HARD COPY

RECEIVED
FEB 21 2017
OFFICE OF THE SECRETARY

**UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION**

**ADMINISTRATIVE PROCEEDING
File No. 3-16349**

In the Matter of	:
BARBARA DUKA	:
Respondent.	:

RESPONDENT BARBARA DUKA'S POST-HEARING BRIEF

PETRILLO KLEIN & BOXER LLP

655 Third Avenue, 22nd Floor
New York, New York 10017
Telephone: (212) 370-0330
Telecopy: (212) 370-0391

Attorneys for Barbara Duka

Dated: February 17, 2017

TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

FACTS 2

ARGUMENT 2

POINT I: The Division Failed to Prove that Duka Violated Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder 2

A. Duka did not "Make" the Statements in the 2011 Presales 2

B. The Section 17(a)(2) Claim Should be Dismissed Because Neither Duka nor S&P Received "Money or Property" by Means of the Disclosure in the 2011 Presales 3

C. The Division Failed to Prove That the 2011 Presales Were Misleading 3

D. The Division Failed to Prove Materiality 5

1. The Division was Required to Prove Materiality in Connection With the Alleged Violations of Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3) 5

2. The Evidence Overwhelmingly Demonstrated That S&P's use of a Blended Constant was Immaterial 6

a. The Investment Analyses of CMBS Investors did not Consider S&P's DSCs .6

b. Investors did not Review the S&P BBB DSCs in Making an Investment Decision 7

c. The Offering Documents for the 2011 CF Transactions Underscored the Responsibility of Investors to Conduct Their Own Due Diligence 7

d. The Absence of any Investor Questions Shows that the Constants Employed by S&P Were not Considered in the Investment-Decision Process 8

e. S&P Affirmed the Ratings on the 2011 CF Transactions Following an Independent Analysis, Confirming Immateriality 9

f. Immateriality is Further Clear Because the Increased "Stress" Imposed by Use of a Table 1 Constant was Analytically Meaningless 9

g. Immateriality is Also Clear Because Investors did not Know S&P's Rationale for Using a "Stressed" Constant to Assess Term Default Risk 10

h. Neither AEGON nor PFG Reviewed the 2011 Revised Presales 10

i. The Failure to Produce Evidence of Markdowns of the 2011 CF Securities Negates a Finding of Materiality 11

j. Investors Could not Ascribe Significance to Particular Metrics in the 2011 Presales Because They Could Only Generally Understand how S&P Arrived at the CE Levels Included in these Reports 12

k. Materiality is Lacking Because Investors Determined That the CE Levels Were Attractive 12

l. The Investor Testimony Further Proves Immateriality.................................. 13

m. The Division's Arguments in Favor of Materiality are Meritless.................... 16

E. The Division Failed to Prove That Duka Acted With *Scienter* or Possessed the Requisite Mental State for Aiding and Abetting or Causing Liability or Acted Negligently 20

1. The Division may not Cite a Negligence Theory to Prove its Claims Under Section 17(a)(2) and (a)(3)... 21

2. The Division Failed to Prove *Scienter*, and Even if Permitted to Rely on Negligence, the Division failed to Prove Duka was Negligent 22

a. Duka did not Cause the 2011 Presales to Include Table 1 DSCs 22

3. Disclosure in the "Methodology" Sections of the 2011 Presales 23

4. Duka Received no Adverse Feedback Concerning the Disclosure in the 2011 Presales 24

5. The Division Cannot Explain the Evidence that is Flatly Inconsistent With a Finding of *Scienter*... 25

6. The Disclosure in the 2011 Presales did not Fall Short of the then-S&P Standard of Disclosure 26

7. The Division Focused on Inaction but the OIP Does not Charge a Failure to Supervise....27

F. The Revised Scheme Liability Theory was not Alleged in the OIP, and, in any Event, the Division did not Prove Scheme Liability....28

1. The OIP did not Charge the Now-Alleged Scheme Liability....28

2. In any Event, the Division Failed to Prove Deceptive Conduct Not Involving Alleged Misstatements....29

POINT II: The Division Failed to Prove That Duka Aided, Abetted, or Caused S&P's Violations of Rule 17g-6(a)(2)....30

A. The Division Failed to Prove That the Ratings on the 2011 CF Transactions Were not Determined in Accordance with S&P's "Established Procedures and Methodologies"....30

1. NI's Use of Blended Constants Imposed More Stress Than Required by the Criteria....30

2. The Drafting History of the 2009 Criteria Refutes the Division's Charge....31

3. The Use of the Table 1 Constants to Compute Debt Service was not Criteria Because Such Application of Methodology was Neither Documented nor Published....32

4. Investors Expected That S&P Would use Actual Constants to Compute Debt Service Under Criteria....32

5. The March 2010 Memorandum and its Implementation Evidence That Criteria did not Contemplate the use of Table 1 Constants....32

6. CMBS Members' Views That Use of the Blended Constant was Consistent With the 2009 Criteria Corroborates that Table 1 Constants Were Not Required....33

7. The Division's Position is Unsupported by Reliable Evidence....34

B. The Division Failed to Prove That Duka Supported Use of the Blended Constant for the Purpose of Obtaining More CF Rating Engagements for S&P....35

C. The Division Otherwise Failed to Prove *Scienter*, as Required for "Causing" Liability....37

POINT III: The Division Failed to Prove a Violation of the IC Statute....37

A. The Alleged Violation of the IC Statute Violates the Notice Requirement of Due Process....37

B. Duka Cannot be Liable for a Secondary Violation of the IC Statute Because Duka Did Not Serve in a Control Function....37

C. The Division Failed to Prove that S&P's Internal Control Structure was Ineffective.38

D. The Criteria Process Allegations Fail Based on the Evidence....38

E. The RAMP Allegations Have No Evidentiary Support....40

F. The MQR Allegations Fail Based on the Evidence....40

POINT IV: The Division Failed to Prove a Violation of 17g-2(a)(6)....41

A. The RAMP Allegations are not Actionable Under 17g-2(a)(6)....41

B. The 17g-2(a)(6) Violation Also Fails Based on the Evidence....42

POINT V: The Administrative Proceeding Violated Article II of the U.S. Constitution....42

CONCLUSION....43

TABLE OF AUTHORITIES

Cases: **Page**

Aaron v. S.E.C., 446 U.S. 680 (1980) 21

Abuhamdan v. Blyth, Inc., 9 F. Supp. 3d 175 (D. Conn. 2014) 29

Alizac Partners v. Rospatch Corp., 712 F. Supp. 5997 (W.D. Mich. 1989) 8

Basic Inc. v. Levinson, 485 U.S. 224 (1988) 5, 6, 11

Bendix Corp. v. F.T.C., 450 F.2d 534 (1971) 21

Brody v. Transitional Hosps. Corp., 280 F.3d 997 (9th Cir. 2002) 3

Castellano v. Young & Rubicam, Inc., 257 F.3d 171 (2d Cir. 2001) 15, 20

Charal Inv. Co. v. Rockefeller, 131 F. Supp. 2d 593 (D. Del. 2001) 5

City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.,
632 F.3d 751 (1st Cir. 2011) 21

City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173 (2d Cir. 2014) 17

EC v. Goldstone, No. 12 Civ. 257, 2016 WL 3135651 (D.N.M. May 10, 2016) 11

Eckstein v. Balcor Film Investors, 8 F.3d 1121 (7th Cir. 1993) 11

Flannery v. S.E.C., 810 F.3d 1 (1st Cir. 2015) 7, 8, 20

Ganino v. Citizens Utils. Co., 228 F.3d 154 (2d Cir. 2000) 17

Goldenberg v. Indel, Inc., 741 F. Supp. 2d 618 (D.N.J. 2010) 14

Harkavy v. Apparel Indus., Inc., 571 F.2d 737 (2d Cir. 1978) 15

Hoffman v. UBS-AG, 591 F. Supp. 2d 522 (S.D.N.Y. 2008) 3

In re Fannie Mae 2008 Sec. Litig., 891 F. Supp. 2d 458 (S.D.N.Y. 2012) 2

In re Royal Bank of Scotland Grp. plc Sec. Litig., No. 09 Civ. 300, 2012 WL 3826261 (S.D.N.Y.
Sept. 4, 2012) 14

In the Matter of David J. Montanino, Release No. 773, 2015 WL 1732106 (Apr. 16, 2015) 22

In the Matter of Fox Sec. Co., Inc. Morris Fox, Release No. 10475,

45 S.E.C. 377 (Nov. 1, 1973) 27

In the Matter of Gregory M. Dearlove, CPA, Release No. 315 (July 27, 2006) 28

In the Matter of Harding Advisory LLC & Wing F. Chau, Release No. 4600, 2017 WL 66592 (Jan. 6, 2017) 5

In the Matter of Richmark Capital Corp., Release No. 201, 2002 WL 412145 (Mar. 18, 2002) 28

In the Matter of Robert Bruce Lohmann, Release No. 214, 2002 WL 31086307 (Sept. 19, 2002) 28

Janus Capital Grp., Inc. v. First Derivative Traders, 564 U.S. 135 (2011) 2

Little Gem Life Scis., LLC v. Orphan Med., Inc., 537 F.3d 913, 917 (8th Cir. 2008) 22

Livid Holdings Ltd. v. Salomon Smith Barney, Inc., 416 F.3d 940 (9th Cir. 2005) 13

Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27 (2011) 5

Muncie Aviation Corp. v. Party Doll Fleet, Inc., 519 F.2d 1178 (5th Cir. 1975) 26

Neder v. United States, 527 U.S. 1 (1999) 6

Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 135 S. Ct. 1318 (2015) 3, 4, 9

Oregon Pub. Emps. Ret. Fund v. Apollo Grp. Inc., 774 F.3d 598 (9th Cir. 2014) 6

Rodale Press, Inc. v. F.T.C., 407 F.2d 1252 (D.C. Cir. 1968) 21

S.E.C. v. Berlacher, No. 07 Civ. 3800, 2010 WL 3566790 (E.D. Pa. Sept. 13, 2010) 11

S.E.C. v. Cedric Kushner Promotions, Inc., 417 F. Supp. 2d 326 (S.D.N.Y. 2006) 22

S.E.C. v. Church Extension of the Church of God, Inc., No. 02 Civ. 1118, 2005 WL 3370568(S.D. Ind. Dec. 12, 2005) 14

S.E.C. v. Jaeger, No. 07 Civ. 39, 2012 WL 4461521 (D.N.H. Sept. 26, 2012) 5

S.E.C. v. Kelly, 663 F. Supp. 2d 276 (S.D.N.Y. 2009) 13, 20

S.E.C. v. Kelly, 817 F. Supp. 2d 340 (S.D.N.Y. 2011) 2, 27

S.E.C. v. Levin, No. 12 Civ. 21917, 2013 WL 5588224 (S.D. Fla. Oct. 10, 2013) 5

S.E.C. v. Lucent Techs., Inc., 610 F. Supp. 2d 342 (D.N.J. 2009) 29

S.E.C. v. Obus, 693 F.3d 276, 286 (2d Cir. 2012) 20

S.E.C. v. Pasternak, 561 F. Supp. 2d 459, 514 (D.N.J. 2008) 26

S.E.C. v. Shanahan, 646 F.3d 536 (8th Cir. 2011) 24

S.E.C. v. St. Anselm Exploration Co., 936 F. Supp. 2d 1281, 1299 (D. Colo. 2013) 29

S.E.C. v. Syron, 934 F. Supp. 2d 609 (S.D.N.Y. 2013) 3

S.E.C. v. Treadway, 430 F. Supp. 2d 293, 339 (S.D.N.Y. 2006) 22

S.E.C. v. Wyly, 33 F. Supp. 3d 290, 301 (S.D.N.Y. 2014) 17

SEC v. Capital Cove Bancorp LLC, No. 15 Civ. 98, 2015 WL 9704076 (C.D. Cal. Sept. 1, 2015) 17

