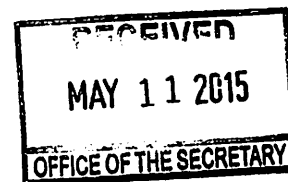


**HARD COPY**

**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

**MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF RESPONDENT  
BARBARA DUKA'S MOTION FOR SUMMARY DISPOSITION**

**PETRILLO KLEIN & BOXER LLP**

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

*Attorneys for Barbara Duka*

Dated: May 8, 2015

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Respondent Barbara Duka (“Duka”) respectfully moves, pursuant to Rule 250 of the Rules of Practice of the Securities and Exchange Commission (“SEC” or “Commission”), for summary disposition of the claims in the Order Instituting Administrative and Cease-and-Desist Proceedings (“OIP”) that Duka willfully aided and abetted and caused Standard & Poor’s Ratings Services (“S&P”) to violate (1) Section 15E(c)(3) of the Exchange Act, 15 U.S.C. § 78o-7(c)(3)(A) (“Internal Controls Statute” or “IC Statute”), (2) Rule 17g-2(a)(2)(iii) under the Exchange Act, (3) Rule 17g-2(a)(6) under the Exchange Act, and (4) Rule 17g-6(a)(2) under the Exchange Act.

### **PRELIMINARY STATEMENT**

Duka has filed an Answer to the OIP denying all of its charges,<sup>1</sup> and a hearing is scheduled to commence on September 16, 2015. This motion seeks summary disposition of certain of the charges in the OIP on the grounds that under the undisputed or incontrovertible facts, the SEC, as a matter of law, cannot establish the elements of the violations alleged, and, concerning one of these charges, may also not proceed for reasons of due process.

By way of summary, as relevant to this motion:

(1) The OIP charges Duka with causing and aiding and abetting an alleged violation of S&P to “establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings, taking into consideration such factors as the Commission may prescribe, by rule,” 15 U.S.C. § 78o-7(c)(3)(A). This allegation should be dismissed on multiple grounds including that it violates due process notice requirements; it would not even be cognizable under the Rules eventually adopted by the SEC in 2014 (after the conduct alleged here) under the statute; and is wholly unsupported by the voluminous record assembled during the investigation in this case.

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<sup>1</sup> This motion solely concerns charges under the OIP that, we respectfully submit, are ripe for consideration by the Court for summary disposition in that they do not concern arguably disputed material facts. Following the hearing, additional grounds will be presented for dismissal of these and the OIP’s remaining charges. Duka, in making the arguments in this Memorandum, hereby expressly preserves all legal and factual contentions relating to all the violations alleged in the OIP.

(2) The OIP's charge that Duka caused and aided and abetted S&P's alleged transgression of Rule 17g-2(a)(2)(iii) – which requires that a record be maintained by a Nationally Recognized Statistical Rating Organization (“NRSRO”) of any material difference between a credit rating implied by a quantitative model and a final credit rating issued by the NRSRO – makes no sense given the undisputed facts: the model used relating to the eight presale reports of focus in the OIP **was** maintained by S&P and cannot rationally be said to have reflected a material difference in relation to the ratings determined using the model.

(3) The OIP's allegation that Duka caused and aided and abetted S&P's alleged violation of Rule 17g-2(a)(6) – which requires an NRSRO to keep a record documenting its procedures and methodologies to determine credit ratings – lacks a factual predicate: S&P complied with the Rule by publishing criteria by which it determined ratings; it did not fail to keep a record of these criteria.

(4) The OIP also asserts that Duka caused and aided and abetted S&P's violation of Rule 17g-6(a)(2), which prohibits the issuance offer or threat to issue a credit rating that is not determined in accordance with the NRSRO's “established procedures and methodologies” to determine credit ratings based on whether the rated person or affiliate purchases or will purchase the credit rating. The irrefutable evidence, however, is that Duka reasonably believed that the ratings here were derived pursuant to “established procedures and methodologies,” as the SEC's recent *Brady* disclosures further confirm.

## STATEMENT OF FACTS

### I. S&P's Organizational Structure

#### A. S&P's CMBS Group

At all relevant times (2009 to 2011), S&P was an NRSRO that provided rating opinions concerning, among others, Commercial Mortgage Backed Securities (“CMBS”).<sup>2</sup> S&P's CMBS analytical ratings function consisted of (1) a group of analysts who developed and proposed ratings regarding new CMBS issuances (“New Issuance”), and (2) a group of analysts who proposed ratings relating to existing securities (“Surveillance”; together with New Issuance, the

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<sup>2</sup> See OIP ¶ 2.

“CMBS Group”).<sup>3</sup> The CMBS Group was one of the functional groups that fell within S&P’s Structured Finance division, which was led by David Jacob during the relevant period.<sup>4</sup>

From October 2008 through early 2011, Duka was the Analytical Manager assigned to oversee New Issuance;<sup>5</sup> and Eric Thompson was her counterpart in Surveillance.<sup>6</sup> In January 2011, Thompson left S&P to work at an S&P competitor, and Duka was assigned to manage Surveillance in addition to her existing assignment in New Issuance.<sup>7</sup>

In New Issuance, Duka’s two primary subordinates were, from early 2009 until January 2011, David Henschke and Kurt Pollem.<sup>8</sup> Mr. Henschke left S&P in January 2011, and was replaced in March 2011 by James Digney, who, before joining New Issuance, was assigned to Surveillance.<sup>9</sup> Others in New Issuance in the relevant period included primary analysts such as Brian Snow, Lucienne Fisher, and Louis Cicerchia.<sup>10</sup>

#### B. S&P’s Criteria Group

S&P defined “Criteria” as the “analytical procedures or methodologies used for determining Credit Ratings, including all fundamental quantitative and qualitative elements, analytical principles, methodologies, and assumptions used to produce Credit Ratings.”<sup>11</sup>

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<sup>3</sup> See Goldman Declaration (“Goldman Decl.”), Ex. 1 (SP-CMBS 00480756).

<sup>4</sup> See *id.*, Ex. 2 (SP-CMBS 01477387); *id.*, Ex. 3 (Jacob, 9:17-20, 56:23-57:5).

<sup>5</sup> See *id.*, Ex. 4 (DUKA-000513); *id.*, Ex. 5 (SP-CMBS 01773203).

<sup>6</sup> See *id.*, Ex. 6 (Thompson, 8:5-9:2).

<sup>7</sup> See OIP ¶ 1.

<sup>8</sup> See Goldman Decl., Ex. 7 (Duka, 100:9-12).

<sup>9</sup> See *id.*, Ex. 2 (SP-CMBS 01477391); *id.*, Ex. 7 (Duka, 88:24-89:2); *id.*, Ex. 9 (Digney, 18:3-14).

<sup>10</sup> See *id.*, Ex. 2 (SP-CMBS 01477391).

<sup>11</sup> See *id.*, Ex. 10 (SP-CMBS 00611717); see also *id.*, Ex. 11 (SP-CMBS 02339905).



Because the Criteria did not and could not anticipate all future market- and ratings-related issues and developments, S&P's Criteria Group was in place, according to Jacob, to perform real-time "analysis that would eventually come up with the criteria by which ratings were done."<sup>12</sup> The Criteria Group was structured to be independent from the groups within S&P that issued rating opinions, such as the CMBS Group.<sup>13</sup> It was led by a Chief Credit Officer.<sup>14</sup> Reporting to the Chief Credit Officer was a Chief Criteria Officer ("CCO") in each of "Global Corporate & Government," "Global Structured Finance," "Asia-Pacific," and "Europe/Middle East/Africa."<sup>15</sup>

The Criteria Officers ("COs") for CMBS, CDO, ABS, and RMBS reported to the CCO for Global Structured Finance.<sup>16</sup> "Criteria officers [were] primarily responsible for managing the development, approval and periodic review of criteria that are used by ... analysts in the ratings process[,] ... [and] lead the criteria committees for the ratings practice they are assigned to."<sup>17</sup>

From May 2008 to December 2011, Mark Adelson served as the Chief Credit Officer,<sup>18</sup> and from October 2009 to March 2012, Frank Parisi was the CCO for Global Structured Finance.<sup>19</sup> From in or around the fall of 2009 to the summer of 2010, James Manzi was the

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<sup>12</sup> See *id.*, Ex. 3 (Jacob, 84:21-24).

