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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16349

In the Matter of

BARBARA DUKA

Respondent.

MOTION *IN LIMINE* TO EXCLUDE TESTIMONY AND EXHIBITS REFERENCING THE FINDINGS AND CONCLUSIONS OF STANDARD & POOR'S INTERNAL INVESTIGATIONS

Pursuant to Rule 321 of the Rules of Practice, the Division of Enforcement (the "Division") hereby moves for an order to exclude evidence (whether in the form of testimony or exhibits) referencing Standard & Poor's ("S&P") internal inquiries regarding the CMBS group's change to their ratings process to use a 50/50 blend of the S&P stressed loan constant and the actual loan constant. This evidence should be excluded for three primary reasons. First, evidence of any findings or conclusions reached by Standard & Poor's personnel with respect to Duka's conduct is inappropriate opinion testimony and fails to meet the threshold requirements for relevance under the Commission's Rules of Practice and for admissibility under Rule 701 of the Federal Rules of Evidence ("FRE"). In particular, such evidence includes the subjective views of other S&P employees regarding Duka's state of mind concerning the switch to blended constants and disclosure of that material change in S&P's CMBS ratings methodology, which is improper lay opinion evidence and intrudes on the factfinder's central role at this hearing.[1] Second, certain documents generated in the course of S&P's internal inquiry into Duka's conduct reflect purported statements by witnesses who are expected to testify at the hearing and others. These statements are

[1] To be clear, the Division submits that the introduction of any opinion testimony about Duka's state of mind is improper – whether elicited during the S&P internal inquiries or otherwise.

second-level hearsay and should be excluded under the principles of Federal Rules of Evidence ("FRE") 801 and 802. Nor can such statements be used for impeachment of testifying witnesses to the extent inconsistent with any material testimony that may be elicited at the hearing, as a third party's characterization of a witness's prior statement is not competent extrinsic evidence of a prior statement. Finally, the dangers of undue prejudice and wasting time substantially outweigh any probative value of the evidence concerning S&P's internal inquiries. It is the role of the ALJ to weigh the evidence to find the facts, and any findings made or conclusions reached by S&P personnel are wholly irrelevant to such a determination.

FACTUAL BACKGROUND

Standard & Poor's conducted two internal inquiries concerning the methodology applied by the CMBS group in the ratings process. The first inquiry, which was narrow in scope, took place in January 2011. In early January 2011, Patrick Milano – then the Executive Vice President of Operations for Standard & Poor's – was forwarded an anonymous complaint via his personal e-mail account by former S&P employee Kim Diamond.[2] *See* PM-SEC 001-005; Div. Ex. 321. In sum and substance, the complaint alleged that Barbara Duka and others at S&P were loosening the CMBS criteria for improper commercial purposes. As a result, Susan Barnes, the chief quality officer for structured finance, was tasked with conducting an inquiry into whether a blended constant being used by the CMBS group was the result of improper commercial considerations. *See* KD000000001-5; Div. Ex.'s 339, 340.

In connection with her inquiry, Barnes spoke at least twice with Dr. Frank Parisi, then the Chief Criteria Officer for Structured Finance (including CMBS) , and several other S&P employees. Barnes summarized her findings in an email to Neri Bukspan dated January 7, 2011,

[2] In reality, the "anonymous" complaint was sent by James Palmisano, a former S&P employee, to Ms. Diamond.

marked as Respondents Exhibit 355 (the "January 7, 2011 Barnes Email"). In the email, Barnes advised Bukspan that she did "not see the need to look further into this[,]" referring to the anonymous complaint received by Milano. The email is replete with second-level hearsay, as Barnes characterized her discussions with other S&P employees, including Frank Parisi, who purportedly told Barnes "that he had a couple of conversations with Barbara [Duka] and Eric Thompson on the use of the criteria constants[.]" S&P-SEC 2012 0357308. Barnes described Parisi as having "first discuss[ed] with them (*i.e.*, Duka and Thompson) the need to document and substantiate any request for criteria exceptions" and then having discussed the issue further with Duka. *Id.* Barnes' inquiry did not uncover the fact that Duka's CMBS group had switched from using an S&P stressed loan constant to a 50/50 blend of the stressed loan constant and the actual loan constant.

