed" to be incorporated into that indenture. The 1990 amendments dealt with the latter issue: by automatically deeming a qualified indenture to incorporate all TIA requirements, regardless of whether they are specifically listed in the indenture, the amendment "streamline[d]" the SEC's obligations in connection with the administration of the TIA. S. Rep. No. 101-155, at *22 (1989). This relieved the SEC of the obligation to flyspeck every indenture to determine whether or not it included each of the myriad TIA requirements. *Id.* (describing "procedures for qualification of indentures" and explaining that the amendment "would make the terms now required to be recited within a qualified indenture to be applicable as a matter of law"). Nothing in this language suggests that Congress intended the TIA to apply to securities not issued with qualified indentures. If it had, there would be no need for "procedures for [the] qualification of indentures" because every agreement accompanying a security would, without more, be *deemed* to be a TIA-qualified indenture.

This is just the conclusion that the court reached in *Vernon Johnson Family Ltd. P'ship v. Bank One Texas*, 80 F. Supp. 2d 1127 (W.D. Wash. 2000). Plaintiffs' sole response—that citation to this authority "is nonsensical as that case involved notes that were exempt from both the Securities Act of 1933 and the TIA" (Pls. Reply 42 n.15)—is puzzling. The circumstances in *Vernon Johnson* are in relevant respects *identical* to the circumstances here. There, like here, the issuer did not qualify the security because the issuer claimed it was exempt from the TIA; there, like here, the plaintiff contended that the securities were *not* exempt. 80 F. Supp. 2d at 1131. But the court held this disagreement to be beside the point because "these notes were not qualified under the TIA"—and that, by itself, meant that an action under the TIA was not available. *Id.* For identical reasons, plaintiffs' argument here also must fail.

3. That the Court must narrowly construe the scope of an implied cause of action (BNYM Br. 43-45) further compels this conclusion. Plaintiffs contend that the right of action under the TIA is "express" (Pls. Reply 43), but rely for that assertion on the 1990 TIA amendments, which provided, not a right of action, but *jurisdiction* for suits pressing "any liability or duty created by" the TIA. BNYM Br. 44 n.18. Given that, prior to this amendment, the Supreme Court had interpreted *identical* jurisdictional language as *not* creating a private cause of action (*see Touche Ross & Co. v. Redington*, 442 U.S. 560, 577 (1979)), it is doubtful that the enacted statutory text can properly be taken to create a private right of action under the TIA. But even if a court were to infer a private cause of action in these circumstances, that action, absent clear contrary congressional direction, should not be extended to suits involving securities that were not, at the time of their issuance, qualified under the Act. BNYM Br. 44-45 n.18.

D. Applying The TIA To PSA-Governed Certificates Would Cause Great Disruption In The Market.

1. Finally, we showed in our opening brief (at 35-39; *see also* ABA Amicus Br. 12-19) that compelling practical considerations favor our understanding of the TIA: for decades, all participants in the MBS market have understood that the TIA does not apply to PSA-governed certificates,

leading to the creation of trillions of dollars worth of securities that were not qualified under the statute. It should not need extensive demonstration to show that the sudden, retroactive application of the TIA's obligations to these securities would have destructive and destabilizing consequences.

Plaintiffs' cavalier suggestion that retroactive application of the TIA in these circumstances "will not revolutionize the litigation landscape" (Pls. Reply 48) cannot obscure this reality; the plain fact is that the TIA's terms cannot be reconciled with the existing PSA structure.[9] Thus, for example, plaintiffs cannot explain who would serve as "obligor" if the TIA applied to PSA-governed trusts. Plaintiffs do not dispute that the TIA *requires* the existence of an obligor, who is given significant duties. *See*, *e.g.*, 15 U.S.C. § 77nnn; BNYM Br. 35-37. "Obligor" is defined to include "every person (including a guarantor) who is liable upon the security or securities in which such certificate evidences an interest or participation." *Id*. § 77ccc(12). In typical debt arrangements, the obligor is the borrower. *Beck v. Mfrs. Hanover Trust Co.*, 632 N.Y.S.2d 520, 525 (App. Div. 1995).

