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UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16349

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In the Matter of :

BARBARA DUKA :

Respondent. :

-- x

RESPONDENT'S POST-HEARING OPPOSITION 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: March 15, 2017

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PRELIMINARY STATEMENT

As its brief confirms, the Division – following three years of investigation – has fallen woefully short of establishing liability on any count in the OIP. Equally clear is that, in prosecuting this case, the Division cannot credibly purport to have acted on behalf of investors. No investor testified to having been misled; no investor testified even to having considered S&P's BBB DSCs or Table 1 Constants in making any decision to purchase any of the 2011 CF Securities; and no evidence was presented that any of the 2011 CF Securities experienced downgrades or losses. The Division's touting of this case as a fraud has been exposed as no more than prosecution by headline.

For the reasons set forth below and in the RPHB,[1] Duka respectfully requests a ruling in her favor on all counts alleged in the OIP.

RESPONSE TO THE DIVISION'S MISCHARACTERIZATIONS OF THE RECORD

As an initial matter, the Division's post-hearing filings are replete with misrepresentations of the record, citations to evidence not admitted during the hearing, and proposed findings of fact that are unsupported by the accompanying alleged citations:

- The Division's description of facts that "are not disputed," DPHB, 1-2, is grossly inaccurate.
- The Division's statement that "S&P required 19% credit enhancement for the AAA tranche of an average CMBS pool," DPHB, 4, is not true. FOF¶¶ 188-89.
- The Division's statement that "Table 1 constants were generally higher than the actual loan constants derived from the terms of the underlying loans," DPHB, 6, is not accompanied by a citation to the record, and this was not true when the 2009 Criteria were adopted. FOF¶ 144.

[1] We use herein the same defined terms as Respondent's Post-Hearing Brief. Respondent's Post-Hearing Brief is cited as "RPHB;" and the Division's Post-Hearing Brief is cited as "DPHB." The Division's Proposed Findings of Fact are cited as "DFOF."

- The Division's statement that presales are "the collective effort of the committee responsible for rating a transaction," DPHB, 12, is incorrect. FOF¶¶ 426-431.

- The Division's statement that Duka admitted "that she spent hundreds of hours reviewing the ratings and associated RAMPs," DPHB, 35, is false. Tr. 1400:6-1401:10; 1477:7-13.

- DX 318, Duka's Wells submission, which is cited at DPHB, 37 n.33, was not admitted into evidence during the hearing.

- Duka did not "suppl[y] the [allegedly] vague 'consider both' language," DPHB, 35, Pollem did. FOF¶ 478.

- The Division's statement that "Conduit/fusion CMBS comprise approximately 85% of the CMBS market," DFOF¶ 14, is not true for most of the Relevant Period. Tr. 1631:19-1635:5.

- JX 85 does not, as stated in DFOF¶ 32, include the clause "in early 2011, began supervising the Surveillance group."

- DFOF¶ 72 copies and pastes contents information from DX 209, which was not admitted into evidence, based on an agreement between the Division and Duka. Tr. 306:19-307:2, 414:20-415:3, 1410:17-21.

- The Division claims that Duka admitted that using a constant other than the Table 1 Constant required use of the CPG process, DFOF¶ 89, when, in fact, she admitted that such use would be required only if the 2009 Criteria had required Table 1 Constants, FOF¶ 378, which they did not.

- The following of the Division's proposed findings of fact do not find support in the accompanying alleged citations to the record: DFOF¶¶ 5-7, 14, 16, 17, 22, 26-27, 33-34, 36-38, 42-43, 46, 55-56, 67-69, 73, 76, 78, 88, 91, 93, 96, and 99-101.

ARGUMENT

POINT I

The Division Failed to Prove its Fraud Claims

A. The Division Failed to Prove That the 2011 Presales Contained Misstatements or Omissions

The evidence fails to support the Division's contention that the 2011 Presales "contained" misstatements or omissions. *See* DPHB, 31.

The Division argues that the inclusion of Table 1 DSCs in the Presales "created the impression that the Table 1 constants had been used to calculate the DSCR for the pool when they had not." DPHB, 31. But the unrebutted testimony is that investors believed that Actual DSCs, in addition to Table 1 DSCs, were employed in arriving at CE levels. RPHB, 3-4. The Division also asserts, without citing to any testimony, that the presentation of Actual DSCs in the 2011 presale somehow "emphasized the stressed nature of the" Table 1 Constants. DPHB, 32 n.31. This claim not only finds no support in the text of the 2011 Presales, Tr. 1907:3-8, but is also contradicted by the testimony of two of the Division's witnesses and Duka's expert. FOF¶ 708. The Division cannot prove a case by citing to no evidence and ignoring the actual, unrebutted evidence in the record.

The Division's pure omissions claim – that there existed a duty to disclose the use and "impact" of utilizing Blended DSCs in its analysis, *see* DPHB, 31, fares no better. "An omission is only actionable when the speaker has a duty to disclose the omitted facts[,]" *In re Keryx Biopharmaceuticals, Inc., Sec. Litig.*, 13 Civ. 1307 (KBF), 2014 WL 585658, at *6 n.6 (S.D.N.Y. Feb. 14, 2014), as when such duty is imposed by law, *e.g.*, 17 C.F.R. § 229.303(a)(3)(ii), or when a party must disclose all information "necessary in order to make the statements made [by

the party], in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b).