Standard and Poor's then engaged in a second, and more sweeping, internal inquiry in July 2011, after the use of blended constants in the ratings for CMBS was finally discovered by senior management at S&P, causing S&P to withdraw its preliminary ratings for two CMBS transactions. *See* OIP at ¶¶46-47. In the immediate aftermath of the ratings withdrawals, there was a series of internal meetings (including several attended by Duka) and, as a result of those meetings and directives from senior management, numerous S&P employees were tasked with reviewing the ratings process for six other transactions in which the methodology included blended constants. *See id.* Subsequently, the S&P Compliance department conducted a Targeted Post Event Review ("TPER") that was initially focused on one specific transaction (GSMS 2011-GC4) and issued a memorandum on May 24, 2012 (the "Byrnes Report") authored by Bernard Byrnes setting forth the findings of the TPER. *See id.* The Byrnes Report identified specific violations of S&P codes

of conduct and Model Quality Review Guidelines, and set forth disciplinary action to be meted out to certain S&P employees. *See id.*

ARGUMENT

As an initial matter, the parties have already met and conferred regarding the subject of this motion, and are in broad agreement on certain limiting principles regarding evidence of the internal inquiries at S&P. First, the parties agree as a general matter that they will endeavor to limit the introduction of such evidence where possible. In addition, the parties agree that any statements made by Duka – whether in the course of the internal inquiries or otherwise – are admissible as statements of a party-opponent. However, in light of the volume of the exhibits, and the frequency with which many documents make reference to the internal inquiries at S&P, the parties are working to reach agreement on whether certain exhibits may be withdrawn or excluded upon agreement, and if not, whether the parties can further narrow the scope of any dispute about certain documents or testimony that may touch upon these inquiries.

Accordingly, the Division anticipates that there may be a certain number of exhibits that touch on (or were written about) the internal inquiries that remain in dispute. Among other things, Duka may seek to introduce certain prior (arguably inconsistent) statements by witnesses reflected in documents generated in the course of the internal inquiries, or to adduce evidence about the witnesses' subjective views as to Duka's state of mind vis-à-vis the use of blended constants. Accordingly, the Division moves *in limine* to exclude any evidence of the findings and conclusions of the internal investigations and any characterizations of witness's prior statements, and sets forth below the reasons why such evidence should be excluded.

I. Evidence Regarding the Findings and Conclusions of S&P's Internal Inquiries is Inappropriate Opinion Testimony and Should be Excluded Under the Commission's Rule of Practice 320 and the Guidance of Federal Rule of Evidence 701

The Commission's Rules of Practice provide for the exclusion of evidence that is "irrelevant, immaterial, or unduly repetitious." 17 C.F.R. §201.320. While there is no *per se* bar to the admission of hearsay evidence in this proceeding, the proffered evidence must at least be relevant to be admissible under the plain language of the Rules of Practice. *See also Guy P. Riordan*, Securities Act of 1933 Release No. 9085 (Dec. 11, 2009), 97 SEC Docket 23445, 23469. Moreover, while not strictly applicable in these proceedings, the Court may consider the Federal Rules of Evidence as guidance in determining the admissibility of evidence. Here, the Division submits that the findings and conclusions of Standard & Poor's internal inquiries should be excluded under both the Commission's Rules of Practice and the guidance of Federal Rule of Evidence 701, which precludes the admission of improper lay opinion testimony. Such a ruling in advance of the hearing could not only streamline the hearing, but, more importantly, help to avoid a protracted "trial within a trial" on the merits of S&P's internal inquiries. *See Paolitto v. John Brown E&C, Inc.*, 151 F.3d 60, 65 (2d Cir. 1998) (upholding exclusion of findings of Connecticut state agency because of likelihood of confusing jury and protracting proceedings).

Here, as a threshold matter and at a minimum, the Court should exclude the January 7, 2011 Barnes Email and the Byrnes Report, which are nothing more than Standard & Poor's opinions regarding the CMBS practice group's conduct with respect to the use of (and failure to disclose the use of) blended constants in the CMBS ratings process. To be admissible under FRE 701, lay opinion testimony must be (a) rationally based on the perception of the witness; (b) helpful to the jury to clearly understand the issues; and (c) not based on scientific, technical or other specialized knowledge. *See* FRE 701. S&P's internal investigation findings and conclusions

fail to meet any of these requirements, thus rendering any such evidence irrelevant. Here, neither Barnes nor Byrnes was a percipient witness to any of the events that are at issue in this hearing.[3] Accordingly, this Court should exclude any testimony or reports summarizing the opinions of Barnes, Byrnes, or others at S&P that are not based on their personal knowledge of the relevant events – including but not limited to the January 7, 2011 Barnes Email and the Byrnes Report.

Moreover, any opinion testimony about Duka's state of mind – whether elicited from a live witness or memorialized in a document such as the Byrnes Report – should be excluded. While this Court will ultimately have to determine Duka's state of mind, the subjective views of S&P employees about Duka's state of mind are irrelevant to that determination. Moreover, while this Court is more than able to disregard irrelevant and prejudicial evidence, such opinion testimony is nonetheless improper, because it intrudes on the role of the factfinder. *See*, e.g., *Munoz v. United States*, 2008 WL 2942861, at *19 (E.D.N.Y., July 28, 2009) ("Opinion testimony is not helpful to the jury in determining the facts when it attempts to usurp the jury's role by dictating the inferences the jurors should draw from the objective facts of the case[.]") (internal citations omitted).