<sup>13</sup> See *id.*, Ex. 12 (Adelson, 17:21-18:3, 20:12-15, 36:20-37:3); *id.*, Ex. 13 (Barnes, 121:12-19).

<sup>14</sup> See *id.*, Ex. 14 (SP-CMBS 01477400).

<sup>15</sup> See *id.*

<sup>16</sup> See *id.*

<sup>17</sup> See *id.*, Ex. 11 (SP-CMBS 02339911); see also *id.*, Ex. 1 (SP-CMBS 00480756).

<sup>18</sup> See *id.*, Ex. 12 (Adelson, 9:21-24, 10:9-10).

<sup>19</sup> See *id.*, Ex. 17 (Parisi 23:9-12). Prior to Parisi, Thomas Gillis filled this position. See *id.*, Ex. 30 (Gillis, 24:16-22).

CMBS CO.<sup>20</sup> On Manzi's departure from the CO position, Parisi assumed the role of Acting CMBS CO.<sup>21</sup> In mid-December, 2010, Majid Geramian became the CMBS CO, reporting to Parisi, CCO of Global Structured Finance.<sup>22</sup>

### C. S&P's Quality Group

The Quality Group monitored compliance by S&P's analysts with published Criteria and internal ratings processes. As explained by Jacob, it performed "an oversight function" intended to determine "whether or not the analysts were following the criteria.... Were they doing the proper procedures and documentation and all the rest." This involved "testing the files, as it were, to see whether or not any particular rating or loan were inconsistent, following the – following guidelines . . . ."<sup>23</sup> In performing its control function, the Quality Group conducted two types of reviews, Level 1 and Level 2. "A Level 1 review assesses[d] whether an electronic and/or a print file contain[ed] documents required to meet the minimum analytical documentation standards, and also assesses[d] adherence with other policies and guidelines."<sup>24</sup> A Level 2 review consisted of a "review of credit ratings files for substantive analytical issues, including adherence to analytical procedures and methodologies as well as related portions of policies and guidelines."<sup>25</sup> In particular, a Level 2 review involved an assessment of "[t]he

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<sup>20</sup> See *id.*, Ex. 18 (Manzi, 14:15-18). James Palmisano was the CMBS CO prior to Manzi. See *id.*, Ex. 18 (Manzi, 15:21-25).

<sup>21</sup> See *id.*, Ex. 17 (Parisi, 24:24-25:8).

<sup>22</sup> See *id.*, Ex. 19 (SP-CMBS 01388393); *id.*, Ex. 8 (SP-CMBS 01314047); *id.*, Ex. 36 (Henschke, 45:12-15).

<sup>23</sup> See *id.*, Ex. 3 (Jacob, 85:21-86:6); see also *id.*, Ex. 13 (Barnes, 15:19-17:20); *id.*, Ex. 9 (Digney, 295:13-296:18); *id.*, Ex. 7 (Duka, 419:14-420:18); *id.*, Ex. 11 (SP-CMBS 02339911).

<sup>24</sup> See *id.*, Ex. 20 (SP-CMBS 00608120).

<sup>25</sup> See *id.*, Ex. 20 (SP-CMBS 00608119).

quality of the RAMP” and “[t]he proper application of criteria methodologies.”<sup>26</sup> During the relevant period, the Quality Group was led by Chief Quality Officer Neri Bukspan. Susan Barnes was the Quality Officer for Structured Finance, and was also the Quality Officer for CMBS.<sup>27</sup>

D. S&P’s Model Quality Review Group

Separate from the Quality function, the Model Quality Review (“MQR”) group at S&P existed “to determine whether the model was an appropriate computer implementation of the S&P criteria.”<sup>28</sup> During the relevant period, the MQR Group was led by Martin Goldberg. In his group, Haixin Hu reviewed the CMBS ratings model in late 2010 and early 2011.<sup>29</sup>

II. S&P’s Relevant Policies and Procedures

A. Criteria Process Guidelines

The Criteria Process Guidelines (“CP Guidelines”) provided “guidance for the entire criteria development and review process, including the conceptualization, research, approval, dissemination of criteria, and the on-going reviews of their continued applicability and robustness.” *See* SP-CMBS 00793851.

Importantly, introductory Section 2.1 of the CP Guidelines provided that they:

**[D]o not apply to interpretations of the application of our criteria to a particular circumstance which are expected to occur as a natural by-product of our analysis and committee process. Analysts are encouraged to consult with analytical managers, criteria committee members, and criteria officers with application and interpretation questions.**

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<sup>26</sup> *See id.*, Ex. 20 (SP-CMBS 00608122).

<sup>27</sup> *See id.*, Ex. 13 (Barnes, 12:1-7); *id.*, Ex. 21 (SP-CMBS 01477385); *id.*, Ex. 1 (SP-CMBS 00480756); *id.*, Ex. 16 (SP-CMBS 00396355).

<sup>28</sup> *See* OIP ¶ 25; Goldman Decl., Ex. 22 (SP-CMBS 00599869).

<sup>29</sup> *See id.*, Ex. 12 (Adelson, 92:13-18); *id.*, Ex. 23 (Hu, 17:25-18:2).

*Id.* (bold added).<sup>30</sup>

Where a proposed methodology constituted not an interpretation but a change in criteria, the CP Guidelines set forth a five-step process of Initiation,<sup>31</sup> Research,<sup>32</sup> Approval,<sup>33</sup> Dissemination,<sup>34</sup> and Periodic Review<sup>35</sup> to implement a proposed criteria change.<sup>36</sup> CP Guidelines, §§ 3.2 - 3.25. But, during the relevant period, other than the above-quoted Section 2.1, no policy or procedure was in place at S&P concerning criteria interpretations.<sup>37</sup>

B. Ratings Analysis and Methodology Profile (“RAMP”) Guidelines

According to S&P’s RAMP Guidelines, a RAMP was an S&P “template that analysts use to present financial, structural, and other information to a rating committee [that] ... outlines the analyst’s rating recommendation.” The objective of the RAMP is “to explain the rating recommendation to voting committee members through the application of criteria,” capturing

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<sup>30</sup> Section 2.1’s instruction that employees seek guidance concerning criteria interpretations is supplemented by a general recommendation to seek guidance regarding the CP Guidelines in Section 2.3. Section 2.3 of the Guidelines directs employees who have questions about the Guidelines “to any Practice Criteria Officer or any departmental or regional senior credit officer (DRSCO).” *Id.*, Ex. 15 (SP-CMBS 00793851 (bold added)). The term “Practice Criteria Officer” refers to, *e.g.*, the CO for CMBS. *See id.*, Ex. 15 (SP-CMBS 00793853). The term “DRSCO” refers to, *e.g.*, the CCO for Global Structured Finance. *See id.*

<sup>31</sup> *See id.*, Ex. 15 (SP-CMBS 00793857-58 (Initiation phase includes the appointment of “a member of the practice criteria committee to serve as a Criteria Champion for the issue” and the allocation of resources for criteria projects)).

<sup>32</sup> *See id.*, Ex. 15 (SP-CMBS 00793858-60 (Research phase includes the preparation of a criteria article for external publication that names the Criteria Champion and the Practice Criteria Officer)).

<sup>33</sup> *See id.*, Ex. 15 (SP-CMBS 00793860-63 (Approval phase includes how practice criteria committees can make decisions)).

<sup>34</sup> *See id.*, Ex. 15 (SP-CMBS 00793864-66 (Dissemination phase requires that “[C]riteria . . . be disseminated externally through published documentation” on sandp.com and RatingsDirect)).

<sup>35</sup> *See id.*, Ex. 15 (SP-CMBS 00793866 (the Periodic Review phase includes the review of “all criteria articles”)).

<sup>36</sup> *See* OIP ¶ 27.

<sup>37</sup> *See* Goldman Decl., Ex. 24 (SEC-Duka-0358311).