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9 Plaintiffs note that trustees may be subject to suit regarding common-law duties. Pls. Reply 48-49. But those obligations are understood in the marketplace and control the interactions between the parties. That says nothing about whether imposing new and very different obligations under the TIA would disrupt the MBS market.

In the context of PSA-governed securities, the plain terms of this provision would mean that *every* individual homeowner is an "obligor" subject to the TIA. Plaintiffs observe that this result would be ridiculous. Pls. Reply 49. We agree. But in a PSA-governed security, there is no one else who *could* be the obligor. Plaintiffs evidently mean to suggest that BNYM as trustee may serve as the "obligor." *Id.* at 50. But they have no answer to the anti-conflict provision of the TIA, Section 310(a)(5), which *prohibits* a trustee from serving as the obligor; "[n]o obligor upon the indenture securities … shall serve as trustee upon such indenture." 15 U.S.C. § 77jjj(a)(5).[10]

Separately, we demonstrated that application of the TIA to PSA-governed securities would permit a majority of certificateholders to take action adverse to other holders (such as consent to waiver of default) because, unlike MBS securities structured as debt, the PSA-governed securities have not adopted terms that would preclude such acts. BNYM Br. 37-38. Plaintiffs are wrong to contend (Pls. Reply 50) that Section 316(b) rem-

[10] In the context of a debt-style indenture MBS, the trust *itself* is the obligor. That is possible because the notes are issued by Delaware statutory trusts (JA300 JA314, JA434), which have a legal personality independent of the trustee and which are liable on the notes. *See* Del. Code tit. 12, § 3804. In contrast, PSA-governed trusts are common-law trusts that, because they lack legal personality independent of the trustee, cannot serve as an obligor. Restatement (Third) of Trusts § 105 (2012).

edies this problem; that provision expressly does not apply "to a postponement of an interest payment consented to as provided in [Section 316(a)]." 15 U.S.C. § 77ppp(b). And we frankly do not understand plaintiffs' argument with respect to the TIA's *prohibition* on write-downs (Pls. Reply 50-51), which are sometimes *required* by the PSA terms. BNYM Br. 38-39. Plaintiffs' citation to the indentures in addressing this anomaly underscores the point; those securities, unlike PSA-governed certificates, have express mechanisms to alleviate the problem.

Evidently recognizing these difficulties, plaintiffs ultimately suggest that the SEC could somehow issue regulatory relief from those TIA requirements that "do not make sense." Pls. Reply 51. But the SEC cannot rewrite the terms of the PSAs to make them compatible with the TIA—and, even if it could, doing so would cause the very uncertainty, confusion, and defeat of settled expectations that we have described. Plaintiffs cannot deny that such baleful consequences "'argue[] significantly' in favor" of leaving the existing understanding intact. *Harris v. Sullivan*, 968 F.2d 263, 265 (2d Cir. 1992).

2. Against this, plaintiffs argue at length that application of the TIA would boost investor confidence in the MBS market. Pls. Reply 44-48. But nothing could be more unsettling to investors than a ruling that, many

years after the fact, retroactively changed the terms of contracts governing trillions of dollars worth of contracts—and doing so in a way that imposed terms no one (on either side of the contract) believed applied and that the regulator had authoritatively said did *not* apply.

As Judge Koeltl noted, participants in the MBS market—virtually all of whom are highly sophisticated and professionally managed institutional investors—have always been able to choose between MBS securities that are subject to TIA protections and those that are not (and therefore involve lower administrative costs). *Oklahoma Police*, 291 F.R.D. at 65; BNYM Br. 5. If, as plaintiffs speculate, these professional investors prefer securities to be issued as debt instruments subject to the TIA, that preference will establish demand in the marketplace, leading issuers to structure new securities accordingly. But if plaintiffs believe that the TIA should be applied prospectively to such securities by legislative fiat, they should present their request to Congress and the SEC—not to trustees like BNYM.

CONCLUSION

The Court should conclude that the TIA does not apply to securities governed by PSAs.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

Pursuant to Fed. R. App. P. 32(a)(7)(C), undersigned counsel certifies that this brief:

(i) complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(i) because it contains 6,952 words, including footnotes; and

(ii) complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6).

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