The 2009 Criteria called for the use of Actual Constants to compute debt service, and no publication of S&P ever said or suggested otherwise. No evidence supports the proposition that additional disclosure was required in the 2011 Presales to inform investors that NI was applying a stressed constant (the Blended Constant) rather than the Actual Constant required by the 2009 Criteria, even if this constant was "less stressed" than the Table 1 Constant. *See* DPHB, 31-32. Nor was there any duty to disclose the effect of using Blended Constants rather than Table 1 Constants in computing CEs. If there were a duty to do so, then such disclosure would have been required even if the 2011 Presales had disclosed NI's use of the Blended Constant. But, the Division obviously would not have had a cognizable claim had Blended Constants been disclosed. Because neither the Blended Constant nor Table 1 Constant was mandated by the 2009 Criteria, there was no legal duty to disclose the nature and impact of the extra stress S&P was applying to DSCs through use of the Blended Constant versus the Table 1 Constant.

B. The Division Offers Meritless Arguments Concerning Materiality

Because the evidence of immateriality was so conclusive, *see* RPHB, 5-20, the Division resorts to arguing that (1) presales were "part of the total mix of information," DPHB, 20, (2) investors expected presales "to be truthful and accurate," DPHB, 20, and (3) investors were "troubled" upon learning during the hearing that issuers, in certain circumstances, were provided with pool-level weighted average Blended DSCs. DPHB, 22. Were such generalities to suffice to establish legal materiality, it would be difficult to imagine any securities fraud case in which materiality could ever be subject to dispute. For example, annual reports on 10-K are "part of the total mix of information" considered by investors, investors expect 10-Ks to be "truthful and

accurate," and investors would be "troubled" if there was a disparity between a 10-K and an issuer's internal financial books and records. But when a fraud claim is directed at a 10-K, more must be shown to satisfy materiality than the mere existence of an inaccurate representation. *See SEC v. Reyes*, 491 F. Supp. 2d 906, 912 n.6 (N.D. Cal. 2007) ("If a misrepresentation is deemed material simply because it is a misrepresentation, then the law's materiality requirement is altogether meaningless").

The Division also suggests that the failure to disclose the Blended Constant was material because investors expected S&P to apply its "methodology consistently." *See* DPHB, 21 (internal quotation marks omitted). Again, the same argument could be made regarding any methodology employed to report metrics in an SEC filing. Investors, for example, may expect that an issuer's public filings will present financial information prepared through the consistent application of GAAP. But, it is settled that GAAP violations, on their own, are not necessarily material. *See, e.g., Malone v. Microdyne Corp.*, 26 F.3d 471, 478 (4th Cir. 1994); *In re Hansen Nat. Corp. Sec. Litig.*, 527 F. Supp. 2d 1142, 1161 (C.D. Cal. 2007); *SEC v. Stansbury Holdings Corp.*, 06 Civ. 00088 (REB), 2007 WL 1970531, at *1 (D. Colo. June 29, 2007); *Miller Indus., Inc. Sec. Litig.*, 120 F. Supp. 2d 1371, 1382 (N.D. Ga. 2000). Even GAAP violations deemed "material" for accounting purposes, such that a restatement is required, are not sufficient to show legal materiality. *SEC v. Leslie*, 07 Civ. 3444, 2010 WL 2991038, at *28 (N.D. Cal. July 29, 2010) (rejecting the SEC's argument that "a restatement always is material because . . . a restatement issues only when errors are material" under GAAP) (internal citations and quotations omitted); *J & R Mktg., SEP v. Gen. Motors Corp.*, 06 Civ. 10201, 2007 WL 655291, at *12 (E.D. Mich. Feb. 27, 2007). In short, mere defied expectations that a methodology has been applied consistently are not by themselves sufficient to establish materiality. *See* RPHB, 18. Instead,

18. Instead, whether an undisclosed change in application of methodology, such as GAAP, is material depends on whether the evidence sufficiently demonstrates that a reasonable investor would have viewed the undisclosed information as "significantly alter[ing]" the mix of relevant information. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). In this case, for the reasons stated in Duka's opening brief, the Division did not come close to making this required showing.

The Division makes the unsupported claim that "many investors emphasized that the rating agency's assessment mattered in 'trying to make a relative value decision' in buying CMBS." DFOF¶ 73. First, this is not so. Only one investor, Weih, so testified, and he clarified that AEGON would review its "analysis relative to how the rating agencies rated it" at the "**rating level,**" not with reference to any rating agency metrics. FOF¶ 726 (emphasis added). And, in this vein, no explanation of any kind was provided by Weih or any other investor concerning how full disclosure of the Blended Constant would have influenced in any way the investor's ability to "make a relative value decision" in purchasing any of the 2011 CF Securities.