“the key drivers of the issue being rated, the relevant facets of the analysis, the pertinent information considered, and the underlying criteria and applicable assumptions, as well as the committee’s final decision and the rationale for the rating.”<sup>38</sup> The RAMP Guidelines directed that the primary analyst of a transaction complete the RAMP and the chairperson of the Rating Committee review and approve the RAMP upon its completion.<sup>39</sup> The Quality Group, as part of its control function, was assigned to review certain of the completed RAMPs.<sup>40</sup>

### III. Factual Background

#### A. June 2009 Publication by S&P of New CMBS Criteria

On or about June 26, 2009, S&P published a document titled “U.S. CMBS Rating Methodology And Assumptions For Conduit/Fusion Pools” (“2009 Criteria”).<sup>41</sup> The 2009 Criteria defined the term “conduit/fusion” as a “pool of at least 40 loans that is diversified by both property type and geography.”<sup>42</sup>

The 2009 Criteria addressed dozens of issues relating to S&P’s CMBS ratings analysis and approach, and, as the evidence will show, the CMBS Group, with the assistance of its CO, applied judgment under the 2009 Criteria in myriad ways to perform prudent ratings analyses of CMBS issuances. For present purposes, because of their relevance to the OIP Counts as to which dismissal is sought and the OIP generally, we focus on the 2009 Criteria as they related to the determination of the so-called “debt service coverage” (“DSC”) figure.

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<sup>38</sup> See *id.*, Ex. 24 (SP-CMBS 00293775).

<sup>39</sup> See *id.*, Ex. 25 (SP-CMBS 00293776); *id.*, Ex. 25 (SP-CMBS 00293779); *id.*, Ex. 1 (SP-CMBS 00480729-30); *id.*, Ex. 9 (Digney, 196:2-9); *id.*, Ex. 7 (Duka, 450:6-9); *id.*, Ex. 26 (Pollem, 194:2-12).

<sup>40</sup> See *id.*, Ex. 13 (Barnes, 17:13-17); *id.*, Ex. 20 (See SP-CMBS 00608122); *id.*, Ex. 27 (SP-CMBS 01502310).

<sup>41</sup> See *id.*, Ex. 28 (SP-CMBS 00466585).

<sup>42</sup> See *id.*

DSC or the debt service coverage ratio (“DSCR”) refers to the ratio of cash flow, as the same may be defined, to debt service, as the same may be defined, and is expressed typically as a ratio.<sup>43</sup> Generally, the denominator of the ratio is calculated by multiplying the principal balance by a “loan constant.”<sup>44</sup> Per the 2009 Criteria, the DSC was considered by the CMBS Group in assessing whether a particular commercial mortgage loan would hypothetically default during its term.<sup>45</sup>

Notwithstanding the role played by the DSC in the CMBS ratings analysis, the 2009 Criteria were ambiguous concerning calculation of the denominator of the fraction.<sup>46</sup> Specifically, the 2009 Criteria referred to an “archetypical” pool, which was intended to serve “as a general benchmark against which other conduit/fusion deal pools can be compared.”<sup>47</sup> Table 1 of the 2009 Criteria listed by property type certain characteristics of the “archetypical” pool, including the loan to value ratio (“LTV”), DSCs, and “[l]oan constants” (“Criteria

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<sup>43</sup> See Goldman Decl., Ex. 9 (Digney, 25:22-26:3). The equation for calculating a loan constant is:  $\text{Loan Constant} = [\text{Interest Rate}/12] / (1 - (1/(1 + [\text{interest rate} / 12])^n))$ , with n being equal to the number of months in the loan term. See How to Calculate the Loan Constant (Cost of Capital), available at <http://www.slideshare.net/Nellie256Reynolds/how-to-calculate-the-loan-constant-cost-of-capital-11787150>.

<sup>44</sup> See Goldman Decl., Ex. 29 (Fisher, 62:23-63:3); *id.*, Ex. 26 (Pollem, 30:6-9).

<sup>45</sup> See *id.*, Ex. 28 (SP-CMBS 00466601). In New Issuance, the phrase “term default” describes when a borrower hypothetically defaults on its obligation during the term of the loan. The phrase “maturity default” or “balloon default” is used to describe when a borrower is hypothetically able to meet its payment obligations during the term of the loan, but is unable to refinance the loan upon the expiration of the term. See *id.*, Ex. 7 (Duka, 160:23-161:2); *id.*, Ex. 3 (Jacob, 75:21-76:11); *id.*, Ex. 18 (Manzi, 29:14-30:17).

<sup>46</sup> See OIP ¶ 18.

<sup>47</sup> See *id.*, Ex. 28 (SP-CMBS 00466589).

Constants” or “Stressed Constants”).<sup>48</sup> Neither Table 1 nor any other portion of the 2009 Criteria, however, explained how, if at all, the Criteria Constants should be used.<sup>49</sup>

This ambiguity was amplified by other sections of the 2009 Criteria. On page 16 of the 2009 Criteria, S&P provided an example of how it would calculate the NCF, LTV, and DSC for a \$600,000 loan associated with a suburban office building.<sup>50</sup> The DSC in this table was calculated using an “actual constant” (“Actual Constant”), that is, the amount the borrower would actually be required to pay under the terms of the loan, not the Table 1 Criteria Constant for “Office” of 8.25%.<sup>51</sup>

And, in the glossary of the 2009 Criteria, S&P defined the term DSC as “[t]he ratio of a real property’s NCF to the scheduled debt service expressed as a multiple (e.g. 1.2x).”<sup>52</sup> The term “scheduled debt service” is synonymous with debt service generated by use of the Actual Constant.<sup>53</sup>

#### B. July 2009 Undocumented Meeting to Address Constants

Following the publication of the 2009 Criteria, S&P debated whether the CMBS Group should use the Actual Constant or Criteria Constant to calculate the DSC.<sup>54</sup> Some, including

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<sup>48</sup> See *id.*, Ex. 28 (SP-CMBS 00466590 (The loan constant for “Retail” was listed as 8.25%, for “Office,” 8.25%, for “Multifamily,” 7.75%, for “Lodging,” 10.00%, and for “Industrial,” 8.50%)).

<sup>49</sup> See *id.*, Ex. 13 (Barnes, 45:12-18); *id.*, Ex. 30 (Gillis, 104:20-105:8); *id.*, Ex. 7 (Duka, 381:21-382:12); *but see id.*, Ex. 26 (Pollem, 31:4-14, 32:16-33:12 (explaining that he interpreted the 2009 Criteria to require the use of the Actual Constant).

<sup>50</sup> See *id.*, Ex. 28 (SP-CMBS 00466600).

<sup>51</sup> The example given is an office building with a \$600,000 loan balance, an interest rate of 7%, with 30-year amortization. The “S&P NCF for DSC and Value” is \$57,500. The calculation of the DSC for this example is reflected in the spreadsheet annexed as Exhibit 53 to the Goldman Declaration.

<sup>52</sup> See *id.*, Ex. 28 (SP-CMBS 00466614).

<sup>53</sup> See *id.*, Ex. 26 (Pollem, 32:16-33:6).

<sup>54</sup> See OIP ¶ 19; Goldman Decl., Ex. 7 (Duka, 508:20-510:3).

Manzi and Henschke, judged it inappropriate to use the Criteria Constants to calculate term defaults because the interest rates for the term loans were contractually fixed.<sup>55</sup> In this view, when the Criteria Constant is higher than the Actual Constant, using the Criteria Constant to calculate a loan's DSC could cause the loan to default during its term under S&P's ratings model where, because the interest rate is actually fixed, such default would not be expected to occur in reality.<sup>56</sup> Others, including Thompson, advocated using the Criteria Constants because they argued, this would put "all loans on a level playing field," including interest-only loans.<sup>57</sup> This debate, and the ambiguity surrounding the Criteria Constants, led to a meeting on July 31, 2009 among S&P senior management, including Deven Sharma, then-President of S&P, Adelson, Thompson, Manzi, and others (not including Duka).<sup>58</sup> Although recollections differ about who made the ultimate decision,<sup>59</sup> the meeting apparently resulted in a decision that the CMBS Group would use the Criteria Constants to calculate DSCs ("July 2009 Decision").<sup>60</sup>

**The July 2009 Decision was not documented, was not made by the CMBS Criteria Committee,<sup>61</sup> and did not result from the five-step process outlined in the CP Guidelines.<sup>62</sup>**

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<sup>55</sup> See *id.*, Ex. 18 (Manzi, 38:9-18, 39:10-17); *id.*, Ex. 30 (Gillis, 47:2-16, 52:14-54:15).