II. Evidence Regarding the Internal Inquiries Containing Double Hearsay Should be Excluded.

Beyond the Barnes and Byrnes reports, many of the documents listed on the Exhibit Lists are saturated with second-level hearsay. While hearsay is admissible in these proceedings, many of the documents referencing the internal inquiries at S&P consist entirely of hearsay within hearsay – they are out-of-court statements made by S&P employees characterizing the out-of-court statements allegedly made (and not adopted) by interviewees – and are inadmissible because no hearsay exception even arguably applies to either level of hearsay. *See* Fed. R. Evid. 805

[3] Byrnes is not on either party's witness list. Barnes is on both witness lists; should Barnes ultimately testify at the hearing, the Division seeks a ruling that her testimony be limited to events about which she had personal knowledge,

(providing that hearsay within hearsay is only admissible "if each part of the combined statements conforms with an exception to the rule"); *see also J.H. Rutter Rex Mfg. Co. v. NLRB*, 473 F.2d 223, 240 (5th Cir. 1973) (addressing the dangers of unreliability from double hearsay in investigative interview notes). Such second-level hearsay is not sufficiently reliable and relevant to be admitted in these proceedings.

Importantly, many of the individuals who were interviewed during the S&P internal inquiries will be testifying live at trial. Accordingly, there is no exigency that would necessitate introducing second-level hearsay statements, because the witnesses themselves are perfectly capable of testifying as to their personal knowledge of the relevant issues in dispute in this case.

Nor may the prior statements of testifying witnesses (other than Duka) reflected in various internal inquiry documents be used for impeachment, even if arguably inconsistent with testimony elicited at the hearing. "[E]xtrinsic evidence of [a] prior inconsistent statement must be competent and otherwise admissible." *United States v. Ghaliani*, 761 F. Supp. 2d 114, 119 (S.D.N.Y. 2011) (footnote omitted); *see also* FRE 613. A third party's characterization of a witness's purported out-of-court statement does not meet this threshold test. *See, e.g., United States v. Almonte,* 956 F.2d 27, 29-30 (2d Cir. 1992) (per curiam) (proponent of notes containing an alleged prior inconsistent statement must prove that the "notes reflect the witness's own words rather than the note-taker's characterization;" third party's characterization of witness's statement "does not constitute a prior statement of that witness unless the witness has subscribed to that characterization"); *United States v. Schoenborn,* 4 F.3d 1424, 1428 n. 3 (7th Cir. 1993) (quoting *Almonte* and noting that "[o]ur finding that [the] report did not constitute a statement made by [the witness] precludes admission of the report pursuant to Rules

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and exclude any substantive testimony about the findings of the January 2011 or July 2011 internal inquiries.

607 and 613(b)."); *United States v. Benson,* 961 F.2d 707, 709 (8th Cir. 1992) (reports of interviews of witness that were not adopted by witness were "inadmissible double hearsay" and not admissible to prove prior inconsistent statement); *United States v. Saget,* 991 F.2d 702, 710 (11th Cir.) ("[A] witness may not be impeached with a third party's characterization or interpretation of a prior oral statement unless the witness has subscribed to or otherwise adopted the statement as his own."), *cert. denied,* 510 U.S. 950, 114 S. Ct. 396, 126 L. Ed. 344 (1993); *United States v. Leonardi,* 623 F.2d 746, 757 (2d Cir.1980) (FBI notes offered to impeach not attributable to witness because "a witness may not be charged with a third party's characterization of his statements unless the witness has subscribed to them"); 28 WRIGHT & GOLD § 6203 ("Rule 613 does not itself create any exception to the hearsay rule."). Summaries and characterizations of various witness statements contained in documents generated during S&P's internal inquiries are therefore may not be used for impeachment, much less the truth of the matters asserted (unless an independent hearsay exception applies.)

III. Evidence Concerning the Findings of S&P's Internal Investigation is Confusing and Prejudicial and Should be Excluded Under the Principles of FRE 403

Even assuming that evidence of the findings and conclusions of S&P's internal inquiries is not excluded as hearsay or improper lay opinion testimony, it should be excluded under the principles animating Rule 403, as any probative value of the evidence would be substantially outweighed by dangers of confusing the issues, wasting time, and unfairly prejudicing the Division. Moreover, the challenged evidence also invites an unnecessary protraction of the trial. Should the Court admit evidence concerning the results of S&P's internal inquiries, the SEC will be required to demonstrate that the findings were incomplete and unreliable. This competing evidence poses the risk of diverting the trial into a mini-trial of S&P's investigative procedures.

CONCLUSION

For the reasons stated above, the Division hereby moves the Court to exclude all evidence pertaining to the conclusions and findings of S&P's internal inquiries relating to the CMBS ratings process, as well as related testimony and exhibits that are not sufficiently reliable and/or relevant to be considered as competent evidence in these proceedings.

Dated this 26st day of October, 2016.

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CERTIFICATE OF SERVICE

On October 26, 2016, the foregoing Division of Enforcement's Motion *in Limine* was sent to the following parties and other persons entitled to notice as follows:

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