The Division also emphasizes that S&P had "access" to more "proprietary materials" and more time to analyze the 2011 CF Securities than investors, *see* DPHB, 21, yet, unsurprisingly, fails to explain how any asymmetry with respect to such information and resources rationally relates to NI's use of Blended Constants versus Table 1 Constants. [2]

Finally, the Division's arguments support a finding of immateriality because

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[2] The Division seeks to minimize the import of S&P's affirmance of the ratings on the 2011 CF Transactions, *see* RPHB, 9, arguing that "the ratings were reaffirmed because a contrary decision" would have negatively impacted the market, investors, and S&P. DPHB, 23 n.24. That is not what the witnesses testified. FOF¶¶ 676-679.

they do not differentiate between major and minor discrepancies in the application of methodology (a) described in the 2011 Presales and (b) used to arrive at the CE levels in the 2011 Presales.[3] *See*, *e.g.*, DPHB, 33. Even if, for example, NI used a weighting of 99% Table 1 Constant and 1% Actual Constant to compute debt service, but only Table 1 DSCs were disclosed, under the Division's view, *see* DPHB, 20-22, 32-33, the discrepancy would be material.

There is no evidence in the record – **none** – to suggest that the discrepancies complained of in this case **significantly altered** the mix of information available to the reasonable CMBS investor in connection with any investment decision.[4]

C. The Division Failed to Prove That "Money or Property" was "Obtain[ed] by Means of" Misstatements in the 2011 Presales, as Required by Section 17(a)(2)

The evidence does not allow for a finding that "money or property" was "obtain[ed] by means of" alleged misstatements in the 2011 Presales. 15 U.S.C. § 77q(a)(2).

[3] The difference in CE levels arrived at using Blended Constants and arrived at using Table 1 Constants, *see* RPHB, 16-17, is irrelevant. The "omitted fact" here, *see Basic*, 485 U.S. at 231-32 (1988) (internal quotation marks omitted), is NI's use of Blended Constants, not the CE levels that would have been produced using Table 1 Constants. Consider the case in which NI's use of Blended Constants had been prominently disclosed in the 2011 Presales. In that circumstance, the Division would have had no claim; yet, investors would still have been unaware of the difference in CE levels produced by the application of Blended Constants and Table 1 Constants. What is more, it appears that the Division itself does not hold the view that the impact on CEs of using Blended Constants relative to Table 1 Constants is relevant to materiality. If it did, it would not have charged fraud with respect to the FREMF 2011-K14 Presale, where it concedes that the CEs did not change regardless whether the Blended Constant or Table 1 Constant was used. *See* DX 335, 50, n.137 ("[t]he support levels for one FREMF transaction did not change using blended loan constants").

[4] The Division's claim that "it is not credible for Duka to argue that her own work, for which S&P received millions of dollars in fees, is irrelevant," DPHB, 33, is miles wide of the mark. The Division did not prove that S&P received any fees, and the issuers' obligations to pay S&P to rate the 2011 CF Transactions was not conditioned on S&P's publication of the 2011 Presales. *See infra* at 7-8. Further, materiality is not judged from the subjective viewpoint of the speaker, but "objectively" from the perspective of a "reasonable investor." DPHB, 32. Finally, Duka bears no burden to show that 2011 Presales in their entirety were relevant or irrelevant. In any event, she elicited testimony from expert Richard, Tr. 2020:10-2021:6, and from Reidy, FOF¶¶ 766-767, concerning how investors may use information in NRSRO presale reports; it just happens as a factual matter that such uses do **not** include consideration of S&P's BBB DSCs.

First, the 17(a)(2) claim fails because the Division did not prove that S&P "obtain[ed]" the "approximately $7 million" in fees for rating the 2011 CF Transactions. *See* DFOF¶ 5. Only Rubinstein touched on the matter, DFOF¶ 5, identifying "Bates numbers SP-CMBS SUPP 056, 057, 058, 059, 060, and 062" as support for his listing of "Ratings Fee" information in Table 4 of his report. DX 335, 50 n.138. The Division cannot sustain its burden by relying on Rubinstein, who has no personal knowledge as to S&P's fees, and whose report simply rehashes what is purportedly contained in unauthenticated and unadmitted documents. *Strauss v. Credit Lyonnais, S.A.*, 925 F. Supp. 2d 414, 445 (E.D.N.Y. 2013) (expert opinion based on review of unauthenticated documents inadmissible); *Highland Capital Mgmt., L.P. v. Schneider*, 379 F. Supp. 2d 461, 468-69 (S.D.N.Y. 2005); *In re Rezulin Prod. Liab. Litig.*, 309 F. Supp. 2d 531, 551 (S.D.N.Y. 2004).