SEC v. Ginder, 752 F.3d 569 (2d Cir. 2014) 21, 26

SEC v. Goldstone, No. 12 Civ. 257, 2016 WL 3135651 (D.N.M. May 10, 2016) 11

Tongue v. Sanofi, 816 F.3d 199 (2d Cir. 2016) 4

TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) 7

United States v. Litvak, 808 F.3d 160 (2d Cir. 2015) 5

Statutes

15 U.S.C. § 77q 2, 3, 5, 6, 21, 28, 29
15 U.S.C. § 78m 37, 38
15 U.S.C. § 78o 37, 38
Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 939A(a)(1)-(2), 124 Stat. 1376, 1887 (2010) 10

Other Authorities

Exchange Act Release No. 55231, 89 S.E.C. Docket 2880, 2007 WL 325688 (February 2, 2007) 41

Exchange Act Release No. 55857 (June 5, 2007), 90 S.E.C. Docket 2032, 2007 WL 1624609 (June 5, 2007)....41

Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 72936, 2014 WL 4538057 (Aug. 27, 2014)....38

Removal of Certain References to Credit Ratings & Amendment to the Issuer Diversification Requirement in the Money Mkt. Fund Rule, Release No. IC-31828 (Sept. 16, 2015)....10

Removal of Certain References to Credit Ratings Under the Sec. Exch. Act of 1934, Release No. 34-71194 (Dec. 27, 2013)....10

Rules

17 CFR § 240.10b-5....2, 5, 6, 28, 29
17 CFR § 240.17g-2....29, 30, 32, 41, 42
Commission Rule of Practice 222....19

PRELIMINARY STATEMENT

This case has no merit whatsoever. The hearing evidence did not establish that Duka acted with *scienter* or that the DSC figures contained in the Presales were material to a reasonable CMBS new issuance investor's analysis or decision to invest. The evidence also fell far short of establishing that Duka violated any of the alleged rating agency statutes and rules cited in the OIP.

The Division's inability to call witnesses or produce documents to support its claims is the hallmark of this case. The OIP charged that beginning in Fall 2010, the CMBS NI group engaged in a scheme to relax its analyses to procure new ratings engagements. But the Division called only one witness from the Group other than Duka, and this witness, who did not join NI until March 2011, endorsed the analytic soundness of the Groups' ratings approach and its disclosure of the same to the Model Quality Group, and flatly denied participating in or being aware of any scheme to deceive or to act for commercial purpose. The evidence otherwise presented overwhelmingly showed that commercial motive had nothing to do with NI's use of Blended Constants beginning in January 2011, but instead that NI (a) acted more conservatively than required by Criteria; (b) was analytically justified in employing Blended Constants as an interpretation of Criteria, as corroborated by a contemporaneous inquiry by Quality; and (c) generated through such application of Criteria results that promoted ratings consistency with the Surveillance model. The Division asserted materiality, but, the questions asked of the Division-called investors were not probative of legal materiality, and, critically, the Division never asked whether any investment-related mix of information would be significantly altered had S&P published different DSC figures in the Presales. In any event, the investors called by the Division confirmed the irrelevance of S&P's Presale publication DSC metrics to their investment

analyses. Finally, the Division called an expert whose testimony concerning materiality failed wholesale to account for the independent analysis conducted by sophisticated investors in this market, rendering his opinion of insignificant value, and whose general bias manifested to such a degree as to be cringe-inducing.

The credible and corroborated evidence in this case, including that of seasoned investors and an expert called by Duka, and S&P analytic and managerial professionals and the documents they contemporaneously authored, roundly disproves every allegation in the OIP.

FACTS

The relevant facts are set forth in Respondent's Proposed Findings of Fact and Conclusions of Law, filed herewith.[1]

ARGUMENT

POINT I

The Division Failed to Prove that Duka Violated Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder

A. Duka did not "Make" the Statements in the 2011 Presales

The statements made in the 2011 Presales were not made by Duka within the meaning of *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135 (2011). As such, she cannot be held liable as a primary violator of Rule 10b-5(b) and Section 17(a)(2). *See S.E.C. v. Kelly*, 817 F. Supp. 2d 340, 345 (S.D.N.Y. 2011). "In the post-*Janus* world, an executive may be held accountable where the executive had ultimate authority over the company's statement; signed the company's statement; ratified and approved the company's statement; or where the statement is attributed to the executive." *In re Fannie Mae 2008 Sec. Litig.*, 891 F. Supp. 2d 458, 473

[1] This Post-Hearing Brief uses the same defined terms as Respondent's Proposed Findings of Fact and Conclusions of Law.

(S.D.N.Y. 2012), *aff'd*, 525 F. App'x 16 (2d Cir. 2013). No evidence shows that Duka signed, approved, or ratified the statements made in the 2011 Presales; and the statements were attributed to S&P, not Duka. *See, e.g.*, JX 22. The Division also failed to prove that Duka had "ultimate authority" over the content of the 2011 Presales. FOF ¶ 437.

B. The Section 17(a)(2) Claim Should be Dismissed Because Neither Duka nor S&P Received "Money or Property" by Means of the Disclosure in the 2011 Presales

Neither Duka nor S&P "obtain[ed] money or property by means of" the statements in the 2011 Presales. 15 U.S.C. § 77q(a)(2); *see also U.S. S.E.C. v. Syron*, 934 F. Supp. 2d 609, 637 (S.D.N.Y. 2013). S&P's receipt of fees from issuers for rating the 2011 CF Transactions was not connected to the disclosures in the 2011 Presales. *See* JX 21, 29, 36, 45, 52, 59, 67, 76 (engagement letters). Accordingly, Duka cannot be held liable for primary or secondary liability under Section 17(a)(2).

C. The Division Failed to Prove That the 2011 Presales Were Misleading

For a disclosure to be misleading, "it must affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists." *Brody v. Transitional Hosps. Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002); *see also Hoffman v. UBS-AG*, 591 F. Supp. 2d 522, 535 (S.D.N.Y. 2008).

The fraud claims are based on the allegation that readers of the 2011 Presales were misled regarding how S&P "formed the opinion,"[2] *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1328 (2015), expressed in the 2011 Presales, supposedly because readers were led to believe that S&P arrived at CE levels using Table 1 DSCs, when Blended DSCs were used in the analysis. *See* DPB at 7.

---

[2] S&P's ratings of the 2011 CF Transactions constituted S&P's opinions regarding the creditworthiness of the 2011 CF Securities. FOF¶¶ 50, 52-53; RPB at 35-36.

But, the unrebutted evidence is that investors believed that Actual DSCs were considered, in addition to Table 1 DSCs, in S&P's determination of CE levels. FOF¶ 708. Each of the 2011 Presales referred to and/or included Actual DSCs, FOF¶¶ 491, 493, 511, 513, 530, 532, 553-554, 571, 573-574, 591, 593-594, 611, 616, 618-619, 633, 636, 638-639, with increased focus on Actual DSCs during 2011 in (1) tabular data showing ranges of Actual DSCs, FOF¶¶ 554, 574, 594, 619, 639, and (2) summary weighted average pool-level BBB Actual DSCs in the Rationale sections of the GSMS 2011-GC4 and FREMF 2011-K14 Presales. FOF¶¶ 611, 633. No investor contemporaneously expressed the belief that only Table 1 DSCs were in use. To the contrary, the evidence supports the inference that reasonable investors who read the Presales would believe that S&P was using Actual DSCs in some way to determine CE levels. FOF¶ 708. The Division thus failed to prove that reasonable investors, with the understanding that Actual DSCs and Table 1 DSCs were used to arrive at the CE levels, were nevertheless misled by S&P's use of a Blended Constant.[3] *See Omnicare*, 135 S. Ct. at 1330 ("[A]n investor reads each statement [in a registration statement], whether of fact or of opinion, in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information. And the investor takes into account the customs and practices of the relevant industry. So an omission that renders misleading a statement of opinion when viewed in a vacuum may not do so once that statement is considered, as is appropriate, in a broader frame."); *Tongue v. Sanofi*, 816 F.3d 199, 211 (2d Cir. 2016) (*Omnicare* "emphasized the need to examine the context of an allegedly misleading opinion").

[3] The Division, anticipating this deficiency in proof, enlisted Rubinstein to aver that the presentation of Actual DSCs was intended to convey the nature of the stress being imposed through use of the Table 1 Constants. Rubinstein Rept. ¶ 96; Tr. 1904:23-1907:8. Rubinstein's testimony finds no support in the text of the 2011 Presales, Tr. 1907:3-8, and is against the overwhelming weight of the testimony from the CMBS investors. FOF¶ 708.

D. The Division Failed to Prove Materiality

A misrepresentation is material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (internal quotation marks and citation omitted); *see also Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44 (2011). The materiality of any alleged misrepresentation, omission, or half-truth must be assessed in light of the sophistication of the class of investors to whom the alleged misrepresentation, omission, or half-truth is directed. *See United States v. Litvak*, 808 F.3d 160, 185 (2d Cir. 2015); *In the Matter of Harding Advisory LLC & Wing F. Chau*, Release No. 4600, 2017 WL 66592, at *7 (Jan. 6, 2017).

1. The Division was Required to Prove Materiality in Connection With the Alleged Violations of Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3)

Rule 10b-5(a) and Section 17(a)(1) prohibit any "device, scheme or artifice to defraud," and Rule 10b-5(c) and Section 17(a)(3) prohibit an "act,[4] practice or course of business which operates . . . as a fraud or deceit." Although materiality "is not an express element" of these provisions, proof of materiality is required. *U.S. S.E.C. v. Jaeger*, No. 07 Civ. 39, 2012 WL 4461521, at *1 (D.N.H. Sept. 26, 2012) (under these provisions, the SEC "retains the burden to establish materiality to the extent the express elements of the claims (e.g., 'fraud') necessarily include that concept . . . [F]raud, by its nature, inherently contemplates a form of deception that matters."); *S.E.C. v. Levin*, No. 12 Civ. 21917, 2013 WL 5588224, at *11 (S.D. Fla. Oct. 10, 2013); *Charal Inv. Co. v. Rockefeller*, 131 F. Supp. 2d 593, 603 (D. Del. 2001) ("[C]laim pursuant to Rule 10b-5(a) requires a demonstration of materiality even though it is not expressly

[4] Section 17(a)(3) uses the term "transaction" instead of "act."

required in the language of the rule."); *see also Neder v. United States*, 527 U.S. 1, 22 (1999) ("[T]he well-settled meaning of 'fraud' require[s] a misrepresentation or concealment of *material* fact.").[5] The Division's contention that it need not prove materiality under Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3), *see* DPB at 18-19, is erroneous.

2. The Evidence Overwhelmingly Demonstrated That S&P's use of a Blended Constant was Immaterial

The Division attempted to establish materiality by asking whether investors deemed ratings, the 2009 Criteria, or credit enhancement generally "important," all of which is peripheral to the materiality question in this case, namely, whether S&P's use of a Blended Constant as compared to a Table 1 Constant in connection with its CE determinations for the 2011 CF Transactions was material. The evidence convincingly showed that it was not. Indeed, neither the investor testimony advanced in the Division's case nor a single exhibit aided the Division's case; rather, this evidence confirmed that the DSCs published in the Presales were immaterial to a reasonable investor in CMBS issuances in 2011.

a. The Investment Analyses of CMBS Investors did not Consider S&P's DSCs

CMBS investors are sophisticated, FOF¶ 705, and used loan-level information provided in the offering documents to conduct their own analyses of the collateral backing the 2011 CF Transactions. FOF¶¶ 718, 722, 746, 761, 775. They re-underwrote some or all of the loans,

---

[5] In *Neder*, the Supreme Court held that even in the absence of an express materiality requirement, "materiality of falsehood is an element of the federal mail fraud, wire fraud, and bank fraud statutes." 527 U.S. at 25. Courts "must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning" under common law, and found that "the common law could not have conceived of 'fraud' without proof of materiality." *Id.* at 21-22 (internal quotation marks omitted). Likewise here, Section 10(b), Rule 10b-5, and Section 17 derive from common law, *Basic*, 485 U.S. at 253 ("[T]he case law developed in this Court with respect to § 10(b) and Rule 10b–5 has been based on doctrines with which . . . are familiar: common-law doctrines of fraud and deceit."); *Oregon Pub. Emps. Ret. Fund v. Apollo Grp. Inc.*, 774 F.3d 598, 605 (9th Cir. 2014) ("law on securities fraud is derived from common-law fraud"), and express no intention of Congress to eliminate materiality as an element.