<sup>56</sup> See *id.*, Ex. 30 (Gillis, 47:12-16); *id.*, Ex. 7 (Duka, 367:1-7).

<sup>57</sup> See *id.*, Ex. 18 (Manzi, 38:19-39:8); *id.*, Ex. 7 (Duka, 512:16-23).

<sup>58</sup> See *id.*, Ex. 62 (SP-CMBS 01693274).

<sup>59</sup> Compare *id.*, Ex. 18 (Manzi 42:1-6) with *id.*, Ex. 32 (Palmisano, 14:22-15:8).

<sup>60</sup> See *id.*, Ex. 6 (Thompson, 17:5-24).

<sup>61</sup> In July 2009, the members of the CMBS Criteria Committee included, among others, Duka, Thompson, Craig Brundage, and Pollem. See *id.*, Ex. 33 (SP-CMBS 00977821 (minutes of the CMBS Criteria Committee dated May 8, 2009)); *id.*, Ex. 34 (SP-CMBS 01792863 (email to "CMBS Criteria Committee Members" dated June 9, 2009)); *id.*, Ex. 35 (SP-CMBS 01782874).

<sup>62</sup> See *id.*, Ex. 13 (Barnes, 38:20-42:17); *id.*, Ex. 18 (Manzi, 53:21-54:22).



C. March 2010 Interpretation Concerning Constants

In March 2010, the CMBS Group determined to use the higher of the Actual Constant or the Criteria Constant to calculate DSCs (“March 2010 Decision”).<sup>63</sup> In this time frame, certain loans reviewed by the CMBS Group carried Actual Constants higher than the Criteria Constants.<sup>64</sup> For such loans, using the Criteria Constant to calculate the DSC meant under the ratings model that the borrower would be required to pay less than the rate the borrower contractually agreed to pay.<sup>65</sup> Although the March 2010 decision was documented, **it was not made by the CMBS Criteria Committee, and did not result from the five-step process described in the CP Guidelines.**<sup>66</sup>

D. December 2010 Criteria Interpretation Concerning Constants

In the fall of 2010, Henschke and others continued to believe that analytically there was no warrant for the use of constants other than actual constants in determining term default scenarios under the Criteria and that use of the Criteria Constants, where they were higher than actual, would, in modeling, inappropriately overstate such defaults.<sup>67</sup> Notably, as interest rates continued to drop in 2010, the Criteria Constants diverged increasingly from Actual Constants.<sup>68</sup>

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<sup>63</sup> See *id.*, Ex. 31 (SP-CMBS 01692973 (“The original version of the model used the [Criteria Constants] to calculate debt service payments. Some new issuance requests had been received, however, where the actual debt service was higher than that calculated with the criteria constants. It was decided that, going forward, the model would calculate the higher of the debt service derived by the constants outlined in the criteria or actual debt service.”)); *id.*, Ex. 26 (Pollem, 36:2-24).

<sup>64</sup> See *id.*, Ex. 31 (SP-CMBS 01692973).

<sup>65</sup> See *id.*, Ex. 7 (Duka, 206:20-207:6); *id.*, Ex. 36 (Henschke, 73:18-74:4).

<sup>66</sup> See *id.*, Ex. 32 (Palmisano, 17:13-18:8); *id.*, Ex. 18 (Manzi, 72:5-24); *id.*, Ex. 26 (Pollem, 39:25-40:19, 237:22-238:3); *id.*, Ex. 7 (Duka, 209:11-24, 213:7-216:19).

<sup>67</sup> See *id.*, Ex. 36 (Henschke, 32:6-34:1, 60:25-62:6); *id.*, Ex. 9 (Digney, 53:9-25, 55:25-56:17).

<sup>68</sup> See *id.*, Ex. 7 (Duka, 340:22-341:4).

As reflected in a contemporaneous document, Duka gradually came to agree with Henschke's view.<sup>69</sup> Others in the CMBS Group held similar views.<sup>70</sup>

Duka, consistent with Section 2.1 of the CP Guidelines, brought the issue to Acting CO Parisi in mid-December<sup>71</sup> and presented the analytic case for using a blend of Actual and Criteria Constants in the DSC calculation. Use of the blend ("Blended Constant") would in part address the analytical issue raised by Henschke and also be a more incremental change than a change to use solely of Actual Constants.<sup>72</sup> According to witnesses to this discussion, witnesses who spoke to Parisi shortly after the discussion and a recent acknowledgement by counsel to Parisi, Parisi approved use of the Blended Constants as an interpretation, rather than an amendment, of Criteria.<sup>73</sup> Geramian, who was then in the process of replacing Parisi as CO in CMBS, contemporaneously discussed the matter with Parisi, who confirmed that he had approved the change; in Parisi's interpretation of the Criteria, according to Geramian, "it was not their job to

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<sup>69</sup> See *id.*, Ex. 37 (SP-CMBS 00399623); Goldman Decl., Ex. 7 (Duka, 365:7-367:8).

<sup>70</sup> See *id.*, Ex. 9 (Digney, 30:15-17; 53: 16-22; 56:3-15).

<sup>71</sup> See *id.*, Ex. 7 (Duka, 400:6-13).

<sup>72</sup> See *id.*, Ex. 7 (Duka, 405:14-406:2, 412:12-21).

<sup>73</sup> See *id.*, Ex. 7 (Duka, 403:24-404:22, 584:3-13, 628:14-629:11); see *id.*, Ex. 38 (April 1, 2015 Letter from the SEC Pursuant to Rule of Practice 230(b)(2) ("Brady Letter")) (Parisi stated through counsel that Duka "asked Mr. Parisi for input on her group's proposed use of a 'blended' loan constant that incorporated both interest rate data stated in S&P's 2009 Criteria and actual interest rates observed in the market. Mr. Parisi thought her proposal was analytically sound and that the approach was a criteria interpretation that did not need to go through S&P's process for criteria changes."). Counsel's representation, as summarized in the Brady Letter, appears to conflict with Parisi's testimony. Parisi testified that he only approved the use of a Blended Constant for a single transaction, see *id.*, Ex. 17 (Parisi, 105:6-108:6). Very substantial evidence casts doubt on this testimony. For example, in May 2011, Parisi received a memorandum that specifically stated that the CMBS group was "using a 50/50 blend of actual loan constants and the stressed loan constants set forth in Table 1 of the criteria (unless the actual loan constant is higher)." See *id.*, Ex. 39 (SP-CMBS 00565254). He did not respond to this memorandum with any expression of confusion or disapproval. Furthermore, as explained by Digney and Henschke, the analytical justification for using a blended constant was generic to New Issuance transactions not tailored to a single transaction. See *id.*, Ex. 9 (Digney, 301:3-302:14.-303); *id.*, Ex. 36 (Henschke, 48:25-49:13).

tell Duka's group what constant to use."<sup>74</sup> Also, in January 2011, Quality Officer Barnes spoke with Parisi, Geramian, and Duka, and concluded that Parisi had communicated to Duka a criteria interpretation permitting the use of a Blended Constant in the calculation of DSC.<sup>75</sup>

#### E. Pre-Sale Ratings

Per the December Criteria interpretation, from February 2011 through July 2011, the CMBS Group employed Blended Constants in its analysis of eight CMBS transactions: MSC 2011-C1; FREMF 2011-K701; JPMCC 2011-C3; FREMF 2011-K11; FREMF 2011-K13; JPMCC 2011-C4; GSMS 2011-GC4; and FREMF 2011-K14. For each transaction, CMBS used a quantitative model and prepared a RAMP.<sup>76</sup>

#### F. MQR Process

As part of its remit, the MQR Group began a review of the so-called CMBS Framework Model in the fall of 2010.<sup>77</sup> As of November, Hu of MQR had completed a draft report regarding the model.<sup>78</sup> From November 2010 to June 2011, the CMBS Group provided feedback to Hu concerning the draft report.<sup>79</sup> On May 10, 2011, Duka approved the MQR Report.<sup>80</sup> Geramian, the CMBS CO in 2011, approved the MQR Report on June 8, 2011.<sup>81</sup>

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<sup>74</sup> See *id.*, Ex. 38 (Brady Letter); see also *id.*, Ex. 32 (Palmisano, 35:16-36:2).