Second, even under the authority cited by the Division, *see* DPHB, 30 n.28, the Division was required to prove a causal link between the 2011 Presales and the fees received by S&P. *See SEC v. Stoker*, 865 F. Supp. 2d 457, 463-64 (S.D.N.Y. 2012) ("SEC plausibly alleged Stoker, acting as Citigroup's agent, facilitated a fraud by which Citigroup obtained millions of dollars by means of material misstatements and omissions because, for example, Complaint alleged that investors would not have invested in Fund if they had known that Citigroup had effectively chosen many of Fund's assets while maintaining a short position in those assets."); *see also SEC v. Forman*, 2010 WL 2367372, at *8 (D. Mass. June 9, 2010); *SEC v. Hooper*, 2006 WL 778640, at *12 (S.D. Tex. March 24, 2006). Under the terms of the engagement letters here, S&P was not even required to publish the 2011 Presales to obtain fees for rating the 2011 CF Transactions, *see, e.g.*, JX 21 at SP-CMBS 00139210 ("Rating Services reserves the right to use, publish, disseminate, or license others to use, publish or disseminate the rating provided hereunder and

any analytical reports, including the rationale for the rating . . ."), and would have received the same fees whether Table 1 Constant-derived DSCs or Blended Constant-derived DSCs were disclosed. *See* RPHB, 3. The Division's claim, therefore, that "Duka made . . . the misstatements and omissions in the course of her employment to benefit the company," DPHB, 30 n.28, is devoid of merit.

Third, Duka cannot be held primarily liable for a Section 17(a)(2) violation because there is no proof that Duka herself received "money or property by means of" the 2011 Presales. *SEC v. DiMaria*, 15 Civ. 7035 (GHW), 2016 WL 4926200, at *10 (S.D.N.Y. Sept. 15, 2016); *SEC v. Syron*, 934 F. Supp. 2d 609, 639-40 (S.D.N.Y. 2013); *SEC v. Daifotis*, 11 Civ. 00137 (WHA), 2011 WL 2183314, at *10-11 (N.D. Cal. June 6, 2011); *but see SEC v. Stoker*, 865 F. Supp. 2d 457, 463 (S.D.N.Y. 2012).

D. The Evidence did not Establish that Duka Possessed the Requisite Mental State

1. The Division Cannot Assert and did not Prove Negligence in Connection With the Publication of the 2011 Presales to Support a Violation of Section 17(a)(2)

The Division cannot assert a negligence theory under Section 17(a)(2) in connection with publication of the 2011 Presales,[5] RPHB, 21-22, and, even if it could, it failed to prove Duka was negligent.[6] Notably, Division witness Digney, who supervised the preparation of the JPMCC 2011-C4 and GSMS 2011-GC4 presales, FOF¶¶ 585, 608, testified that the inclusion of Table 1 DSCs in the 2011 Presales was the result of "sloppiness" by the analysts, not negligence by

[5] The Division's discussion of the RAMP Allegations in the section of the DPHB related to Section 17(a)(2), DPHB, 34-36, is puzzling considering that the RAMP Allegations for a number of reasons cannot form the basis for liability under Section 17(a)(2). For example, not even the Division contends that the 2011 RAMPs involved "use of interstate commerce," or were prepared "in connection with a purchase or sale of securities" or "in the offer or sale of securities." DPHB, 34; *see also SEC v. Pirate Investor LLC*, 580 F.3d 233, 244 (4th Cir. 2009).

[6] Negligence is insufficient to find Duka liable for aiding and abetting S&P's violation of Section 17(a)(2). *See SEC v. Shanahan*, 646 F.3d 536, 547 (8th Cir. 2011).

Duka. FOF¶ 649. Moreover, the Division failed to call a single witness who was involved in the "substantial effort . . . necessary to separately calculate credit enhancement levels based on blended constants,"[7] DPHB, 13-14, much less attempt through evidence to link Duka to the calculation of any DSC (or any) metrics that appeared in the 2011 Presales.

The Division argues that Duka was negligent because she allegedly failed to live up to her representation to Parisi that she would "disclose any use of blended constants in the presales." DPHB, 35. But, an unfulfilled commitment is not tantamount to negligence. If it were, then every breach of contract claim could also be brought as a negligence claim. *Augusta Mut. Ins. Co. v. Mason*, 274 Va. 199, 645 S.E.2d 290, 293 (2007) ("To avoid turning every breach of contract into a tort, . . . , in order to recover in tort, the duty tortiously or negligently breached must be a common law duty, not one existing between the parties solely by virtue of the contract") (internal quotation marks omitted); *Splitt v. Deltona Corp.*, 662 F.2d 1142, 1147 (5th Cir. 1981). Evidence of an unfulfilled representation to Parisi, FOF¶ 349, did not relieve the Division of its burden to establish the standard of care that existed at S&P and to prove a violation of the same by Duka. And, the record is replete with evidence that the disclosures in the 2011 Presales did not fall below the then-standard of disclosure that existed at S&P during the Relevant Period. RPHB, 22-28.

In addition, even assuming that the disclosures in the 2011 Presales fell short of the then-prevailing standard at S&P, the Division did not prove that Duka should be held accountable. The Division did not elicit testimony from any analyst who actually calculated the BBB DSCs included in the 2011 Presales. Only speculation is available now as to who, if anyone, guided

[7] Needless to say, the Division's use of the term "substantial effort" to describe changing the value in one cell of a spreadsheet from 50 to 100 is overblown.

these analysts. What the record does show is that NI's use of a Blended Constant was "universally known," FOF¶ 360, that all S&P employees were required to abide by the Code of Conduct, DFOF¶ 82, and that, four days after the December 14, 2010 meeting with Parisi, Duka's subordinates were directed to **"document" the use of an "alternate debt constant" in the RAMPs** if the Table 1 Constants were not going to be used in the analysis. FOF¶ 362. The unrebutted evidence furthermore is that the **presales themselves served as the source of information for completing the RAMPs**. Tr. 773:12-24; Tr. 1753:13-1754:13. In this context – ignored by the Division – no basis in evidence exists to hold Duka negligent for allegedly failing to convey to her subordinates that they should include BBB Blended DSCs in the 2011 Presales. The Division's position that it was unreasonable for NI "to run the model two or three times to generate the misleading metrics reported in the presales," DPHB, 35, only counsels further against finding that Duka was negligent; should not the obvious have been clear to all members of NI?