FOF¶¶ 744, 746, 762-763, 785, and, using Trepp or proprietary models, performed customized stress scenarios on the loans in the CF pool, FOF¶¶ 723-724, 747-748, 762, 775, 787. Following such analyses, investors determined whether the issuer-offered CEs were sufficient in light of the price, yield, and quality of the collateral. FOF¶ 706.

No evidence shows that a single metric from any of the 2011 Presales, let alone BBB Table 1 DSCs, was part of this independent analysis. FOF¶¶ 728, 750, 752. The Division, with vast resources and subpoena power, did not call a single investor to testify that S&P metrics were considered in any internal investment analysis and did not offer any document reflecting that a CMBS investor even jotted down any of the Table 1 BBB DSCs. *See Flannery v. S.E.C.*, 810 F.3d 1, 11 (1st Cir. 2015). The absence of this evidence confirms that disclosure of the Blended Constant, would have assumed **no** "actual significance in the deliberations" of a reasonable investor. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

b. Investors did not Review the S&P BBB DSCs in Making an Investment Decision

Five representatives of sophisticated institutional investors in the 2011 CF Transactions testified, Weih, Peterson, Reidy, Born, and Wood. Not one asserted that BBB S&P DSCs were relevant to their analyses whether to invest in any CMBS NI. No document in evidence reflects that any internal analysis of a CMBS issuance by any of these investors noted, much less considered, an S&P published DSC. On this record, it would eviscerate the materiality standard were the evidence held to be sufficient to establish materiality.

c. The Offering Documents for the 2011 CF Transactions Underscored the Responsibility of Investors to Conduct Their Own Due Diligence

The offering documents for the 2011 CF Transactions warned investors that, especially after the financial crisis, investors should not give significant weight to the methodology

employed by NRSROs to assign credit ratings. FOF¶ 701. These documents also informed investors that the NRSROs selected to rate the particular transaction were selected,[6] in part, because they proposed lower credit enhancement levels. FOF¶¶ 700, 703. Investors thus understood that un-selected NRSROs might view S&P's CE levels as insufficient. *Id.*

d. The Absence of Investor Questions Shows that the Constants Employed by S&P Were not Considered in the Investment-Decision Process

The record is devoid of evidence that investors asked questions that naturally would have arisen if S&P's constant was considered by these sophisticated parties.

Investors never asked about the difference between (1) the RFC, the 2009 Criteria, and the November 2010 Criteria, each of which disclosed use by S&P of actual constants to compute DSCs, FOF¶¶ 144, 147-150, 204-207, 213, 289-290, and (2) the presentation of Table 1 DSCs in the 2011 Presales. Tr. 1908:7-13. Investors did not question the Commentary's mention of "stressed" constants, FOF¶ 284, or the June 2010 Criteria Article, published eight days earlier, which drew on Actual DSCs in its illustrative examples. FOF¶¶ 275-280. Investors did not ask how S&P "consider[ed] both the loan's actual debt constant and a stressed constant," *see, e.g.*, FOF¶ 491, as described in the 2011 Presales, although, according to Rubinstein, the disclosure was "totally opaque." Tr. 1907:19-1908:6.

This absence of inquiry corroborates that the specific stressed constant[7] employed by S&P was immaterial. *Flannery*, 810 F.3d at 10; *Alizac Partners v. Rospatch Corp.*, 712 F. Supp. 599, 607 (W.D. Mich. 1989) ("reasonable investor faced with these contradictory sets of figures .

[6] The offering documents also disclosed that, with the exception of FREMF 2011-K701, each of the 2011 CF Transactions was rated by one or more NRSROs other than S&P. FOF ¶ 698.

[7] Richard Rept. ¶ 78 ("Unlike the actual constant, both the Table 1 Constant and the Blended Constant would have been viewed by reasonable investors as stressed loan constants.").

. . would have asked . . . for an explanation concerning the discrepancies"). Revealingly, the **only** investor to ask S&P about "constants" did so as a result of the first ANPCC in late July 2011, FOF¶ 668, and queried where he could "learn how S&P derives its loan constant rates and how they compare to actual debt service amounts" because the November 2010 Criteria did not address these issues. FOF¶ 672.

e. S&P Affirmed the Ratings on the 2011 CF Transactions Following an Independent Analysis, Confirming Immateriality

The immateriality of S&P's use of Blended Constants was confirmed when senior members of the Criteria Group conducted an analysis, and affirmed the ratings of the 2011 CF Transactions. FOF¶ 676-679. In concluding that the ratings were "consistent" with S&P's "rating definitions," FOF¶ 678-679, S&P communicated, *e.g.*, that 18.375% AAA credit enhancement for JPMCC 2011-C4, JX 60 at SP-CMBS 00285401, was sufficient to protect AAA security holders from losses in a Great Depression-like economic environment. FOF¶¶ 52-53. In the language of *Omnicare*, whether S&P "formed the opinion," 135 S. Ct. at 1328, regarding the CE levels using the Table 1 Constant or the Blended Constant, S&P's opinion did not change.[8]

f. Immateriality is Further Clear Because the Increased "Stress" Imposed by Use of a Table 1 Constant was Analytically Meaningless

The use of Table 1 Constants resulted in the imposition of an arbitrary, unjustified stress because (1) the contractual annual debt service of a fixed rate loan did not change during its term regardless of economic environment,[9] FOF¶¶ 340, 471, and (2) the degree of stress using Table

---

[8] Accordingly, the evidence that certain investors were subject to investment guidelines that, *e.g.*, restricted their capacity to purchase securities below AAA, is irrelevant.

[9] As ratings are opinions about the "likelihood" of default, FOF¶ 50, a rating methodology should not stress an immutable condition such as fixed debt service during the term. FOF¶ 471. The debt service could only change at maturity, the reason NRSROs use "stressed" constants in maturity default tests. FOF¶ 390.

Constants would randomly vary depending on each loan's fixed rate. FOF¶¶ 340, 473, 476. No evidence advanced any rationale as to how any marginal credit enhancement resulting from the use of Table 1 constants was beneficial to investors, FOF¶ 477. Rather, had the Table 1 Constants been used, investors would have paid more for the 2011 CF Securities, and would not have received greater protection from default in a stressed economic environment. FOF¶ 474.

g. Immateriality is Also Clear Because Investors did not Know S&P's Rationale for Using a "Stressed" Constant to Assess Term Default Risk

No testifying investor understood S&P's reason for using a Table 1 Constant or, for that matter, any "stressed" constant to assess term default risk. FOF¶ 709. It is, therefore, highly implausible that investors making investment decisions would have attributed any significance to S&P's use of a particular "stressed" constant versus another in making their independently analyzed investment decisions.[10]

h. Neither AEGON nor PFG Reviewed the 2011 Revised Presales

The 2011 Revised Presales included the information that the Division contends should have been included the 2011 Presales. FOF¶¶ 502-503, 521-522, 540-541, 562-563, 581-582, 601-602, 627-628, 647-648. There is no evidence that Division witnesses AEGON and PFG reviewed the 2011 Revised Presales. FOF¶ 739. Because the "omitted fact" here lacked any

[10] Furthermore, in response to the financial crisis, Congress and regulatory agencies (including the SEC), discouraged investor overreliance on credit ratings. Section 939A of the Dodd-Frank Act required each federal agency to "review . . . any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument and . . . any references to or requirements in such regulations regarding credit ratings." Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 939A(a)(1)-(2), 124 Stat. 1376, 1887 (2010). Pursuant to Section 939A, the Commission amended a number of rules to remove references to credit ratings. *See* Removal of Certain References to Credit Ratings & Amendment to the Issuer Diversification Requirement in the Money Mkt. Fund Rule, Release No. IC-31828 (Sept. 16, 2015); Removal of Certain References to Credit Ratings Under the Sec. Exch. Act of 1934, Release No. 34-71194 (Dec. 27, 2013). Here, where (1) investors had no clue why S&P was using "stressed" constants to assess term default risk, FOF¶ 709, and (2) where such use was analytically unjustifiable, the Division should not even be suggesting materiality in this case.

significance to these investors' independent analyses, they understandably were uninterested in its "correction." *Basic*, 485 U.S. at 231-32.[11] In a real fraud case, defrauded investors care about learning the "truth" and its possible implications for their original investment analyses.

i. The Failure to Produce Evidence of Markdowns of the 2011 CF Securities Negates a Finding of Materiality

Although the Division agrees that ratings affect the pricing of CF securities, Tr. 1622:18-1623:13, the Division offered no evidence that any investor in the 2011 CF Transactions, including AEGON and/or PFG, changed the marks on its books for any of the 2011 CF securities after the ANPCC (JX 6) was published on July 27, 2011, FOF¶ 668 ("[b]ecause of the early stage of the review, the potential impact on outstanding ratings is uncertain"), or the revised presales were published on September 2, 2011.[12] FOF¶¶ 502-503, 521-522, 540-541, 562-563, 581-582, 601-602, 627-628, 647-648; *S.E.C. v. Berlacher*, No. 07 Civ. 3800, 2010 WL 3566790, at *7-*8 (E.D. Pa. Sept. 13, 2010) (disclosure "immaterial as a matter of law" due to failure to offer proof of "movement in the stock price"); *Eckstein v. Balcor Film Investors*, 8 F.3d 1121, 1130 (7th Cir. 1993).

---

[11] The Division may suggest that because AEGON and PFG already purchased certain of the 2011 CF Securities, they had no reason to review the revised presales. Tr. 1011:1-13. That is akin to arguing that reasonable investors do not review restated financial statements because they already conducted due diligence in purchasing shares of a company.

[12] The Division also failed to proffer an event study, which is required for a finding of materiality in the Third Circuit, and "almost obligatory" in the Second Circuit. *SEC v. Goldstone*, No. 12 Civ. 257, 2016 WL 3135651, at *46 (D.N.M. May 10, 2016) (internal quotation marks omitted).

j. Investors Could Not Ascribe Significance to Particular Metrics in the 2011 Presales Because They Could Only Generally Understand how S&P Arrived at the CE Levels Included in these Reports

The 2009 Criteria and the 2011 Presales permitted investors to understand only generally how S&P arrived at CE levels, rendering Blended DSCs necessarily insignificant to an investor's analysis.

Neither the 2009 Criteria nor the 2011 Presales explained how S&P evaluated a substantial portion of the loans in the 2011 CF Transactions. In particular:

- Each of MSC 2011-C1, JPMCC 2011-C3, JPMCC 2011-C4, and GSMS 2011-GC4 contained loans made on property types that were not listed in Table 1 or Table 5 of the 2009 Criteria, ranging from 5.3% to 13.9% of the pool. FOF¶¶ 489, 528, 589, 614. Investors could not determine among other things how S&P would calculate either the numerator or the denominator of the DSCs for these loans. FOF¶ 712.

- Each of the 2011 CF Transactions contained partial interest-only and/or interest-only loans, ranging from 13.8% to 63.9% of the pool. FOF¶¶ 490, 510, 529, 550, 570, 590, 615, 635. The Criteria were silent and the Presales were not specific as to how S&P evaluated these loans. FOF¶ 710.