<sup>75</sup> Barnes interviewed Parisi, Geramian, and Duka in January specifically in connection with a review assigned to Barnes by Bukspan to follow up on an anonymous complaint that Duka was using the Blended Constant for commercial reasons. Based on her interviews, Barnes concluded that (a) Parisi had approved use of the Blended Constants as a criteria interpretation, and (b) use of the Blended Constant was supported by sound analytical reasons and not driven by a commercial motive. See *id.*, Ex. 13 (Barnes, 125:21-132:12); *id.*, Ex. 40 (S&P-SEC 2012 0357306-08).

<sup>76</sup> See, e.g., *id.*, Ex. 41 (SP-CMBS 00003025 (RAMP for JPM 2011-C3)).

<sup>77</sup> See *id.*, Ex. 43 (SP-CMBS 00479677).

<sup>78</sup> See *id.*, Ex. 42 (SP-CMBS 00479671-72).

<sup>79</sup> See, e.g., *id.*, Ex. 44 (SP-CMBS 00476074); *id.*, Ex. 45 (SP-CMBS 00771284); *id.*, Ex. 46 (SP-CMBS 00522830); *id.*, Ex. 37 (SP-CMBS 00399621); *id.*, Ex. 47 (SP-CMBS 00399521); *id.*, Ex. 48 (SP-CMBS 00517857); *id.*, Ex. 49 (SP-CMBS 00399243); *id.*, Ex. 50 (SP-CMBS 00464979); *id.*, Ex. 51 (SP-CMBS 00464866).

#### IV. OIP Allegations Challenged in this Motion

The OIP, as relevant here, alleges violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aiding and abetting and causing violations by S&P of Rule 17g-6(a)(2), the IC Statute, Rule 17g-2(a)(2)(iii), and Rule 17g-2(a)(6). The alleged violations of the IC Statute, Rule 17g-2(a)(2)(iii), and Rule 17g-2(a)(6) are collectively referred to here as the “Non-Scienter Allegations,” and are presented in the OIP as supported by factual allegations in the following categories:

- allegations concerning the CP Guidelines, namely, that Duka (1) “unilaterally concluded that she obtained” Dr. Parisi’s approval “for use of the blended constants,” (2) failed to document Dr. Parisi’s approval, and (3) concluded unreasonably that Dr. Parisi was authorized to interpret the criteria to allow for the use of Blended Constants (collectively, the “Criteria Process Allegations”).<sup>82</sup>
- allegations concerning the MQR process, namely, that Duka failed to provide MQR with a model that incorporated a blended constant (the “MQR Allegation”).<sup>83</sup>
- allegations that the RAMPs (1) did not disclose DSCRs calculated using the blended constants, (2) “did not describe the use of blended constants,” and (3) did not describe “the fact that the models were modified to apply blended constants” (collectively, the “RAMP Allegations”).<sup>84</sup>

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<sup>80</sup> See *id.*, Ex. 22 (SP-CMBS 00599873).

<sup>81</sup> See *id.*, Ex. 22 (SP-CMBS 00599874).

<sup>82</sup> See OIP ¶ 27, 30.

<sup>83</sup> See OIP ¶ 39.

<sup>84</sup> See OIP ¶ 41-43.

The alleged violation of Rule 17g-6(a)(2) alleges in substance that Duka supported the use of a Blended Constant, and sought approval from Parisi to use the same, because she was allegedly motivated to assist S&P in increasing the number of its CMBS rating engagements.<sup>85</sup>

### ARGUMENT

As set forth in more detail below, this Court should dismiss the allegations that Duka aided and abetted and caused S&P to violate the IC Statute, Rule 17g-2(a)(2)(iii), Rule 17g-2(a)(6), and Rule 17g-6(a)(2). As a matter of law, these allegations cannot be sustained given the undisputed or incontrovertible facts.

Under Rule 250(b) of the Rules of Practice, the hearing officer may grant a motion for summary disposition if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law. *See* Rule 250(a) (authorizing motion for summary disposition). In this setting, the allegations in the pleadings of the party against whom the motion is made shall be assumed as true, except as modified by stipulations or admissions made by that party, by uncontested declarations, or by facts officially noted pursuant to Rule 323 of the Rules of Practice. *Id.*

To establish an aiding and abetting violation under 15 U.S.C. § 78t(e); 15 U.S.C. § 77o(b), the SEC must prove: (1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) knowledge of this violation on the part of the aider and abettor; and (3) ‘substantial assistance’ by the aider and abettor in the achievement of the primary violation.” *SEC v. Apuzzo*, 689 F.3d 204, 211 (2d Cir. 2012). “The knowledge requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or an active participant.” *In re China Ruit Ai Int'l Holdings Co., Ltd., Dian Min Ma, Gang Ma, &*

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<sup>85</sup> See OIP ¶ 23-29.

*Jintian*, Release No. 742, 2015 WL 468886, at \*8 (Feb. 5, 2015). But “[i]naction on the part of the alleged aider and abettor ordinarily should not be treated as substantial assistance, except when it was designed intentionally to aid the primary fraud or it was in conscious and reckless violation of a duty to act.” *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983).

To establish “causing” liability under 15 U.S.C. § 77h-1 and 15 U.S.C. § 78u-3, the SEC must prove that “due to an act or omission the person knew or should have known would contribute to such violation.” “For a causing violation, three similar elements [to aiding and abetting] are required: (i) a primary violation occurred; (ii) an act or omission of the respondent contributed to the violation; and (iii) respondent knew, or should have known, his conduct would contribute to the violation.” *In re Douglas W. Powell, Charles D. Elliott, III, & Russell S. Tarbett*, Release No. 255, 2004 WL 1845545, at \*18 (Aug. 17, 2004). Negligence is sufficient to establish causing liability where the primary violation is non-scienter based. *See In re KPMG Peat Marwick LLP*, Release No. 43862, 2001 WL 47245, at \*19 (Jan. 19, 2001). “[S]cienter is required to establish secondary liability for causing a primary violation that requires scienter.” *See In re Brandt, Kelly & Simmons, LLC, & Kenneth G. Brandt*, Release No. 289, 2005 WL 1584978, at \*7 (June 30, 2005).

## POINT I

### **The Alleged Violation of the IC Statute Should be Dismissed on Multiple Grounds**

The alleged violation of the IC Statute should be dismissed because the statute is unconstitutionally vague as applied to the conduct alleged in the OIP; would not even be cognizable under the rules recently adopted under the statute; and lacks any evidentiary support in the SEC investigative record.

A. *The Allegation Violates the Notice Requirement of Due Process*

Enforcement of a statute that provides no meaningful notice concerning the conduct that it prohibits is barred as a matter of constitutional due process. This principle bars the continued pursuit by the SEC of the OIP allegation that Duka caused or aided and abetted S&P's violation of the Internal Controls statute.

The OIP merely tracks the language of the IC Statute in alleging that “[a]s a result of the conduct described [in the OIP], Duka willfully aided and abetted and caused S&P’s violations of Section 15E(c)(3) of the Exchange Act, which requires NRSROs to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.”<sup>86</sup>

To satisfy due process, a regulation must give “the person of ordinary intelligence a reasonable opportunity to know what is prohibited.” *United States v. Strauss*, 999 F.2d 692, 697 (2d Cir. 1993) (internal quotation marks omitted). “In addition to a requirement of adequate notice of what is prohibited, a regulation must provide at least as much notice of what is required.” *Hayes v. New York Attorney Grievance Comm. of the Eight Judicial Dist.*, 672 F.3d 158, 168-69 (2d Cir. 2012). “After determining whether a regulation affords adequate notice, [one] must also determine whether it provides explicit standards for those who apply it to guard against the risk of discriminatory or inconsistent enforcement.” *Id.* (internal quotation marks omitted). “If the rule is an economic regulation or if it includes a scienter requirement, the Court’s review is less strict.” *SEC v. Brown*, 740 F. Supp. 2d 148, 160 (D.D.C. 2010)

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<sup>86</sup> See OIP ¶ 51.