The Division's only answer is that it is "incredibl[e]" that Duka did not notice that the BBB DSCs were based on Table 1 Constants. Actually, given Duka's seniority, and that there was no proof she was required to review the 2011 Presales at all, RPHB, 22, it is not surprising that Duka (1) did not review how the specific metrics were calculated, [8] RPHB, 22-23, and (2) did not realize that the BBB DSCs in the 2011 Presales were Table 1 DSCs. *Id.* Notably, the term "Standard & Poor's Ratings Services loan constant" is nowhere defined as being associated solely with Table 1 Constants, Tr. 2022:20-2023:2, and one could not easily discern from the

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[8] The Division's citation to *SEC v. Hughes Capital Corp.* 124 F.3d 449 (3d Cir. 1997) is inapt and incomplete. The Division omits the critical portion of the opinion that stated that the defendant "concede[d] that she made false statements in the two press releases." *Hughes Capital Corp.*, 124 F.3d at 453.

number itself, *e.g.*, "8.46%," FOF ¶ 486, that it was based on a Table 1 and not a Blended Constant.[9]

The Division chides Duka for allegedly failing to "take any steps to review and correct the omissions and misstatements" in the 2011 Presales. *See* DPHB, 35. But, "[s]ection 10(b) does not impose [primary] liability for a failure to correct another's misrepresentations." *Pomeroy v. GreatBanc Trust Co.*, 2014 WL 7177583, at *3 (N.D.Ill. Dec. 16, 2014) (citing *Fulton County Employees Ret. Sys. v. MGIC Inv. Corp.*, 675 F.3d 1047, 1051-52 (7th Cir. 2012)). But, the Division's argument here purportedly sounds in a "failure-to-supervise" theory under 15 U.S.C. § 78o-7(d)(1)(F), which is not alleged in the OIP. *See SEC v. U.S. Envtl., Inc.*, 94 Civ. 6608 (PKL)(AJP), 2003 WL 21697891, at *22 (S.D.N.Y. July 21, 2003), *aff'd*, 114 F. App'x 426 (2d Cir. 2004) (finding failure to supervise for failure to notice pattern of red flags, apparent from a review of the trading record of USE securities); *In the Matter of Kolar*, Release No. 152, 1999 WL 977373, at *29 (Oct. 28, 1999).

2. <u>The Division did not Prove Duka Acted With *Scienter*</u>

The Division attempts to argue that the record establishes that Duka acted with *scienter*, claiming that, in supporting a transition to using a constant lower than the Table 1 Constants to compute debt service, she was motivated to obtain additional CF engagements for S&P and intentionally omitted reference to the Blended Constant to "tout[] S&P's 2009 Criteria as so conservative that AAA bonds could withstand another 'Great Depression.'" DPHB, 37. No evidence -- direct or circumstantial -- supports this outrageous claim, and mounds of evidence contradict it. RPHB, 35-37. Furthermore, the ratings on the 2011 CF Transactions, arrived at

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[9] The specific calculation of metrics in the 2011 Presales is, by analogy, akin to citations to inapt cases or statutes in a brief. Despite the importance of citing authority properly, a senior partner reviewing eight lengthy briefs reviewed already by a junior partner would not be negligent for failing to notice "hundreds of instances" of improper citations.

using the Blended Constants, could, in fact, withstand another Great Depression, as was determined by a senior group of S&P criteria officers. RPHB, 9; FOF¶¶ 676-678. The Division also states that the omission of Blended DSCs was intentional because "Duka would have known that any criteria change that appeared to loosen criteria could lead to criticism, either internally or externally." DPHB, 15. This assertion is not only unsupported by anything in the record, but is also inconsistent with the Division's own admission that "the 2009 Criteria were widely viewed as unreasonably conservative." DPHB, 5.[10]

E. Duka was not the "Maker" of the Statements at Issue

In arguing that Duka can be held primarily liable for the disclosures in the 2011 Presales, the Division fundamentally misunderstands *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135 (2011). Specifically, it contends that because "Duka admitted that she told Dr. Parisi that she would disclose the use of blended constants in the presales," DPHB, 38, she effectively admitted that she had "ultimate authority over the content of the presales." *Id.* at 38-39. "[U]ltimate authority," as that phrase is used in *Janus*, however, does not arise from authority in the organizational structure that, if exercised, would allow a senior manager to control what is disclosed. Instead, it arises from the authority a person *actually* exercises to control the content of what is disclosed. *Janus*, 564 U.S. at 142. The Division also makes the unfounded claim that because Duka approved the "'consider both' language," for use in the 2011 Presales, she somehow became the maker of the entirety of the content in the 2011 Presales. The Division cites no post-*Janus* authority for this argument, which defies common sense. The content of publicly filed documents is routinely sourced from the contributions of different

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[10] The Division's suggestion that Duka stated "that she did not want to have to explain to the market the difference in methodology employed by New Issuance and Surveillance," DPHB, 37, is untrue. Duka never made such a statement. FOF¶¶ 695-697.

draftsmen; by contributing to a document, each does not become the "speaker" of the document in its entirety.