Moreover, without access to S&P's model, FOF¶ 70, investors could not determine with any useful degree of clarity how or to what degree S&P's metrics or "consideration" of qualitative factors influenced CE levels in any specific case. FOF¶¶ 492, 512, 531, 552, 572, 592, 617, 637, 711. Thus, an investor could not extract from the Presales enough analytic detail to permit it to assess the significance to the CE determination of the specific constants used in the model's DSC term test. As such, the constants cannot have been significant to the sophisticated investor in this market.

k. Materiality is Lacking Because Investors Determined That the CE Levels Were Attractive

Before investing in the 2011 CF Securities, investors determined that the CEs, which were arrived at using the Blended Constant, FOF¶¶ 485, 506, 525, 546, 566, 586, 609, 631,

offered appropriate levels of credit support. FOF¶ 706. No evidence was elicited that investors considered S&P's use of Table 1 DSCs in making this determination or that a "substantial likelihood" existed that investors "would have acted differently" had the Blended Constant been disclosed. *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005).

1. The Investor Testimony Further Proves Immateriality

The testimony of CMBS investors proved that the specific "stressed" constant used by S&P not only failed to alter significantly the total mix of information, but was irrelevant to the analysis of the reasonable investor.

Weih (AEGON)

Weih did not know that the Table 1 DSCs in the 2011 Presales were tied to the BBB stress, FOF¶ 729, offered no explanation of how a BBB Table 1 DSC helped AEGON evaluate whether to purchase the AAA securities that AEGON acquired, FOF¶ 730, and considered the CEs in the MSC 2011-C1 Presale an "attractive aspect of the deal." FOF¶ 727.

Confirming immateriality, Weih, when asked how, if at all, AEGON's analysis would have been altered had the disclosed weighted average pool BBB DSCs been higher than published, answered that the securities would have been **more** attractive:

> I guess I would say hypothetically if it -- we're looking at debt coverage -- we're looking at pool metrics, right? So if it was 1.4, and other deals that were brought were 1.2, we might look at that deal **more favorably** for all else equal.

FOF¶ 731 (emphasis added).

Because Blended DSCs were *higher* than Table 1 DSCs, *see, e.g.*, DX 365, Weih's answer suggests that AEGON would have been *firmer* in its conviction to purchase the CF securities if the higher weighted average BBB Blended DSCs had been disclosed. *See S.E.C. v. Kelly*, 663 F. Supp. 2d 276, 284 (S.D.N.Y. 2009). As important, no evidence showed that

AEGON actually engaged in a comparative analysis of pool level BBB DSCs in deciding to purchase any of the 2011 CF Securities. Weih's testimony that AEGON "*might* look" at a "deal more favorably" falls short of meeting the "substantial likelihood" required for a finding of materiality.

Most importantly, Weih acknowledged that he did not review the methodology section of S&P's presales. FOF¶ 736. This renders him an inappropriate proxy for a reasonable investor. *In re Royal Bank of Scotland Grp. plc Sec. Litig.*, No. 09 Civ. 300, 2012 WL 3826261, at *6 (S.D.N.Y. Sept. 4, 2012) ("In evaluating claims of securities misstatements, statements must be read in their entirety to determine whether a reasonable investor would have been misled.") (internal quotation marks omitted); *Goldenberg v. Indel, Inc.*, 741 F. Supp. 2d 618, 642 (D.N.J. 2010) ("[A] reasonable investor reads the whole prospectus."); *S.E.C. v. Church Extension of the Church of God, Inc.*, No. 02 Civ. 1118, 2005 WL 3370568, at *3 (S.D. Ind. Dec. 12, 2005).

Finally, S&P's Presale metrics were generally so unimportant to AEGON that, when AEGON prepared a comparison of CF transactions issued after the financial crisis, RX 741, only Moody's metrics were included; where S&P rated a CF transaction, the table was left blank. FOF¶¶ 732-735.

Peterson (Principal Group)

When asked whether it would have "matter[ed]" to Peterson "if the DSCR number or loan constant number" in the presale were not the numbers "used to drive credit enhancement," Peterson explained that it **only** would "matter" to him "if a different set of assumptions were going to be used in surveillance," FOF¶ 753, because PFG would not want the CF securities it purchased to be downgraded solely because of a methodological difference between NI and Surveillance. FOF¶ 754. Given this testimony, the Division, to close the evidentiary loop, was

required (but failed) to offer any evidence that the 2011 CF Securities were more likely to be downgraded simply because they were arrived at using Blended Constants. *Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 180 (2d Cir. 2001) ("When contingent or speculative future events are at issue, the materiality of those events depends on a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of company activity.") (internal quotation marks and citations omitted); *Harkavy v. Apparel Indus., Inc.*, 571 F.2d 737, 741-42 (2d Cir. 1978) (plaintiff failed to demonstrate materiality when "[t]he indicated probability that the plans would be acted upon was slight, and the anticipated magnitude of the event in light of the totality of the company activity was, at best, speculative") (internal quotation marks omitted). Notably, the evidence showed that use of the Blended Constant harmonized the credit enhancement levels between NI and Surveillance. FOF¶¶ 348, 685-694. And, importantly, Peterson testified that it would be problematic if through S&P's use of the Table 1 Constants, the securities in the surveillance period would have been subject to automatic upgrade because of a difference in methodology. FOF¶ 754.[13]

Reidy (Fort Washington)

Reidy reviewed NRSRO presales approximately 25% of the time, FOF¶ 765, did not review the MSC 2011-C1 or JPMCC 2011-C4 presales, FOF¶ 769, and explained that S&P's metrics were not relevant to Fort Washington's investment decision-making process. FOF¶ 768.

Born (PPM)

PPM's review of presales "primarily" involved review of the top ten loans for factual information PPM's analysis may have lacked, not for analytic calculations. FOF¶ 778. Born

---

[13] Moreover, because S&P's methodology was not transparent, FOF¶¶ 163, 735, 791, any concern whether the analytical approach of NI differed from Surveillance would have existed even if the Blended Constant were fully disclosed.

explained that the manner in which S&P arrived at credit enhancement levels "candidly ... was not a big consideration" in PPM's decision to invest because PPM's analysis of the top 10 loans was the "driving" force behind PPM's investment decision. FOF¶ 779.

Wood (Hartford)

The CMBS team at Hartford did not typically review S&P's presales. FOF¶ 789. Hartford's files did not contain S&P's presales for two of the 2011 CF Transactions that it purchased, FOF¶ 790, and Wood believed his team did not review the two S&P presales that were collected. *Id.*

Richard

Expert witness Richard, a CMBS investor with more than 20 years of experience, FOF¶ 791, which included experience evaluating whether to purchase CF securities in 2011, FOF¶ 792, opined that whether S&P used a Table 1 Constant or a Blended Constant was not "analytically significant" to CMBS investors. FOF¶ 791.

m. The Division's Arguments in Favor of Materiality are Meritless

None of the evidence that the Division is expected to highlight constitutes proof of materiality.

i. The materiality inquiry should ask whether disclosure of the Blended DSCs used to arrive at the disclosed CEs would have "significantly altered" the total mix of information in the decision-making process of the reasonable investor, *see* Tr. 1910:24-1911:9 (if the 2011 Presales contained full disclosure of the Blended Constant, the CEs levels would have remained the same), not, as the Division would have it, whether the total mix of information would be altered if the Presales published the CEs that would have resulted from use of Table 1 Constants. The repetitively posed hypothetical – whether investors would want to know if a 300-500 basis

point difference would have been generated if S&P had used the Table 1 Constant – is not only non-probative but unworkable because had the CEs been higher, the prices of the 2011 CF Securities would have been higher as well. FOF¶ 474.[14] The Division, in essence, was asking investors about an investment decision that they never made, not the decision they actually analyzed and made.

ii. It is also irrelevant that investors expected presales to be "accurate and truthful," *see, e.g.*, Tr. 910:16-19, or to be provided the same metrics as issuers. Materiality depends not on showing that disclosure is impeachable but on whether the omitted or inaccurate information in issue, once known, would cause the mix of information available to the reasonable investor making an investment decision to be significantly altered. *SEC v. Capital Cove Bancorp LLC*, No. 15 Civ. 980, 2015 WL 9704076, at *7 (C.D. Cal. Sept. 1, 2015). And, that which investors "would want to know" does not equate to material information. *S.E.C. v. Wyly*, 33 F. Supp. 3d 290, 301 (S.D.N.Y. 2014) ("[A] fact is not material merely because a reasonable investor would very much like to know [it].") (internal quotation marks omitted).

iii. Nor does evidence that an investor considers an item "important" equate to a showing of materiality. *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 185 (2d Cir. 2014) ("[W]hile importance is undoubtedly a *necessary* element of materiality, importance and materiality are not synonymous."); *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162 (2d Cir. 2000) ("It is not sufficient to allege that the investor might have considered the misrepresentation or omission important.").

[14] Moreover, Rubenstein's calculation of the difference between Table 1 CEs and Blended CEs is unreliable because, critically, it did not use the S&P model to break out the portion of the difference attributable to the model's flawed lost interest calculation. Tr. 1851:14-16, 1866:13-1867:6. The Division argues only that investors thought Table 1 DSCs were used. That claim aside, there was no evidence that investors understood that S&P was stressing the lost interest calculation for loss calculation purposes.

iv. The Division's questioning concerning "importance" was not focused on investment in the specific 2011 CF Transactions. Instead, the Division elicited lay opinion on how, in the abstract, the CMBS market should function as a normative matter. Thus, there was no testimony that any benefit of "apples-to-apples" comparison among CMBS issuances, Tr. 1010:22-25, Tr. 1041:3-6, was considered in, much less significantly affected, a decision to invest in any of 2011 CF Transactions.

v. Moreover, to the extent investors expected that NI would apply its methodology consistently, they necessarily expected that the 2009 Criteria would be applied consistently, FOF¶ 227, and the 2009 Criteria called for the use of actual constants to compute debt service. FOF¶¶ 204-207, 213. In addition, the Blended Constant was applied consistently to every CF transaction rated by S&P after the financial crisis. FOF¶¶ 485, 506, 525, 546, 566, 586, 609, 631. Finally, whether a preference for consistent application of methodology pertains to an investment decision would depend on the nature of the inconsistency. Were a ratings agency to use an error-ridden methodology to rate five transactions, and then without disclosing that the subject errors were corrected use a corrected methodology to rate a sixth transaction, the failure to disclose the inconsistent application of methodology would be immaterial to an investor who purchased only the sixth transaction.[15] No evidence introduced at the hearing distinguishes this case from this hypothetical.

vi. The Division focused on the time available to investors to evaluate NI transactions. But S&P's use of a Table 1 Constant or a Blended Constant is unrelated to this

[15] For all of the Division's focus on the "importance" of being able to compare CMBS issuances, there was *no* explanation offered for how the Table 1 Constant, which imposed a different level of stress depending on the interest rate environment, somehow facilitated meaningful comparisons of CMBS issuances. Tr. 1894:19-1895:21; Tr. 379:8-22.

issue. It is also unrelated to whether S&P and investors had access to the same information about the loan collateral in the CF pools.

vii. The decision of S&P to withdraw the preliminary ratings on GSMS 2011-GC4 is irrelevant to the investment decision-making process of reasonable investors.

viii. Dr. Rubinstein's report and testimony should be given no weight. Initially, because the Court questioned Rubinstein's experience to opine from the perspective of a CMBS investor, *see* Order on Motions to Exclude at 4-5, Rubinstein belatedly identified his experience working at a hedge fund. Tr. 1605:17-1606:2. This testimony should be disregarded because Rubinstein was required and failed to disclose this experience in his report. Commission Rule of Practice 222(b)(1). Independently, Rubinstein's testimony should not be credited due to his transparent willingness to slant his testimony to favor the Division even in the face of incontrovertible evidence contradicting the OIP. For example, Rubinstein testified that he did not understand the Archetypical Pool to be a benchmark, Tr. 1815:8-1818:16, even though the 2009 Criteria explicitly state as much and no other witness agreed with this errant view. FOF¶ 188. And, even though Rubinstein stated "investors want to know exactly what they're getting," and "read the criteria" to "form an opinion in their mind of how they view that," Tr. 1620:15-17, he did not "know why anybody reading [the 2009 Criteria] would ever" gain an understanding that the DSCs in Table 6 of the 2009 Criteria were Actual DSCs, Tr. 1823:7-15,[16] an understanding available to the reader through elementary algebra.