The IC Statute archetypally fails to define what is prohibited and what is required, as Senator Carl Levin recognized when he commented on an SEC proposal not to issue rules under the statute to elaborate on its elements.

Specifically, the statute was enacted in July 2010 as Section 932(a)(2)(B) of the Dodd-Frank Act.<sup>87</sup> On May 18, 2011, the SEC issued Release No. 64514, titled Proposed Rules for Nationally Recognized Statistical Rating Organizations. In that release, the SEC described the statute as “self-executing,” and concluded that “it would be appropriate at [the] time to defer prescribing factors an NRSRO must take into consideration with respect to its internal control structure” to allow for the SEC “to review how the NRSROs have complied with this self-executing requirement” during the “NRSRO examination process.”<sup>88</sup> In providing notice to the public of an opportunity to provide comment on possible rules to be issued under the statute, the SEC listed several topics for public comment<sup>89</sup> and also posed the following question:

Should the Commission, as part of this rulemaking initiative, prescribe factors that an NRSRO would need to take into consideration when establishing, maintaining, enforcing, and documenting an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings? For example, can the objectives of the self-executing requirement in Section 15E(c)(3)(A) of the Exchange Act be adequately achieved by NRSROs if the Commission does not prescribe factors?<sup>90</sup>

Senator Levin responded, stating:

To ensure effective internal control structures for credit rating agencies, it is critical for the SEC to establish a framework against which the relevant internal controls of a specific NRSRO can be measured. Ideally, this framework would identify the objectives

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<sup>87</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 932 (enacted July 21, 2010).

<sup>88</sup> Proposed Rules for Nationally Recognized Statistical Rating Organizations, Release No. 64514, 2011 WL 1894728, at \*3 (May 18, 2011).

<sup>89</sup> See *id.* at \*4-\*6.

<sup>90</sup> See *id.* at \*3.



to be achieved by the internal controls, a set of mandatory minimum components, and how a material weakness -a serious deficiency in an internal control that would prevent it from achieving its objective would be handled. **Without such a framework, NRSRO boards of directors would have no federal guidance when evaluating and approving a proposed internal control structure, SEC personnel would have no benchmarks for evaluating effectiveness and identifying material weaknesses, and investors would have a difficult time understanding what a NRSRO is doing. In addition, without this framework, each NRSRO would formulate its own approach, making oversight by SEC personnel more time consuming, subjective, and expensive, and inviting misunderstandings, disagreements, and conflicts between NRSRO and SEC personnel over acceptable practice.**

Comments on Proposed Rule Nationally Recognized Statistical Rating Organizations [Release No. 34-64514; File No. S7-18-11, Senator Carl Levin, 2011 WL 3970300, August 8, 2011 (bold added).

Senator Levin's description of the statute's vagueness zeroes in on the insuperable problem presented here. The IC Statute did not provide notice of the conduct that it purported to prohibit. "A person of ordinary intelligence" would not know that any of the Non-Scienter Allegations would give rise to an action for causing or aiding and abetting S&P in a violation of the statute because it is not clear in the least what would satisfy the statute's command that S&P "establish, maintain, enforce, and document an effective internal control structure." *See Holder v. Humanitarian Law Project*, 561 U.S. 1, 18 (2010).

For example, the SEC criticizes Duka for failing to write down that Parisi had approved the use of a Blended Constant as an interpretation of the 2009 Criteria. *See* OIP ¶ 30. But there was no requirement at S&P that criteria interpretations be documented, even by the S&P COs, let alone Duka. How would anyone in Duka's shoes have nonetheless reasonably known or been on notice that the IC Statute may have required S&P to mandate such a writing and that she was required in turn to create the writing? Likewise, how would one know that errors in RAMP documents, even negligent errors authored by primary analysts in CMBS, would cause S&P's

“internal control structure” to be ineffective under the statute? Would that have been the case if only one RAMP were mistaken? Two? Concerning the MQR Allegations, how would an individual in Duka’s position know or be on notice that it would cause a violation by S&P of the statute if she did not include with the CMBS Group’s comments on the MQR draft report a spreadsheet incorporating a Blended Constant (which would merely have changed the constant’s numerical value within one cell of a complex spreadsheet)?

This amorphous charge, based on a standard-less statute, strikes at the heart of the concerns embodied in the due process notice requirement, especially, where, as here, the SEC, at the time of the relevant conduct, had issued no rules elaborating on the law’s requirements. *E.g.*, *Timpinaro v. S.E.C.*, 2 F.3d 453, 460 (D.C. Cir. 1993) (“after consulting the relevant statutes and regulation, a trader would be hard pressed to know when he is in danger of triggering an adverse reaction from the NASD.”). Because Duka lacked fair notice as to what this statute required of S&P or prohibited, the secondary violation alleged against her cannot stand. *See Upton v. S.E.C.*, 75 F.3d 92, 98 (2d Cir. 1996) (holding that a CFO of a brokerage firm lacked fair notice that he violated Rule 15c3–3(e) despite the fact that he was warned by an NYSE examiner that the brokerage firm had a “problem with the spirit of the rule” and suggested that the brokerage firm “stop [the] practice”).

**B. *The Alleged Violation Would not Even be Cognizable Under the Rules Newly Enacted under the Internal Controls Statute***

Even under the rules eventually promulgated by the SEC in an effort to particularize the IC Statute, the OIP would not plead an aiding and abetting or causing violation against Duka.

Approximately three years after issuing Release No. 34-64514, the SEC, pursuant to Section 15E(c)(3), amended Rule 17g-3 (17 C.F.R. § 240.17g-3), to list factors for NRSROs to consider in “establishing, maintaining, enforcing and documenting effective internal control[s].”

The Rule became effective on November 14, 2014, and thus was not in effect during the relevant period.<sup>91</sup> Even had it been applicable, it would not support the OIP's claims because under the Rule, S&P's internal control structure would not have been rendered ineffective based on the Non-Scienter Allegations (taken as true for purposes of argument only).

Under the Rule, each NRSRO is required to file an annual report with the SEC that contains, among other things, a statement by NRSRO management concerning "whether the internal control structure was effective" during the period covered by the report. To provide guidance, the Rule defines a "deficiency" and a "material weakness."<sup>92</sup> "[A] deficiency in the internal control structure exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect a failure of the [NRSRO] to ... [a]dhere to an implemented policy, procedure, or methodology for determining credit ratings." *See id.* A "material weakness" is "a deficiency, or a combination of deficiencies, in the design or operation of the internal control structure creates a reasonable possibility that a failure identified in paragraph (a)(7)(iii) of this section that is material will not be prevented or detected on a timely basis." *See id.* As the Rule explains, the existence of "one or more material weaknesses in the internal control structure" would prevent NRSRO management from concluding that the internal control structure was effective. *See id.*

Accordingly, nothing in the Non-Scienter Allegations would cause or implicate the effectiveness of S&P's internal control structure under the Rule. To run afoul of the Rule, said structure must experience one or more "deficiencies" that were "not prevented or detected on a

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<sup>91</sup> *See* Nationally Recognized Statistical Rating Organizations, Release No. 34-72936, 2014 WL 4538057 (Aug. 27, 2014).

<sup>92</sup> *See id.* at \*44 ("The existence of a deficiency in the internal control structure, however, does not necessarily mean that a material weakness exists. Even a well-designed internal control structure cannot guarantee that a deficiency will never occur.").

timely basis.” The focus of the Rule is the detection and prevention and response to the “deficiency,” not the “deficiency” itself. Nothing in the Non-Scienter Allegations goes to S&P’s ability to detect, prevent or respond to any lack of compliance with its implemented policies, procedures or standards, any more than it can be said that a safety incident in a factory “causes” factory management to have failed to adopt procedures designed to prevent such an accident or detect it in a timely manner.