F. The Division's Pursuit of Scheme Liability Under Rules 10b-5(a) and (c) and Sections 17(a)(1) and (3) Should be Rejected

The Division cannot now pursue an assertion of scheme liability for "directing a sweeping change in rating methodology without following internal procedures and then failing to ensure that the change was disclosed to investors," DPHB, 40, or for "creat[ing] the false impression" internally and externally "that S&P's CMBS ratings were based on S&P's 2009 Criteria." *Id.* These allegations were not included in the OIP. RPHB, 28-29.

In addition, it is well-settled that scheme liability requires deceptive conduct beyond misrepresentations and omissions actionable under Rule 10b-5(b) and Section 17(a)(2). *United States v. Naftalin*, 441 U.S. 768, 774 (1979) ("Each subsection [of Section 17(a)] proscribes a distinct category of misconduct."); *see also Public Pension Fund Group v. KV Pharmaceutical Co.*, 679 F.3d 972, 987 (8th Cir. 2012); *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005); *SEC v. Penn*, 14 Civ. 0581 (VEC), 2016 WL 7413518, at *5 (S.D.N.Y. Dec. 21, 2016); *SEC v. Sullivan*, 68 F. Supp. 3d 1367, 1377 (D. Colo. 2014); *SEC v. Garber*, 959 F. Supp. 2d 374, 380 (S.D.N.Y. 2013); *SEC v. Lucent Techs., Inc.*, 610 F. Supp. 2d 342, 359 (D.N.J. 2009); *SEC v. Patel*, 2009 WL 3151143, at *6-7 (D.N.H. Sept. 30, 2009); *In re Nat'l Century Fin. Enters., Inc. Inv. Litig.*, 2006 WL 469468, at *21 (S.D. Ohio Feb. 27, 2006); *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 475 (S.D.N.Y. 2005); *but see Dennis J. Malouf*, Exchange Act Release No. 78429, 2016 WL 4035575, at *7-10 (July 27, 2016). This is what the Division is attempting to do. Indeed, it effectively acknowledges that it seeks to hold Duka accountable

under scheme liability for the **same conduct** that the OIP alleges violated Rule 10b-5(b) and Section 17(a)(2). *Compare* DPHB, 31-33 *with* DPHB, 39-41.

In any event, scheme liability conduct must, at the very least, be proven to have been in furtherance of the alleged scheme. *SEC v. Goldstone*, 952 F. Supp. 2d 1060, 1205 (D.N.M. 2013). Here, the alleged failure of Duka to "follow[] internal procedures" at S&P – the alleged failure to follow the CPG and alleged failure to be transparent with MQR – cannot be said to have been in furtherance of a "scheme" involving the disclosures in the 2011 Presales.

POINT II

The Division Failed to Prove That the 2011 CF Transactions Were Rated in a Manner Contrary to S&P's Established Procedures and Methodologies

As earlier explained, in connection with the alleged violations of Rule 17g-6(a)(2), Rule 17g-2(a)(6), and IC Statute, the Division failed to prove that (1) the ratings on the 2011 CF Transactions were not determined in accordance with the 2009 Criteria, RPHB, 30-34, or (2) Duka was negligent in concluding that NI could rate the 2011 CF Transactions using Blended Constants based on Parisi's approval. RPHB, 38-39. We respond briefly to the Division's arguments to the contrary.

- Ignoring the text of the 2009 Criteria, the drafting history of the 2009 Criteria, and investors' understanding of the 2009 Criteria, the Division argues that the Table 1 Constants were mandated by the 2009 Criteria because "the Table 1 constants were in fact used by" Surveillance in rating CF transactions. DPHB, 6. That Table 1 Constants were used does not render them required by the 2009 Criteria.

- The Division states that the July 2009 Decision "[p]ut[] to rest any doubt" that the "2009 Criteria called for use of the Table 1 Constants." DPHB, 6. There was no evidence presented concerning who made this decision or why it was made. Moreover, Thompson's limited recollection regarding the meeting was faulty. Thompson testified that the outcome of the July 2009 meeting was that the CMBS Group would use the Table 1 Constants for both the term and maturity default tests. FOF¶ 263 (Table 1 Constants were never used for testing maturity default).

- In trying to discredit Duka's recollection of the December 14, 2010 meeting with Parisi, the Division oddly seeks to draw support from Thompson's testimony. Thompson testified that Parisi indicated that "discretion could always be had" to use a Blended Constant, FOF¶ 379, and wrote that the CMBS Group could use "an alternate debt constant in certain circumstances since the criteria doesn't stipulate that we have to use loan constants listed." FOF¶ 362. Thompson's testimony and his contemporaneous writing support a finding in favor of Duka's good faith adherence to process.