Moreover, Rubinstein's opinion that S&P's use of a Blended Constant would have been deemed significant by investors relied on (1) the CE basis-point difference between use of Table

[16] Rubinstein's statement that the CE levels for six of the 2011 CF Transactions "were below and sometimes well below the level of credit support that S&P's criteria officers had determined as being necessary to make CMBS transactions as safe as other triple-A securities rated by S&P," Rubinstein Rept. ¶ 94, was premised on a misunderstanding of the 19% AAA CE for the Archetypical Pool. FOF¶¶ 188-193.

1 Constants in the NI model and use of the Blended Constants in the model (without correcting for the model's flawed lost interest calculation), an irrelevant comparison *see supra* at 16-17; (2) the assumption that the Commercial Motive Allegations are true, Tr. 1912:8-1915:8, when they are not, *see infra* at 35-37; and (3) the assumption that the 2009 Criteria required use of the Table 1 Constants, Rubinstein Tr. 1891:5-9, which they did not. *See infra* at 30-34. Statements of Rubenstein such as "should we have another recession . . . , the bonds won't hold up as well," Tr. 1621:14-16, were, of course, not accompanied with any "indicated probability" that such an event will occur, *see Castellano*, 257 F.3d at 180, and failed to grapple with the independent conclusion of sophisticated investors who purchased the bonds that the CEs were sufficiently attractive to support a decision to purchase. Significantly, the Division failed to present any evidence that any of the 2011 CF Securities have experienced losses or downgrades.

Finally, Rubinstein testified that if the Blended Constant was fully disclosed, investors "may have still chosen to purchase the deal. They may not have." Tr. 1910:19-20. This testimony is insufficient to meet the burden of show a "substantial likelihood" that investors would have "acted differently." *Kelly*, 663 F. Supp. 2d at 284.

E. The Division Failed to Prove That Duka Acted With *Scienter* or Possessed the Requisite Mental State for Aiding and Abetting or Causing Liability or Acted Negligently

"Liability for securities fraud requires proof of scienter, defined as a mental state embracing intent to deceive, manipulate, or defraud." *S.E.C. v. Obus*, 693 F.3d 276, 286 (2d Cir. 2012) (internal quotation marks omitted). Scienter "may be established through a showing of reckless disregard for the truth, that is, conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care." *Id.*

"Questions of materiality and scienter are connected." *Flannery*, 810 F.3d at 9. "If it is questionable whether a fact is material or its materiality is marginal, that tends to undercut the

argument that defendants acted with the requisite intent or extreme recklessness in not disclosing the fact." *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.*, 632 F.3d 751, 757 (1st Cir. 2011).

1. The Division may not Cite a Negligence Theory to Prove its Claims Under Section 17(a)(2) and (a)(3)

Under the Administrative Procedures Act, 5 U.S.C. § 554(b), agencies are required to "give a clear statement of the theory on which a case will be tried." *Bendix Corp. v. F.T.C.*, 450 F.2d 534, 542 (1971). "[A]n agency may not change theories in midstream without giving respondents reasonable notice of the change." *Rodale Press, Inc. v. F.T.C.*, 407 F.2d 1252, 1256 (D.C. Cir. 1968).

Although violations under Section 17(a)(2) and (a)(3) may be based on negligent conduct, *see Aaron v. S.E.C.*, 446 U.S. 680, 695-97 (1980), beginning with the OIP and continuing throughout these proceedings, the Division has propounded a theory of intentional misconduct as a basis for these claims.[17] Indeed, the OIP *expressly disclaimed* negligence as a theory of liability:

> The inclusion of data in the Presales based on criteria constants *did not result from error, mistake, or negligence*. Since the CMBS Group did not use the data that it published in the Presales, the CMBS Group had no analytical reason to calculate it. In order to calculate such data, the CMBS Group needed to enter the models, know where the blended loan constants appeared in the formulas, change those formulas to reflect the criteria constants, re-run the models with the criteria constants, and copy the resulting data into the Presales. *These acts were all done intentionally.*
>
> OIP ¶ 36 (emphasis added).

[17] *See, e.g.*, OIP ¶ 7 ("...Duka and the CMBS Group knew that the Presales contained inaccurate data and intentionally or recklessly caused such inaccurate data to be published . . . ."); OIP ¶ 44 ("Duka explicitly decided not to disclose DSCRs using blended constants . . . .").

The Division, in its prehearing brief, nevertheless revealed for the first time that it intended to rely on a negligence theory.[18] DPB at 9. The Division may not change its theory on the eve of trial and avail itself of a standard that it specifically disclaimed in the OIP. *See SEC v. Ginder*, 752 F.3d 569, 576 (2d Cir. 2014); *In the Matter of David J. Montanino*, Release No. 773, 2015 WL 1732106, at *27 (Apr. 16, 2015).

2. The Division Failed to Prove *Scienter*, and Even if Permitted to Rely on a Negligence Theory, Failed to Prove Duka was Negligent

a. Duka did not Cause the 2011 Presales to Include Table 1 DSCs

The primary analyst was responsible for drafting the 2011 Presales, FOF¶ 426, and the secondary analyst was assigned to review her work. FOF¶ 428. The proof did not show that Duka was required to review the 2011 Presales. FOF¶ 437; *see Little Gem Life Scis., LLC v. Orphan Med., Inc.*, 537 F.3d 913, 917 (8th Cir. 2008) ("[n]egligence requires a duty, an obligation of conduct"). Duka's practice was to review portions of the presales before publication, FOF¶ 432-434, but not to review specific S&P metrics. FOF¶ 436. She focused on presentational consistency. FOF¶ 434; *see S.E.C. v. Cedric Kushner Promotions, Inc.*, 417 F. Supp. 2d 326, 336 (S.D.N.Y. 2006) (SEC failed to proffer evidence of substantial assistance where "Angel's role in the preparation of the Form 10-KSB was very limited, and . . . Angel was not involved in preparing or reviewing the financial or accounting statements that contained the alleged misstatements or omissions").

It is unsurprising given Duka's seniority that the Division was unable to present evidence that connected her to the presentation of Table 1 DSCs in the 2011 Presales. Duka was in a senior position in relation to both the modelers who calculated the metrics in the 2011 Presales,

---

[18] The boilerplate language in OIP ¶ 48 ("Duka violated the standard of care for a person in her position") cannot override the OIP's express disclaimer of a negligence theory.

FOF¶¶ 430-431, and analysts who drafted the reports. FOF¶ 426, 429. Digney, Duka's subordinate, was not even aware that different versions of the models were used to prepare the 2011 Presales. FOF ¶ 650. Nor is there any evidence that Duka instructed her subordinates to include only Table 1 DSCs in the 2011 Presales, FOF¶ 659; rather, the evidence is that that the Table 1 DSCs were included because of the preparers' "sloppiness." FOF¶ 649. Critically, the Division failed to call any witness who ran a model using a Table 1 Constant in the production of any Presale to explain why she did so.[19] The evidence is simply insufficient to allow for the inference that Duka caused the 2011 Presales to include Table 1 DSCs.[20]

3. Disclosure in the "Methodology" Sections of the 2011 Presales

After meeting with Parisi, *see* FOF¶¶ 349, 350, Duka focused on the "Methodology" section of the presales to address disclosure of the change in application of methodology discussed with Parisi. FOF ¶ 480. Pollem drafted the disclosure in this section. FOF¶ 478. Duka approved Pollem's proposed disclosure because she believed its reference to the consideration of both the Table 1 and actual constants alerted the reader that S&P was not calculating DSCs solely using Table 1 Constants. FOF¶¶ 480-481. The reasonableness of this belief is evident because the "consider both" disclosure (1) contrasted directly with the disclosure in the June 2010 Commentary, *compare* FOF¶ 284 (S&P "typically evaluates a

[19] The Division also failed to call any witness who authored an email to an issuer that included a Blended DSC to explain the background to such an email. And, even though the Division through questioning suggested that these emails showed *scienter*, Tr. 1222:23-1223:6, no evidence connected Duka to preparation of the feedback emails. Second, (1) the JPMCC 2011-C3 feedback email to the issuer contained a **Table 1** DSC, FOF¶¶ 526, 537 and (2) the feedback emails for FREMF 2011-K11, FREMF 2011-K13, and FREMF 2011-K14 did **not** contain any DSCs, FOF¶¶ 559, 578, 644, casting doubt on the Division's theory that the feedback emails were the product of a scheme.

[20] The Division argues that the 2011 Presales are obviously the product of intentional misconduct because the model needed to be adjusted to produce the 2011 Presales. OIP ¶ 36. But the record does not include any draft Presale or draft data table rejected by Duka or anyone else that reflected use of the Blended Constant or Blended DSCs.

transaction's loan default probability using a stressed DSC") *with* FOF¶ 478 ("In determining a loan's DSCR, Standard & Poor's will consider both the loan's actual debt constant and a stressed constant"); (2) was made in a paragraph that was otherwise identical to the description of the CF methodology in the September 2010 hybrid JPMCC 2010-C2 Presale, *compare* FOF¶ 442 *with* FOF¶ 491; and (3) was consistent with the "factors considered" species of disclosure that permeated the 2011 Presales. FOF¶¶ 492, 512, 531, 552, 572, 592, 617, 637.

The reasonableness of Duka's view was further confirmed in the MQR review. Criteria Officer Geramian, who knew that NI was using Blended Constants, FOF¶¶ 388, 392-393, approved the MQR report describing the loan constant "used in the model" as a "combination of the actual loan constants" and Table 1 Constants. FOF¶¶ 417-418. And Digney twice expressed his view to Duka that describing the Blended Constant as "look[ing] at both" or a "combination" of the actual and Table 1 Constants was sufficiently clear. FOF¶¶ 403-405, 410-412. Against the above, the Division can only express its after-the-fact contrary opinion – no substitute for proof.

4. Duka Received no Adverse Feedback Concerning the Disclosure in the 2011 Presales

No evidence reflected adverse feedback to Duka concerning the Methodology or other Presales disclosure. The presales were distributed widely, including to senior management. FOF¶¶ 494, 514, 533, 555, 620, 640. *S.E.C. v. Shanahan*, 646 F.3d 536, 544 (8th Cir. 2011) ("It is undisputed that none of these professionals ever raised to Shanahan Jr. any concern regarding option dating and pricing and the OPS disclosures . . . . Depending on others to ensure the accuracy of disclosures to purchasers and sellers of securities—even if inexcusably negligent—is not severely reckless conduct that is the functional equivalent of intentional securities fraud."). Notably, Snow, a primary analyst on the first of the two 2011 Presales, FOF¶¶ 484, 505, sent an

email evidencing his thinking about disclosure concerning S&P's use of constants in which he **did not** suggest that Blended DSCs be included in the presales. FOF¶ 542.