Rule 17g-8 also lists factors that NRSROs “must take into” consideration in complying with the Internal Controls Statute, including in “establish[ing]” internal controls, 17g-8(d)(1), “maintain[ing]” internal controls, 17g-8(d)(2), “enforce[ing]” internal controls, 17g-8(d)(3) and “document[ing]” internal controls, 17g-8(d)(4). Neither these categories of controls nor the factors to be considered under the Rule in designing controls are related to functions that were assigned to Duka as Analytical Manager of CMBS. She was not assigned the responsibility to “establish” policies and procedures at S&P, for example. And, even were the SEC to attempt to read the general requirement that Duka comply with S&P policies and procedures somehow to mean that any alleged noncompliance on her part might be viewed as a failure to “maintain” policies, the SEC’s own rules would contradict this reading: The Non-Scienter Allegations do not fall within the factors identified in 17g-8(d)(2) relating to the maintenance of internal controls.<sup>93</sup>

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<sup>93</sup> See 17 C.F.R. § 240.17g-8(d)(2) (e.g., “Controls reasonably designed to ensure that the nationally recognized statistical rating organization conducts periodic reviews of whether it has devoted sufficient resources to implement and operate the documented internal control structure as designed”).

C. *In any Event, the Criteria Process Allegations are Wholly Unsupported by the Investigative Record*

The OIP claim that Duka aided and abetted and caused an S&P violation of the IC Statute is also defeated by an overwhelming record – indeed, one that we believe the SEC will not seek to contradict in view of its recent *Brady* letter to counsel.

As explained above, S&P’s CP Guidelines expressly state that the procedures for amending Criteria did **not** apply to “interpretations” of Criteria, and analysts, under these Guidelines, were encouraged to consult with “analytical managers, criteria committee members, and criteria officers with application and interpretation questions.”

The evidence that, consistent with this guidance, Duka consulted with Thompson (an analytical manager), and Parisi (Acting CMBS CO and CCO for all of Structured Finance) and that Parisi advised Duka that New Issuance could employ the Blended Constant under an interpretation of the 2009 Criteria, is not materially contradicted.

Duka testified that during this meeting Parisi (a) opined that the use of a Blended Constant constituted an interpretation of criteria, (b) approved the use of a Blended Constant, and (c) stated that he had the authority to approve the use of a Blended Constant as a criteria interpretation.<sup>94</sup> Her testimony is corroborated by the testimony of Barnes,<sup>95</sup> who inquired of Parisi in January regarding his determinations in December. Parisi, through counsel,<sup>96</sup> also confirms Duka’s recollection, as does Geramian.<sup>97</sup> In view of this testimony and attorney

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<sup>94</sup> See Goldman Decl., Ex. 7 (Duka, 403:24-404:22, 584:3-13, 628:14-629-11).

<sup>95</sup> See *infra* at 13-14.

<sup>96</sup> See *id.*

<sup>97</sup> See *id.*

proffer, the OIP's allegation that Duka "unilaterally concluded" that Parisi approved the use of blended constants must be rejected, and the Criteria Process Allegation dismissed.

The SEC seems to have anticipated this adverse evidentiary bonanza at the time of the filing of the OIP because the OIP asserts that even if Parisi approved the use of a Blended Constant, Duka would still be liable because Parisi's action "would not have satisfied the requirements of the Criteria Process Guidelines."<sup>98</sup> This alternative pleading is patently without basis. The CP Guidelines themselves identify criteria interpretation as outside the process of Criteria amendment. And, at the time, **there was no S&P policy governing such criteria interpretations.** The SEC knows this. In a September 13, 2012 examination letter from the SEC to S&P, the Commission chided S&P for not having such a policy, stating as follows:

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.

*See* SEC-DUKA-0358311. Thus, Duka could not have been negligent in seeking a Criteria interpretation by consulting with the CMBS CO. No rule or practice suggested she should do anything different; or that she should have "unilaterally" rejected the CO's guidance.<sup>99</sup> Notably, both Barnes, the Quality Officer, and Geramian, the CMBS CO appointed in December 2010, knew that Parisi had provided Duka with a Criteria interpretation and never suggested that Parisi

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<sup>98</sup> *See* OIP ¶ 30.

<sup>99</sup> *See* Goldman Decl., Ex. 13 (Barnes, 41:3-5 ("Or if it's an interpretation [of criteria], then solely criteria people should make that assessment.")); *id.*, Ex. 36 (Henschke, 44:17-45:04); *id.*, Ex. 7 (Duka, 217:16-20).

had acted contrary to the CP Guidelines.<sup>100</sup> Additionally, Jacob, who was head of all Structured Finance at the time, testified that Parisi was authorized to interpret the Criteria to allow CMBS to use the Blended Constant.<sup>101</sup> Indeed, when Parisi, in or around October 2010, drafted a job description for CMBS CO, which was emailed to Duka,<sup>102</sup> he wrote that the CMBS CO's duties would include making "**final** interpretations of criteria for his/her coverage area."<sup>103</sup>

In view of this evidence, the OIP's assertion that Duka was negligent in accepting Parisi's Criteria interpretation as authorized and effective is unfounded and wrong.<sup>104</sup> Duka followed standard practice at S&P, consistent with specific advice in the CP Guidelines, and properly relied on Parisi's Criteria interpretation.

The SEC also alleges that Duka was negligent because she failed to make a "record of the meeting" of Parisi's decision.<sup>105</sup> The claim is borderline frivolous considering that, as stated above, there was no policy governing criteria interpretations at all, let alone one that required Duka to document anything.<sup>106</sup> Parisi, moreover, said it was **his** practice to make notes of his

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<sup>100</sup> See *infra* at 13-14.

<sup>101</sup> Goldman Decl., Ex. 3 (Jacob, 161:1-162:8).

<sup>102</sup> See *id.*, Ex. 52 (SP-CMBS 00584541).

<sup>103</sup> See *id.*, Ex. 52 (SP-CMBS 00584543 (bold added)); see also *id.*, Ex. 54 (SP-CMBS 01373802 (Dr. Parisi noted in an email that "interpretation of criteria resides with criteria"))).

<sup>104</sup> Based on the questioning of the witnesses by the Staff, the SEC's view seems to be that, because the Blended Constant was applied to all conduit fusion deals after Parisi's interpretation, the change should have been considered a change in criteria not an interpretation. But, such view is mere disagreement with Parisi, and provides no evidence that Duka should have known that Parisi was acting outside the scope of his authority.

<sup>105</sup> See OIP ¶ 30.

<sup>106</sup> See *infra* at 25-26. Only after the events in question did S&P formalize its criteria interpretation policy. Goldman Decl., Ex. 56 (SP-CMBS 01422584).

daily meetings.<sup>107</sup> This claim is also inconsistent with a number of examples in the investigative record where criteria interpretations were provided informally over email.<sup>108</sup>

Finally, Parisi's Criteria interpretation must be evaluated in the context of the July 2009 Decision and the March 2010 Decision. Neither of those decisions followed the five-step process of Criteria amendment set forth in the CP Guidelines, and neither resulted in an external publication."<sup>109</sup> Moreover, the July 2009 Decision, **involving the Chief Credit Officer and President of S&P**, was not documented in any form. The Parisi Criteria interpretation concerning Blended Constants was in lock-step with S&P practice. The SEC cannot now impose a standard of conduct on Duka that did not exist at the time.

D. *The MQR Allegation Is Flatly Contradicted by the Head of the MQR Group*

The MQR Allegation is out of whole cloth and without basis. The SEC alleges that Duka aided and abetted and caused S&P's violation of the IC Statute, in that she allegedly "knowingly allowed MQR to perform its important internal control function" without providing MQR with an excel spreadsheet that incorporated a blended constant. This averment is flatly inconsistent with the testimony of both Goldberg, the head of the MQR Group, and Hu. Goldberg and Hu testified that, to perform MQR's function in approving the CMBS model, MQR did not require a spreadsheet that used the Blended Constant.<sup>110</sup> The MQR Allegations thus amount to an accusation that Duka was negligent because she did not provide to MQR a spreadsheet version that MQR Group witnesses neither sought nor needed to complete the MQR Report. How could that be negligence?

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<sup>107</sup> *Id.*, Ex. 17 (Parisi, 10:6-11:23).