- The Division makes no attempt to delineate the line between using a Blended Constant "'on specific loans and/or transactions,'" which the Division accepts that Parisi approved, and an "'across-the-board change.'" DPHB, 10-11. The Division, therefore, is faulting Duka as negligent for allegedly crossing a line that the Division itself was unable to demarcate based on the evidence. This uncertainty, which did not exist only concerning the use of the Blended Constants, FOF¶¶ 383-384, was precisely why the SEC criticized S&P for failing to establish "written policies and procedures applicable to criteria interpretations." RX 643 at SEC-DUKA-0358311.

- The Division's description of the decision memorialized in the March 2010 Memorandum as "less significant" than using Blended Constants is made with the benefit of hindsight. Had interest rates increased following the March 2010 Memorandum, causing routine use of Actual Constants, the Division offers no rationale as why it would not also view this development as a "programmatic change."

- The Division statement that the March 2010 Memorandum "largely followed the CPG process," DPHB, 17, is frivolous. At S&P, there were only interpretations of Criteria and applications of methodology required by Criteria, and amendments to Criteria required publication, proving that the March 2010 memorandum was an interpretation.

- That NI discussed potentially using an actual constant in the context of the CPG process does not support finding that NI's use of a Blended Constant was a change to the 2009 Criteria. Use of the Blended Constant was an interpretation of the 2009 Criteria, not a requirement.

POINT III

The Division Failed to Prove Commercial Motive in Connection With the Rule 17g-6(a)(2) Violation

The DPHB predictably fails to grapple in any respect with the vast swaths of the record that negate its claim of commercial motive.[11] RPHB, 35-37. Instead, the Division rehashes the familiar line that "issuers generally prefer lower credit enhancement levels," DPHB, 8 n.10, and Duka and other market participants noted that certain CF transactions were lost because S&P's proposed CE levels were higher relative to the other NRSROs. DPHB, 9. These barebones assertions are patently insufficient.[12] The mere perception that "S&P was losing deals because of the conservative nature of the criteria," DPHB, 9, in 2010, rationally fails to connect to Duka's necessarily holding a belief that the 2009 Criteria were *unduly* "conservative" or harboring a commercial motive to change their application. Duka's perspective on the 2009 Criteria was to understand whether their content was analytically sound and if so to let the chips fall as they might. FOF¶ 324. In any event, there was no evidence that she was motivated to act improperly to attain a commercial advantage. RPHB, 35-37. By analogy, there would be no basis to conclude that a baseball player had taken steroids simply because the player (1) would prefer to

[11] The Division also misrepresents the record. For example, in stating that in 2010, "S&P was largely shunned by issuers," and its "market share plummeted to 20.5% in 2010," DPHB, 8, the Division intentionally fails to mention that this figure concerns the relatively negligible 2010 conduit-fusion market, not CMBS NI generally, where S&P was dominant. DFOF¶ 24. The Division also relies on the Commercial Mortgage Article that attributed S&P's failure to be engaged to rate CF transactions to "higher" CE levels without mentioning that Duka contemporaneously expressed disagreement with the article's conclusion, attributing the dearth of CF rating engagements to the unwillingness of issuers to agree to S&P's 2010 terms and conditions letter. FOF¶ 311.

[12] To support its commercial motive claim, the Division highlights that "[a]fter a string of rejections, S&P was engaged to rate eight CMBS transactions in the first half of 2011." DPHB, 26. But the evidence showed that this uptick in engagements was produced by factors other than S&P's transition to the use of Blended Constants. The CMBS issuance market was picking up overall, FOF¶¶ 292, 296-300, and, as the Division admits, other "impediments," such as issuers' unwillingness to sign S&P's terms and conditions, "were largely resolved by December 2010." DPHB, 8 n.11.

win more baseball games, and (2) observed that his low batting average caused his team to lose games.

POINT IV

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

The Division misses the point when it focuses on the CPG and the RAMPs in discussing the alleged Rule 17g-2(a)(6) violation. Rule 17g-2(a)(6) only required that S&P maintain a record documenting the "established procedures and methodologies" used to rate CF transactions regardless of whether the CPG were followed or the RAMPs were completed properly. Despite being warned by Judge Elliot, the Division failed to prove that the models for each of the 2011 CF Transactions, which S&P clearly maintained, did not "constitute[] part of S&P's record." *See* Order dated July 1, 2015, 10. Moreover, if something more was required, the fault does not lie with Duka. Had Parisi documented the substance of the meeting of December 14, 2010, as he was expected to, FOF¶ 93, S&P, even under the Division's view that the models were not sufficient records, would have fulfilled its responsibilities under Rule 17g-2(a)(6).