From publication of the first presale to the last, the only relevant evidence that Duka was asked about the DSC disclosure is a July 11, 2011 email from Digney to Fisher reflecting the existence of a communication between Digney and Duka that occurred between 8PM and 9PM the night before publication of the GSMS 2011-GC4 Presale (the **seventh** of the 2011 Presales). FOF¶ 603. But neither Digney nor Duka recalled the substance of this communication, and, to the extent it occurred, the exchange took place in a period when Duka's workload was the "heaviest" in her career at S&P. FOF¶¶ 604-605. The email does not provide any contextual insight concerning the communication such as whether during this late evening Duka was otherwise occupied, how Digney framed the discussion or whether the two discussed it for more than a few seconds. In any event, the communication inferable from the Digney-Fisher email can hardly be characterized as raising a concern about the existing disclosure, considering that Digney testified to no intention on his part to deceive anyone in connection with either the JPMCC 2011-C4 Presale or GSMS 2011-GC4 Presale, as to both of which he served as the secondary contact. FOF¶ 655.

5. The Division Cannot Explain the Evidence that is Flatly Inconsistent With a Finding of *Scienter*

The Division cannot cite evidence to explain why, if Duka intended to conceal S&P's transition to the use of a Blended Constant, she would have approved the additional disclosure in the Methodology section in the first place, FOF¶ 480; or why over the course of the Presales, the documents, with no evidence of her intervention or involvement or comment one way or the other, referred increasingly to Actual Constants. *See supra* at 4. Nor does the evidence rebut that had Duka been intent on garnering more CF rating engagements for S&P, she would have

more heavily disclosed the change, getting the word out to issuers that S&P would be imposing less stress than imposed by use of Table 1 Constants. Given that the Table 1 Constants were not required by the express terms of the Criteria – and were analytically indefensible because they imposed random, variable stress regardless of the scheduled interest rates associated with the collateral pools – NI had no reason not to disclose repeatedly the use of a Blended Constant, FOF¶ 656.

6. The Disclosure in the 2011 Presales did not Fall Short of the then-S&P Standard of Disclosure

The Division cannot succeed by arguing that Duka negligently violated a standard of care because it did not adduce evidence to (1) establish the standard of care at S&P during the Relevant Period, and (2) demonstrate that Duka breached that standard. *Ginder,* 752 F.3d at 575 (examining reasonableness of defendant's conduct by reviewing practice of engaging in market timing at Prudential); *Muncie Aviation Corp. v. Party Doll Fleet, Inc.*, 519 F.2d 1178, 1180 (5th Cir. 1975) ("Evidence of custom within a particular industry, group, or organization is admissible as bearing on the standard of care in determining negligence"); *see S.E.C. v. Pasternak,* 561 F. Supp. 2d 459, 514 (D.N.J. 2008).

In any event, the standard the Division would impose without evidence did not exist at S&P during the Relevant Period. Concerning the disclosure of constants used in the DSC calculation, S&P never engaged in disclosure more precise than did NI in the 2011 Presales:

- In 2009, despite investor focus on the term default test in the RFC, FOF¶¶ 163, 165, 171, on multiple occasions, Surveillance failed to disclose that there was a stress imposed on debt service through use of the Table 1 Constants. FOF¶¶ 168, 228-230.
- Surveillance took rating actions using the Table 1 Constants to compute debt service before the July 2009 Decision, FOF¶¶ 231, 234-235, without disclosing in press releases that a stress was imposed on debt service (the denominator of DSC), FOF¶ 236, and suggested by implication that the only stress applied to the DSC was in its numerator. FOF¶ 237.

- The July 2009 Decision was never published, FOF¶ 252, although the RFC and the 2009 Criteria called for the use of actual constants to compute debt service. FOF¶¶ 144, 147-150, 204-207, 213.

- Surveillance took rating actions using the Table 1 Constants to compute debt service after the July 2009 Decision, without disclosing in press releases that a stress was imposed on the debt service denominator, FOF¶ 253, and strongly suggested by implication that the only stress to the DSC was to its numerator. FOF¶ 254.

- The June 2010 Criteria Article included examples with Actual DSCs. FOF¶¶ 278-280.

- Adelson testified that use of the Blended Constant contravened the 2009 Criteria, Tr. 286:1-7, but authored an ANPCC, which stated that "[e]ffective immediately, [S&P] will resume assigning ratings to new conduit/fusion transactions by applying the averaging approach described above." FOF¶ 679.

- Adelson testified that the writing skills among analysts was "pretty lousy," Adelson Tr. 374:4-14, and that rating agency publications in the Relevant Period did not meet Adelson's standard of transparency. *Id.* at 273:13-274:2.

This record provides no grounds to conclude that the disclosure in the Methodology section was negligent.

7. The Division Focused on Inaction but the OIP Does not Charge a Failure to Supervise

Concerning Duka's role in the preparation and review of the 2011 Presales, the Division's case focuses on inaction, that is whether, even though she was not required to review the 2011 Presales, FOF¶ 437, Duka should have done more to prevent the "sloppiness," FOF¶ 649, resulting in the DSC disclosures in the 2011 Presales. But this focus goes to whether the Division may claim that Duka failed to supervise NI analysts in their preparation of the 2011 Presales, a violation that was not alleged in the OIP. *See e.g., In the Matter of Fox Sec. Co., Inc. Morris Fox*, Release No. 10475, 45 S.E.C. 377 (Nov. 1, 1973) (in contrast to aiding and abetting, which requires "more of an active participation," or "awareness of improprieties," a failure of

supervision connotes "more an inattention to supervisory responsibilities when more diligent attention would have uncovered improprieties").

F. The Revised Scheme Liability Theory was not Alleged in the OIP, and, in any Event, the Division did not Prove Scheme Liability

Scheme liability under Section 17(a)(1) and (3) and Rule 10b-5(a) and (c) "hinges on the performance of an inherently deceptive act that is distinct from an alleged misstatement." *Kelly*, 817 F. Supp. 2d at 344, 346. "[W]here the primary purpose and effect of a purported scheme is to make a public misrepresentation or omission, courts have routinely rejected the SEC's attempt to bypass the elements necessary to impose 'misstatement' liability under subsection (b) by labeling the alleged misconduct a 'scheme' rather than a 'misstatement.'" *Id.* at 343 (citing cases).

1. The OIP did not Charge the Now-Alleged Scheme Liability

The Division should not be permitted to pursue the theory of scheme liability described in its prehearing brief because the OIP does not allege such liability.

Courts regularly reject belated efforts by the Division to expand its case beyond the four corners of the OIP. *See, e.g., In the Matter of Gregory M. Dearlove, CPA*, Release No. 315 at 45-46 n.40 (July 27, 2006); *In the Matter of Robert Bruce Lohmann*, Release No. 214, 2002 WL 31086307, at *18 n.5 (Sept. 19, 2002), *aff'd*, Exchange Act Rel. No. 48092, 2003 WL 21468604 (June 26, 2003); *In the Matter of Richmark Capital Corp.*, Release No. 201, 2002 WL 412145, at *24 (Mar. 18, 2002), *aff'd*, Exchange Act Rel. No. 48758 (Nov. 7, 2003).

This is basis alone for this Court to reject the Division's belated attempt to change liability theories. The Division's prehearing brief claims that Duka "drastically alter[ed] S&P's CMBS ratings methodology without following S&P's established internal procedures, without adequately disclosing or documenting the change internally, and without disclosing the change to

the investing public." DPB at 7. Concerning the averment that Duka failed to follow "S&P's established internal procedures," and failed to "disclos[e] or document[]" the use of the Blended Constant "internally," the OIP did not cite these S&P-inward facing allegations. Rather, it alleged scheme liability based on an alleged false impression conveyed to investors. OIP ¶ 48. By contrast, the Criteria Process Allegations, COL ¶ 794, RAMP Allegations, *id.*, and MQR Allegations, *id.*, focus on actions solely relating to S&P processes and controls as alleged violations of the IC Statute and/or 17g-2(a)(6). OIP ¶¶ 8, 30, 39, 42.

With respect to the OIP's theory of scheme liability, the allegation that a change was made to the 2009 Criteria "without adequate[]" disclosure "to the investing public," DPB at 7, is "based on the same misstatements that would form the basis of a misrepresentation claim under Rule 10b-5(b) and nothing more"—and is thus insufficient to sustain scheme liability. *S.E.C. v. Lucent Techs., Inc.*, 610 F. Supp. 2d 342, 359 (D.N.J. 2009); *see also S.E.C. v. St. Anselm Exploration Co.*, 936 F. Supp. 2d 1281, 1299 (D. Colo. 2013) (scheme liability impermissible where used to "bolster[]" "10b-5(b) and section 17(a)(1) claims").

2. In any Event, the Division Failed to Prove Deceptive Conduct not Involving Alleged Misstatements

In any event, for the reasons set forth below, the Division failed to prove that the conduct it alleges as a basis for scheme liability was deceptive or, for that matter, even negligent. *See Abuhamdan v. Blyth, Inc.*, 9 F. Supp. 3d 175, 211 (D. Conn. 2014) (dismissing claim for scheme liability because conduct was not inherently deceptive).

POINT II

The Division Failed to Prove That Duka Aided and Abetted, or Caused S&P's Violations of Rule 17g-6(a)(2)

A. The Division Failed to Prove That the Ratings on the 2011 CF Transactions Were not Determined in Accordance with S&P's "Established Procedures and Methodologies"

1. NI's Use of Blended Constants Imposed More Stress Than Required by the Criteria

The evidence showed that the RFC, the 2009 Criteria, and the November 2010 Criteria each contemplated the use of a loan's actual constant, and not the Table 1 Constant, to compute that loan's debt service. The Division's argument to the contrary ignores the facts.

First, the RFC included the Prototypical Pool, which was intended to serve as a "benchmark" pool, FOF¶ 141, and the 2009 Criteria and November 2010 Criteria each included the Archetypical Pool, which, similarly, was intended to serve as a "benchmark." FOF¶ 188. The use of Table 1 Constants would be flatly inconsistent with notion of a benchmark, while the use of Actual Constants preserved the utility of the Prototypical/Archetypical Pool as a benchmark. FOF¶¶ 188-193.

Second, each of the RFC, the 2009 Criteria, and the November 2010 Criteria contained the Suburban Office Building example that included (1) BBB Actual DSCs and AAA Actual DSCs, (2) the debt service figure of $47,902, which was calculated using an actual constant, and (3) a description of the fourth column of the table as "the calculation of the Alternative 'AAA' NCF *used to determine* the 'AAA' DSC." FOF¶¶ 147-150, 204-207, 289 (emphasis added).

Third, these same documents described the second condition of the term default test as occurring when a "property cannot cover its debt service," *i.e.*, actual debt service. FOF¶ 127; JX 1 at SP-CMBS 01754127; JX 2 at SEC-STRS-E-0000016; JX 5 at 16.

Fourth, the glossary in each of these documents contained a definition of DSC that used the term "scheduled debt service." FOF¶¶ 221, 290, JX 1 at SP-CMBS 01754138. The term "scheduled debt service" means actual debt service, FOF¶ 221, and is consistent with the common understanding of the term "DSC." FOF¶ 47.

Accordingly, the allegation that Table 1 Constants were not used as required by Criteria simply ignores the overwhelming evidence that the 2009 Criteria called for the use of Actual Constants to compute debt service.

2. The Drafting History of the 2009 Criteria Refutes the Division's Charge

The chronology leading to the publication of the 2009 Criteria confirms their intent. Prior to publication of the RFC, the CMBS Criteria Committee minutes reflect no discussion that supports the Division's invented theory. FOF¶ 181. Indeed, drafts of the RFC, which contained substantially the same description of the term default test as in the 2009 Criteria, required the actual constant; no Table 1 Constant existed in these drafts. FOF¶¶ 126-127, 135, 137. And, after the RFC was published, the CMBS Criteria Committee minutes and drafts of the 2009 Criteria reflect no contemplation of the use of Table 1 Constants to stress debt service. FOF¶¶ 177, 181. Duka and Manzi believed that the actual constants would be used to compute debt service under the 2009 Criteria. FOF¶¶ 180, 239.[21] No witness pointed to a single word in any of these sources to support a contrary reading.