<sup>108</sup> *Id.*, Ex. 57 (SP-CMBS 00906250); *id.*, Ex. 58 (SP-CMBS 01374731).

<sup>109</sup> *See id.*, Ex. 15 (SP-CMBS 00793858-60).

<sup>110</sup> *See id.*, Ex. 59 (Goldberg 77:2-23, 84:21-86:2); *id.*, Ex. 23 (Hu, 123:16-124:15).



## POINT II

### **Duka is Entitled to Summary Disposition Regarding the Rule 17g-2(a)(2)(iii) Allegation**

The alleged violation of Rule 17g-2(a)(2)(iii) – which requires that a record be maintained by a NRSRO of any material difference between a credit rating implied by a quantitative model and a final credit rating issued by the NRSRO – should be dismissed because there were no material differences between the quantitative models used in connection with the eight transactions at issue and the ratings of those transactions.

This Rule provides that “[i]f a quantitative model was a substantial component in the process of determining the credit rating of a security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction, a record [must be maintained by the NRSRO] of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued.” As explained in Release No. 34-59342, the purpose of this rule is to allow the SEC to determine whether “appropriate **qualitative** factors” were used to derive a particular rating.<sup>111</sup>

The SEC alleges that the model was changed to incorporate the Blended Constant, and the model was used to rate eight transactions.<sup>112</sup> As such, there were no “material difference[s] between the credit rating[s] implied by the model[s] and the final credit rating[s] issued.” To the extent the SEC takes issue with the determination to use the Blended Constant in the model, that issue is not within the scope of and is irrelevant to Rule 17g-2(a)(2)(iii).

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<sup>111</sup> Amendments to Rule for Nationally Recognized Statistical Rating Organizations, Release No. 34-59342, 2009 WL 233865, at \*12 (Feb. 2, 2009).

<sup>112</sup> See OIP ¶¶ 28, 33, 43.

### POINT III

#### **Duka is Entitled to Summary Disposition Regarding the Rule 17g-2(a)(6) Allegation**

The OIP's allegation that Duka aided and abetted or caused a violation by S&P of Rule 17g-2(a)(6) – which requires an NRSRO to keep a record documenting its procedures and methodologies to determine credit ratings – must be dismissed because it lacks a factual predicate: S&P complied with the Rule by publishing criteria by which it determined ratings; it did not fail to keep a record of these criteria.

Specifically, S&P adhered to the Rule because S&P made and “retain[ed]” the 2009 Criteria.<sup>113</sup> Rule 17g-2(a)(6) provides that a NRSRO “must make and retain ... [a] record documenting the established procedures and methodologies used by the nationally recognized statistical rating organization to determine credit ratings.” Because criteria were made and retained by S&P, Rule 17g-2(a)(6) was not violated by S&P.<sup>114</sup>

Through this allegation, the SEC is trying to bootstrap its assertion – naked of any credible evidence – that Parisi's Criteria interpretation permitting the use of Blended Constants was an unauthorized amendment of Criteria. As discussed above, this effort ignores the plain meaning of the CP Guidelines concerning the difference between Criteria interpretations and changes in Criteria, and the repeat practice at S&P of making determinations concerning constants as interpretations of Criteria, not amendments. But, in all events, this Criteria

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<sup>113</sup> See Goldman Decl., Ex. 12 (Adelson, 198:22-199:1 (“[W]ould it be accurate to say that criteria are the established procedures and methodologies by which S&P is supposed to determine credit ratings? Yes.”)); *id.*, Ex. 6 (Thompson, 11:8-13); *id.*, Ex. 60 (SP-CMBS 0169411); *id.*, Ex. 61 (SP-CMBS 00595202).

<sup>114</sup> The SEC's assertion that using the Blended Constant constituted a criteria change does not alter the analysis under Rule 17g-2(a)(6). Stated simply, when an NRSRO issues a rating that is contrary to its “established procedures and methodologies,” that does not mean that the NRSRO failed to maintain records of its “established procedures and methodologies.” Otherwise, the second clause of 17g-6(a)(2) is completely superfluous.

interpretation was provided by Parisi not Duka. No rational or evidentiary basis exists to conclude that she was negligent in relying on the CO's Criteria advice. Under the standard at the time, she was demonstrably not. For example, Barnes, the Quality Officer, whose job it was to ensure adherence to Criteria, obviously did not believe there was any issue in January 2011.

#### **POINT IV**

##### **Duka is Entitled to Summary Disposition Regarding the Alleged Violation of Rule 17g-6(a)(2)**

The OIP also asserts that Duka caused or aided and abetted S&P's violation of Rule 17g-6(a)(2), which prohibits the issuance offer or threat to issue a credit rating that is not determined in accordance with the NRSRO's "established procedures and methodologies" to determine credit ratings based on whether the rated person or affiliate purchases or will purchase the credit rating. This allegation should be dismissed summarily because all of the first-hand and documentary evidence is that Parisi's interpretation of Criteria to permit the use of Blended Constants as an application of Criteria methodology, fell within "established procedures and methodologies."

Rule 17g-6(a)(2) prohibits NRSROs from "[i]ssuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the [NRSRO's] established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the [NRSRO] or any person associated with the [NRSRO]."

As discussed above with respect to the OIP's allegation concerning Rule 17g-2(a)(6), the OIP is unsupported and incorrect that the application of methodology approved by Parisi as a Criteria interpretation effectively amended the Criteria. Rather, such Criteria interpretation was routine, and accepted as part of the implementation of Criteria. *See* CP Guidelines, § 2.1.

Importantly, such interpretation was routine in the case of loan constants, as evidenced by the undocumented and unpublished July 2009 decision and the unpublished March 2010 decision, neither of which was executed per the inapplicable five-step Criteria amendment process. Thus, Parisi's interpretation in December, proven by the first-hand testimonial evidence of Barnes, Geramian, Duka and others, as well as the documentary evidence, was part and parcel of S&P's "established procedures and methodologies for determining credit ratings," meaning that there could be no violation of this Rule.

In any event, this Rule also incorporates a *scienter* element because it concerns actions for a particular purpose.<sup>115</sup> As discussed above concerning the Rule 17g-2(a)(6) allegation, the competent testimony and documentary evidence, augmented by the Parisi admission in the *Brady* Letter, overwhelmingly demonstrates that the relevant S&P professionals at the time viewed Parisi's interpretation as within his authority.<sup>116</sup> On this record, with the issue of motive aside for present purposes only, there is no evidence that Duka (or anyone else who was involved) **knew or was negligent in not knowing** that Parisi's determination was somehow outside of "established procedures and methodologies." This allegation must therefore be dismissed.<sup>117</sup>

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<sup>115</sup> See *Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 502 (1982); *In re Brandt, Kelly & Simmons, LLC, & Kenneth G. Brandt*, Release No. 289, 2005 WL 1584978, at \*7 (June 30, 2005).

<sup>116</sup> See *infra* at 13-14.

<sup>117</sup> *U.S. ex rel. Lockyer v. Hawaii Pac. Health Grp. Plan for Employees of Hawaii Pac. Health*, 343 F. App'x 279, 281 (9th Cir. 2009).

## CONCLUSION

For all of the reasons set forth above, Duka respectfully requests that the Court dismiss with prejudice:

(1) The OIP's charge that Duka caused or aided and abetted a violation by S&P of 15 U.S.C. § 78o-7(c)(3)(A).

(2) The OIP's charge that Duka caused or aided and abetted a violation by S&P of Rule 17g-2(a)(2)(iii).

(3) The OIP's charge that Duka caused or aided and abetted a violation by S&P of Rule 17g-2(a)(6).

(4) The OIP's charge that Duka caused or aided and abetted a violation by S&P of Rule 17g-6(a)(2); and

(5) Such other relief as the Court may deem warranted.

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New York, New York

Respectfully submitted,


PETRILLO KLEIN & BOXER LLP

By: 

Guy Petrillo

  
Daniel Goldman

  
Leonid Sandlar

  
655 Third Avenue, 22<sup>nd</sup> Floor  
New York, New York 10017  
Telephone: (212) 370-0330  
Facsimile: (212) 370-0391