POINT V

The Division Failed to Prove a Violation of the IC Statute

A. <u>The Division Failed to Prove a Primary Violation of the IC Statute</u>

Judge Elliot rejected the Division's theory under the IC Statute that Duka's alleged circumvention of S&P's internal controls rendered S&P's internal control structure ineffective. *See* Order dated July 1, 2015, 11 ("The Division's arguments miss the point, because they do not focus on whether S&P established, maintained, enforced, or documented 'an effective internal control structure.' . . . Instead, the Division's arguments focus on how Duka circumvented, or caused to be circumvented, S&P internal controls . . . But S&P's internal controls may have been

'effective' within the meaning of 15 U.S.C. § 78*o*-7(c)(3), even if Duka intentionally circumvented them," (internal citations omitted)). As a result, the Division now argues vaguely and without basis that S&P is primarily liable because it "rendered its own internal control structure ineffective" by "putting Duka in a position to both modify the 2009 Criteria and evade S&P's internal controls." DPHB, 29. The claim has no merit. The record provides no grounds to question S&P's decisions to assign Duka, a long-serving professional in the CMBS sector, to the CMBS Criteria Committee or as Analytical Manager overseeing NI.

B. Even if S&P's Internal Controls Were Ineffective, the Division Failed to Prove a Causal Connection Between Duka's Conduct and the Primary Violation

To begin with, whatever is meant by the utterance that "S&P rendered its own internal control structure ineffective" by "putting Duka in a position to both modify the 2009 Criteria and evade S&P's internal controls," DPHB, 29, Duka cannot be determined to have aided, abetted, and caused S&P to place her in any such position, and therefore Duka cannot be secondarily liable under the IC Statute.

The Division also argues that "S&P's internal controls were not only ineffective, but Duka failed to maintain and enforce those internal controls that were in place." But the Division does not even attempt to explain how Duka's alleged failure to "maintain and enforce" internal controls "contributed" to render or "substantially assisted" in rendering S&P's internal controls ineffective. S&P issued ratings on thousands of issuers and obligations. The Division makes no effort to explain through evidence or even argument how any of the alleged conduct relating to eight CF transactions played supposedly a role in rendering S&P's entire internal control structure ineffective.

C. <u>In any Event, the Record Fails to Support a Finding of Negligence on Duka's Part</u>

The Division contends that Duka committed a secondary violation of the IC Statute based on the Criteria Process Allegations and the MQR Allegations. For reasons set forth above, *supra* at 15-16, and in Duka's opening brief, RPHB, 38-39, the Criteria Process Allegations lack all merit.

As for the MQR Allegations, to meet its burden of proving that Duka failed to communicate transparently with MQR, the Division, at the very least, was required to call someone from MQR to testify to a nontransparent communication. This was especially so because Hu authored an email confirming that she was informed in certain circumstances that NI used an average of the Actual Constant and Table 1 Constant. FOF¶ 409. Only MQR, with the most likely candidate being Hu, was competent to testify whether MQR transparently or non-transparently received the information relevant to MQR's task. The Division failed to call Hu because it knew she would not offer such testimony.

POINT V

No Sanctions are Warranted.

As part of the fantasy case it has alleged without proof, the Division seeks a third-tier penalty and a permanent bar preventing Duka from associating with an NRSRO or an investment adviser. Given the record, this request for relief can only reflect an outbreak of cabin fever within the Division. Duka has not been employed by an NRSRO for five years. Moreover, the OIP's groundless allegations aver nothing about investor adviser-related conduct. Contrary to the Division's troubling lack of proportion, the factors set forth in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981), would strongly call for no sanction of any kind.

CONCLUSION

The mournful reality of this case is that despite a three-year investigation and inflammatory rhetoric by the bucket-loads, the Division, assuming guilt, never dug into the evidence of good faith on Duka's part, never developed an understanding of how, if at all, investors actually used the information in presales during the relevant period, never understood the implications of the plain language of the 2009 Criteria, Table 6 of the same, and the document's Glossary, and never soberly considered the implications of the convoluted arguments it makes about its own agency's rules and the conclusions the SEC expressed in its September 2012 letter to S&P. *See* RX 643. For the reasons set forth above and the reasons submitted in the RPHB, Duka respectfully requests a ruling in her favor on all of the charges alleged in the OIP.

Dated: March 15, 2017
New York, New York

Respectfully submitted,

PETRILLO KLEIN & BOXER LLP

By:

Guy Petrillo
(gpetrillo@pkbllp.com)

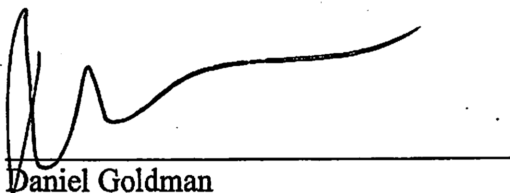
Daniel Goldman
(dgoldman@pkbllp.com)

Theresa Gue
(tgue@pkbllp.com)

655 Third Avenue, 22nd Floor
New York, New York 10017
Telephone: (212) 370-0330
Facsimile: (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 7,000-word limit imposed by the Court's January 9, 2017 Post-Hearing Order and Commission Rule of Practice 450(c). The brief contains 6,929 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

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In the Matter of

BARBARA DUKA

Respondent.

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CERTIFICATE OF SERVICE

On March 15, 2017, Respondent Barbara Duka's Post-Hearing Opposition Brief was 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