[21] Gillis would not have directed Thompson to "cease taking" Surveillance rating actions in summer 2009 and the meeting with the President of S&P in July 2009 would not have been necessary had the CMBS Criteria Committee voted in line with Thompson's recollection. FOF ¶¶ 238, 240. There is no indication that the SFCC and the APB, which approved the 2009 Criteria, FOF ¶¶ 182-183, were consulted in connection with the July 2009 Decision.

3. The Use of Table 1 Constants to Compute Debt Service was not Criteria Because Such Application of Methodology was Neither Documented nor Published

The SEC required S&P to maintain a record of its "established procedures and methodologies" for determining CF ratings, *see* Rule 17g-2(a)(6), and S&P required that criteria be the subject of external publication. FOF¶¶ 56-57, 110-111. The Division offered **no** document evidencing a decision in 2009 that S&P would use Table 1 Constants to compute service, let alone an S&P publication to such effect. FOF¶¶ 252, 257. Members of the CMBS Group did not even know of the supposedly "established" procedure for computing debt service using Table 1 Constants until they saw these constants coded into the CMBS model. FOF¶ 258.

4. Investors Expected That S&P Would Use Actual Constants to Compute Debt Service Under Criteria

Based on the RFC and the 2009 Criteria, investors expected that S&P would use actual constants to compute debt service. FOF¶¶ 144, 213, 227. Surveillance press releases, among other S&P publications, perpetuated this view because they described one stress in the DSC, namely, to its numerator, not its denominator. FOF¶¶ 237, 254.

5. The March 2010 Memorandum and its Implementation Evidence That Criteria did Not Contemplate the use of Table 1 Constants

The decisions reflected in the March 2010 Memorandum – among other things, to use Actual Constants higher than Table 1 Constants -- did not result from a formal criteria process, FOF¶¶ 272-273, and following March, Surveillance did not review all of S&P's outstanding ratings on -CF transactions to apply the enhancements reflected in the March 2010 Memorandum. FOF¶ 274. If the Table 1 Constants were required by Criteria, CMBS could not adopt this new practice and apply it without a formal five-step Criteria amendment process and review of existing ratings.

6. CMBS Members' Views That Use of the Blended Constant was Consistent With the 2009 Criteria Corroborates that Table 1 Constants Were Not Required

The following individuals, in addition to Duka, expressed or acted in line with the view that the use of Blended Constants was consistent with the 2009 Criteria:

- Digney, who agreed with Thompson's comment in RX 334, FOF¶ 363, signed the RAMPs for JPMCC 2011-C4 and GSMS 2011-GC4, FOF¶¶ 595-597, 621-623, and signed the meeting logs for GSMS 2011-GC4 and FREMF 2011-K14. FOF¶¶ 669-671;

- Thompson, who wrote that an "alternate debt constant" can be used because the "criteria doesn't stipulate that we have to use loan constants listed." FOF¶¶ 362-363;

- Henschke, who testified that he did not view NI's use of Blended Constant as a change in the 2009 Criteria. FOF¶ 363;

- Pollem, who signed the RAMPs for MSC 2011-C1, FREMF 2011-K701, FREMF 2011-K11, FREMF 2011-K13, and FREMF 2011-K14, FOF¶¶ 495-497, 515-517, 556-558, 575-577, 641-643, and signed the meeting logs for GSMS 2011-GC4 and FREMF 2011-K14. FOF¶¶ 669-670;

- Geramian, who was informed at least twice that the CMBS Group was using a "50/50 blend" of actual and stressed loan constants, FOF¶¶ 388, 392-393, expressed no objection and approved the MQR Report. FOF¶¶ 417-418;

- Barnes, who was charged with ensuring that the CMBS Group was following the 2009 Criteria, FOF¶¶ 115-117, and was informed that the CMBS Group was going "to use the average of the in-place interest rate and the criteria constant." FOF¶¶ 369-373;

- Hu, who was informed that the loan constant used by NI would be a "combination" or "sometimes . . . the average" of an actual loan constant and Table 1 Constant, FOF¶¶ 409-410, 414, 417, and drafted the final MQR Report, which stated that "[b]ased on information MQR has received, MQR did not find any factual discrepancies between applicable criteria and the model." FOF¶ 417;

- Goldberg, who approved the final MQR Report, which stated (1) "the 'loan constants' used in the model is a combination of the actual loan constants and those depicted in Table 6," FOF¶ 417 and (2) "[b]ased on information MQR has received, MQR did not find any factual discrepancies between applicable criteria and the model." *Id*;

- Jacob, who wrote to President of S&P that "it appears that what was done before was a quite reasonable interpretation of the application of criteria," FOF ¶ 682, and who believed that Parisi had the authority to approve NI's use of the Blended Constant, FOF¶ 380;

- Snow, who signed the RAMPs for MSC 2011-C1, FREMF 2011-K701, JPMCC 2011-C3, FOF¶¶ 495-497, 515-517, 534-536, and the meeting log for GSMS 2011-GC4, FOF¶ 669;

- DeFalco, who signed the RAMP for FREMF 2011-K13, FOF¶¶ 575-577, and the meeting log for FREMF 2011-K14, FOF¶ 670;

- Prabhakar, who signed the RAMP for FREMF 2011-K14 FOF ¶¶ 641-643, and the meeting log for FREMF 2011-K14; FOF¶ 670;

- David Mollin, who signed the meeting log for GSMS 2011-GC4, FOF¶ 669;

- Fisher, who signed the RAMPs for FREMF 2011-K11 and JPMCC 2011-C4, FOF¶¶ 556-558, 595-597;

- Nelson, who signed the RAMP for JPMCC 2011-C3, FOF¶¶ 534-536; and

- Cicerchia, who signed the RAMP for GSMS 2011-GC4, FOF¶¶ 621-623.

The views and actions of these individuals underscore that Table 1 Constants were **not** required by the 2009 Criteria.

7. The Division's Position is Unsupported by Reliable Evidence

The Division's evidence was the weak gruel in the face of the above-cited evidence.

Adelson, who testified that using the Blended Constant contravened the 2009 Criteria, Tr. 286:1-7, was laboring under fundamental misunderstandings of the facts. He not only lacked an understanding of the definition of an actual constant, *compare* Tr. 351:3-13, 352:10-18, 363:10-364:16 *with* FOF¶ 44, he testified that the 2009 Criteria were intended to codify the then-existing methodology of using the "Higher of Approach," Tr. 270:2-13, 354:4-355:19, which, as we assume the Division would stipulate, is not true. FOF¶¶ 269, 272. Moreover, Adelson himself

published an ANPCC that endorsed use of the Blended Constant **prior** to any amendment of Criteria. FOF¶¶ 679-680. Adelson's testimony is not reliable.

The Division also points to the escalation provisions of the Criteria Process Guidelines, and argues the enumerated steps were not followed. But Section 3.13 of the CPG, along with the other provisions of the CPG, did not apply to criteria interpretations. FOF¶¶ 97, 99.

B. The Division Failed to Prove That Duka Supported Use of the Blended Constant for the Purpose of Obtaining More CF Rating Engagements for S&P

NI's use of the Blended Constant was motivated by analytical, not commercial, considerations, as the following summary of the evidence shows:

- In the second half of 2010, as NI was evaluating more CF transactions, various members of the CMBS Group, in NI and Surveillance, discussed whether it was analytically appropriate to continue to use the Table 1 Constants to compute debt service. FOF¶¶ 331-332.
- At the time, NI was reviewing CF transactions and the model was producing credit enhancement levels that were unreasonably high, as the Table 1 Constants were causing "almost all of the loans" to default during the term. FOF¶¶ 333-334.
- Such elevated credit enhancement levels were inconsistent with the expectation that in a low interest rate environment, the risk of term default was lower than the risk of maturity default, FOF¶ 336, and with the conservative underwriting of the loans originated following the financial crisis. FOF¶ 337.
- Two days before the meeting with Parisi, Duka wrote that Henschke was "starting to convince" her that use of the Table 1 Constants is inappropriate and causing unintended analytic results. FOF¶ 340. Specifically, "[t]he use of the Table 1 Constant resulted in the application of inconsistent stresses that depended on the actual interest rates of the loan, and didn't 'accurately reflect the credit risk' of how the loans would perform in an economically stressed environment." *Id.*
- Henschke, FOF¶ 339, Digney, FOF¶ 338, Thompson, FOF¶ 345, and Parisi, *id.*, agreed with Duka's view.

The allegation that Duka sought Parisi's interpretation on December 14, 2010, endorsing the use of Blended Constants, because she was "concerned" that S&P was not rating a sufficient number of CF transactions, OIP ¶ 24, is absurd. FOF¶ 366. S&P rated a substantial number of

non-CF transactions in 2010, FOF¶¶ 293-294, and attained an overall market share of 57%, FOF¶ 295. In 2010, CMBS issuance was increasing. FOF¶ 292. Duka repeatedly requested additional resources, FOF¶ 301, and received complaints from her subordinates about being too busy. FOF¶ 305. And, pre-4Q 2010, Duka recorded her expectation that CMBS issuance would increase in 2011, FOF¶ 296, and that, as a result, S&P would rate more CF transactions, and more CMBS transactions overall. FOF¶¶ 298-300.

Finally, Duka's prudential approach to the rating of NI CF transactions was confirmed by the evidence. NI employed analytical measures that that were *more* punitive (or "conservative" in the Division's formulation) than required by the 2009 Criteria, resulting in pressure upward on credit enhancement levels. FOF¶¶ 443, 457, 463. Duka also declined to rate a transaction because she was uncomfortable with the quality of the collateral, FOF¶ 327, and took steps to preserve the stresses provided for in the 2009 Criteria in the face of possible attempts by issuers to issue commercial mortgages as CDOs under less punishing criteria. FOF¶¶ 325-326. This evidence belies the Division's unsupported assertion of commercial motive.

The Division presented no evidence that Duka was concerned about a salary reduction, losing her job, or a possible downsizing of the CMBS staff in a period when the Division argues that Duka was concerned that S&P was not attracting sufficient CF business. The Division instead points only to a few scattered statements in emails and required monthly activity reports where Duka objectively reported that a transaction was lost due to the 2009 Criteria. Here, clarity is key: Of the seven transactions identified as CF transactions by CMA in 2010, there were **only** two transactions that S&P defined as CF that S&P did not rate for reasons having anything to do with criteria. FOF¶¶ 317-322. But, Duka never identified the use of the Table 1 Constants as responsible for S&P not rating these transactions. FOF¶ 312. Instead, when CMA

reported that the 2009 Criteria caused S&P not to rate CF transactions in 2010, Duka reported that, in her view, it was S&P's terms and conditions that were the real impediment. FOF¶ 311.

C. The Division Otherwise Failed to Prove *Scienter*, as Required for "Causing" Liability

To cause a violation of this Rule by S&P, Duka would have had to act with *scienter*. *See* COL¶ 809. As set forth above, Duka reasonably believed that NI's use of a Blended Constant was consistent with the 2009 Criteria.

POINT III

The Division Failed to Prove a Violation of the IC Statute

A. The Alleged Violation of the IC Statute Violates the Notice Requirement of Due Process

Duka acknowledges that ALJ Elliot rejected her argument pretrial that, concerning the IC statute, Duka lacked the fair notice required by the Due Process Clause, and reiterates it here solely to preserve the issue.

B. Duka Cannot be Liable for a Secondary Violation of the IC Statute Because Duka Did Not Serve in a Control Function

Duka cannot have secondary liability under the IC Statute because she was not responsible for "establish[ing], maintain[ing], enforce[ing], or document[ing] an effective internal control structure" at S&P. 15 U.S.C. § 78o-7(c)(3). Duka was not assigned to MQR, Quality, or Criteria, each of which, according to the SEC, are responsible for S&P's alleged violation of the IC Statute. RX 782 at ¶ 33.

The Division thus charges that Duka "circumvented" S&P's internal controls. Order Denying Division of Enforcement's Motion for Partial Summary Disposition, at 11. But, a comparison of 15 U.S.C. § 78m and the IC Statute shows that this averment is not actionable as a secondary violation of the IC Statute. Like the IC Statute, Section 15 U.S.C. § 78m(b)(2)(B) requires certain issuers to "devise and maintain a system of internal . . . controls." But, unlike in

the case of the IC Statute, Congress specifically prohibited circumvention of a "system of internal control accounting controls." 15 U.S.C. § 78m(b)(5) ("No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account"). Congress thus recognized that "circumvention" of a "system of internal accounting controls," was not actionable under § 78m(b)(2)(B) and adopted a separate provision to add this grounds for liability. Here, there is no enactment adding this basis for liability to the IC Statute.

C. The Division Failed to Prove That S&P's Internal Control Structure was Ineffective

"Even a well-designed internal control structure cannot guarantee that a deficiency will never occur." Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 72936, 2014 WL 4538057, at *44 (Aug. 27, 2014). The Division failed to present any evidence that S&P maintained an ineffective internal control structure or that any of Duka's conduct caused S&P's internal control structure to be ineffective.

D. The Criteria Process Allegations Fail Based on the Evidence

The Criteria Process Allegations fail because the evidence showed that Duka's belief that she was permitted to use the Blended Constant as an interpretation of the 2009 Criteria was reasonable. *See also* above at Point II, A.

The SEC's letter to S&P in September 2012 confirms the reasonableness of Duka's belief:

> It appears that S&P has not established written policies and procedures applicable to criteria interpretations. The lack of such policies and procedures may have contributed to the uncertainty within S&P with respect to the appropriate characterization of the change in the loan constants used to rate new CMBS transactions. Thus, there appears to be an internal disagreement among S&P analysts, Quality, and Criteria as to whether the change in January 2011 from using the Stressed Loan Constant to the Blended Loan Constant in rating new CMBS transactions was an approved criteria interpretation or an unapproved criteria change.

FOF¶ 382.

This description of events by the SEC cannot be squared with the Criteria Process Allegations.

The "uncertainty" cited by the SEC dovetailed with the hearing testimony. Adelson explained that employing an application of methodology "to rate, your 2nd, 3rd, 4th, 5th, 10th, 12th, 20th, at some point you have to codify that" into Criteria. Tr. 402:12-21. Parisi explained that NI's use of loan constants for property types other than those listed in Table 1 of the 2009 Criteria could be considered an interpretation of the 2009 Criteria even though such constants could be applied on an unlimited basis to transactions and/or loans. FOF¶ 383; *see also* FOF¶ 385. These S&P former leaders were unable to clearly define a limit to the number of times a Criteria interpretation could be employed.

Furthermore, the evidence is convincing that Parisi endorsed NI's use of a Blended Constant as an interpretation of Criteria.[22] FOF¶¶ 346, 357, 370, 379, 380, 393-395. It was also entirely reasonable for Duka to rely on Parisi, a criteria officer whose express functions included making final criteria interpretations. FOF¶¶ 91, 98. And that the Table 1 Constants were not historically treated as part of the 2009 Criteria confirmed that Duka had no reason to question Parisi's decision. FOF¶ 381.

Finally, concerning the Division's allegation that Duka should have documented her consultation with Parisi, the uncontroverted evidence is that it was Parisi's responsibility to document that meeting. FOF¶ 93.

---

[22] Parisi's recollection, which he himself questioned in view of the other evidence in the record, was that he approved the use of the Blended Constant for a single Freddie Mac Transaction. Parisi Tr. 1513:18-1514:24; 1587:7-1588:1. He likely confused the two criteria interpretations he provided to Duka at the end of 2010, one relating to Freddie Mac transactions, and one relating to the calculation of debt service more broadly. FOF¶¶ 358-359.

E. The RAMP Allegations Have No Evidentiary Support

The primary analyst and secondary contact were responsible for completing and reviewing the 2011 RAMPs. FOF¶ 76. As such, each was required to comply with the RAMP Guidelines, and thus to document use of the Blended Constant. FOF¶¶ 73-75. Notably, with the exception of the RAMP for JPMCC 2011-C3, all of the 2011 RAMPs were signed by Pollem or Digney as Chairperson, each of whom was reminded on December 17, 2010, of the obligation to document such use in the RAMPS. FOF¶¶ 361-362. Duka was not negligent for failing to remind her senior analysts -- for the third time -- that the RAMPS should document use of the Blended Constant.

F. The MQR Allegations Fail Based on the Evidence

The Division did not prove that Duka was responsible to ensure that Hu possessed a model that incorporated the Blended Constant, much less that she was negligent in not doing so. Hu was informed that NI was not using the "higher of" approach. FOF¶¶ 400-417. She did not request a CMBS Framework Model as in use by NI in 2011. FOF¶ 415. Had she, one would have been provided. *Id.*

Moreover, Duka reasonably believed she had communicated clearly with Hu. The emails she sent that the Division challenges were endorsed by two of her more senior subordinates. FOF¶¶ 404-406. Furthermore, Hu reported that she was informed by NI that the group would, in certain circumstances, use an "average." FOF¶ 409. Additionally, Duka's communication with Hu was no less clear than that of Senior Analytic Manager Thompson who wrote to Hu simply that CMBS may use an "alternate debt constant." FOF¶¶ 361-362.

Finally, the basis of the MQR Allegations is that if MQR had been provided a model for one of the 2011 CF Transactions and/or if Duka had been more clear, then MQR would have

flagged that NI was not using the Table 1 Constants as allegedly required by the 2009 Criteria. But MQR was expressly on notice that NI was not solely using the Table 1 Constants to compute debt service. According the Division, this should have been all that MQR needed to know to exercise its control function. FOF¶ 420. Duka's communications with MQR accordingly could not have "substantially assisted" or "contributed" to the alleged failure of MRQ to carry out its control function.

POINT IV

The Division Failed to Prove a Violation of 17g-2(a)(6)

A. The RAMP Allegations Are Not Actionable Under 17g-2(a)(6)

The RAMP Allegations cannot form the basis for liability under Rule 17g-2(a)(6).

By way of background, on February 2, 2007, the SEC issued a proposed rule, § 240.17g-2(a)(2)(iii), which would have required NRSROs to maintain records of the "procedures and methodologies used to determine" each credit rating issued by such NRSRO.[23] On June 5, 2007, after receiving comments, the SEC issued final rules, omitting this proposed section of § 240.17g-2(a)(2)(iii), explaining as follows:

> Rule 17g-2, as proposed, also would have required a record identifying the procedures and methodologies used to determine the credit rating and the method by which the credit rating was made publicly available. The Commission has eliminated these requirements to reduce recordkeeping burden and because Commission examiners can ascertain the information through a less burdensome requirement. Under paragraph (a)(6) of Rule 17g-2, an NRSRO is required to separately document the procedures and methodologies it uses to determine credit ratings. The Commission examination staff will be able to refer to these records to understand how specific types of credit ratings are determined by the NRSRO. Therefore, examiners will not need an individual record identifying the methodology used to determine each credit rating.[24]

[23] *See* Exchange Act Release No. 55231, 89 S.E.C. Docket 2880, 2007 WL 325688, at *79 (February 2, 2007).

[24] *See* Exchange Act Release No. 55857 (June 5, 2007), 90 S.E.C. Docket 2032, 2007 WL 1624609, at *38 (June 5, 2007).

Having made this determination not to require the maintenance of a RAMP-like document for reasons of burden, the SEC instead enacted Rule 17g-2(a)(6), which required each NRSRO to document the "established procedures and methodologies used by the nationally recognized statistical rating organization to determine credit ratings" to allow the examination staff to determine how each rating was determined by the NRSRO. Thus, S&P was not required to maintain a RAMP. Accordingly, there is no basis no basis to allege a primary violation by S&P under 17g-2(a)(6), and thus no basis for the RAMP Allegations.

B. The 17g-2(a)(6) Violation Also Fails Based on the Evidence

The Division relies on the Criteria Process Allegations and the RAMP Allegations to allege a violation of 17g-2(a)(6). For the reasons set forth above, the Division failed to prove that Duka acted negligently in connection with these Allegations.

POINT V

This Administrative Proceeding Violated Article II of the U.S. Constitution

The SEC's administrative proceedings, including this one, are unconstitutional under the Appointments Clause of Article II of the U.S. Constitution because the SEC has failed to appoint SEC ALJs.

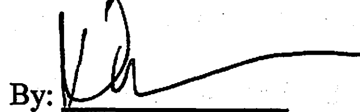
CONCLUSION

For the reasons set forth above, Duka respectfully requests a ruling in her favor on all of the charges alleged in the OIP.

Dated: February 17, 2017
New York, New York

Respectfully submitted,

PETRILLO KLEIN & BOXER LLP



By:

Guy Petrillo
(gpetrillo@pkbllp.com)

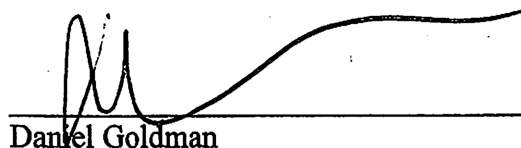
Daniel Goldman
(dgoldman@pkbllp.com)

Theresa Gue
(tgue@pkbllp.com)

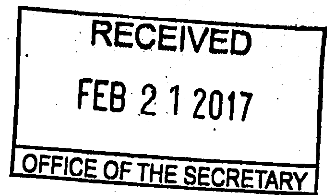
655 Third Avenue, 22nd Floor
New York, New York 10017
Telephone: (212) 370-0330
Telecopy: (212) 370-0391

CERTIFICATE OF COMPLIANCE

Pursuant to Commission Rule of Practice 450(d), I certify that this brief, exclusive of the cover page, table of contents, table of authorities, and signature block, is in compliance with the 14,000-word limit imposed by the Court's January 9, 2017 Post-Hearing Order and Commission Rule of Practice 450(c). The brief contains 13,625 words, according to the word processing system used to prepare the brief.



Daniel Goldman



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16349

-----------------------------------x

In the Matter of

BARBARA DUKA

Respondent.

-----------------------------------x

CERTIFICATE OF SERVICE

On February 17, 2017, Respondent Barbara Duka's Post-Hearing Brief and Respondent's Proposed Findings of Fact and Conclusions of Law were sent to the following parties and other persons entitled to notice as follows:

Brent Fields, Secretary
Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
Phone: 202-551-5400
Fax: 703-813-9793
(Original and three copies by Federal Express; one copy by facsimile)

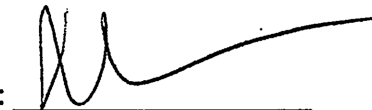
Hon. James Grimes
Administrative Law Judge
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
Email: alj@sec.gov
(by electronic mail and by Federal Express)

Stephen C. McKenna
Trial Attorney
U.S. Securities and Exchange Commission
Denver Regional Office
1961 Stout St., Suite 1700

Denver CO 80294
Email: McKennaS@sec.gov
(by electronic mail)

Alfred Day
Trial Attorney
U.S. Securities and Exchange Commission
Boston Regional Office
33 Arch Street, 23rd Floor
Boston, MA 02110-1424
(by electronic mail)

Rua Kelly
Trial Attorney
U.S. Securities and Exchange Commission
Boston Regional Office
33 Arch Street, 23rd Floor
Boston, MA 02110-1424
(by electronic mail)

By: 

Daniel Goldman
(dgoldman@pkbllp.com)

Petrillo Klein & Boxer LLP
655 Third Avenue, 22nd Floor
New York, New York 10017
Telephone: (212) 370-0336
Facsimile: (212) 370-0391