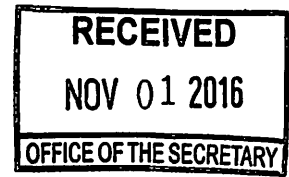


HARD COPY
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16349

In the Matter of

BARBARA DUKA,

Respondent.

**DIVISION OF ENFORCEMENT'S OPPOSITION TO RESPONDENT BARBARA
DUKA'S MEMORANDUM OF LAW IN SUPPORT OF HER MOTION IN LIMINE TO
STRIKE SUBSTANTIAL PORTIONS OF THE EXPERT REPORT OF PETER D.
RUBINSTEIN, PH.D**

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RESPONSE TO PRELIMINARY STATEMENT

Respondent's Barbara Duka's ("Respondent's" or "Duka's") highly vitriolic attack on the Division of Enforcement's ("Division's") Expert Report of Peter D. Rubinstein, Ph.D. ("Rubinstein Report") both argues that Dr. Rubinstein is not opining on the same topics as Respondent's expert – and thus his opinions must be excluded – and misstates and/or mischaracterizes Dr. Rubinstein's opinions and the basis for the Division's claims. The Rubenstein Report offers three, narrow, well-supported, opinions (Rubinstein Report at 2-3, 48-59), along with a description of the factual background that provides context to his opinions (*id.* at 3-48). That fact that Dr. Rubinstein's opinions do not focus on the due diligence conducted by a "reasonable" CMBS investor – as Respondent's expert, John J. Richard, did almost exclusively – does not require exclusion. To the contrary, unlike Mr. Richard's report, Dr. Rubinstein's Report and Opinions are focused on the heart of the Division's allegations.

The Division alleges that Duka, through her CMBS ratings group, changed the methodology for rating new issuance ("NI") CMBS transactions (which is undisputed) and that that change had an impact on the output of the CMBS ratings models, *i.e.* it lowered the credit enhancement supporting the rating (again, undisputed). Dr. Rubinstein analyzed the models used by Standard and Poor's ("S&P's") to rate CMBS transactions and quantified the impact the change from using "criteria constants" to "blended constants" had on the resulting model outputs. He also opines that, given his substantial experience working for ratings agencies, the change Duka made to the models was not adequately disclosed in S&P's Presale reports on the deals it rated and did not follow S&P's Criteria Process Guidelines.

To the extent Respondent takes issue with Dr. Rubinstein’s opinions or the bases therefore, she may bring those disagreements out through examination at the hearing. However, Duka offers no sound basis on which to strike any of Dr. Rubinstein’s opinions or their underlying factual support. Accordingly, Duka’s Motion *in Limine* to Strike Substantial Portions of the Expert Report of Peter D. Rubinstein, Ph.D. (“Motion to Strike”) should be denied.¹

ARGUMENT

I. Legal Standard

Respondent is correct that SEC Rule of Practice 320 provides that the hearing officer “shall exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unreliable.” (See Motion to Strike at 3). The Division also agrees with Duka that “‘*Daubert* does not apply because the Federal Rules of Evidence are inapplicable in our administrative proceedings.’” (*Id.*, quoting *In the Matter of Ralph Calabro*, Release No. 9798, 2015 WL 3439152, at *11 (May 29, 2015)). But, as in *Calabro*, there is nothing in Dr. Rubinstein’s “report or testimony that violates [*Daubert*’s] ‘spirit.’” *Calabro*, 2015 WL 3439152, at *11.

II. Peter D. Rubinstein, Ph.D.’s Qualifications

Respondent’s argument that Dr. Rubinstein has no skill, experience, education, or training with regard to a “reasonable” CMBS investor is ill-founded, but more importantly, it mischaracterizes his testimony and opinions. Dr. Rubinstein’s opinions are as follows:

- First, the primary modification to the model at issue in this case – *i.e.*, the switch from using the loan constants in S&P’s published Criteria (‘Criteria Constants’) to a simple 50/50 average of the Criteria Constants and the actual loan constants (‘blended constants’)—was a dramatic alteration of

¹ Citations to the Motion to Strike herein are citations to the respective pages of the Memorandum of Law in Support of that Motion, filed October 26, 2016.

S&P's published CMBS Criteria that resulted in substantially inflated ratings.

- Second, the switch to blended constants and the resulting inflated ratings were not adequately disclosed in S&P's Presale reports, which left investors with the misleading impression that the ratings were based on the more conservative Criteria Constants when in fact the ratings were based on the less conservative blended constants.
- Third, the switch to blended constants was an 'analytical issue' that was required to be escalated, evaluated, and (if adopted) published pursuant to S&P's Criteria Process Guidelines.

(Rubinstein Report at 2-3 (footnotes and internal citations omitted)). These opinions are based on Dr. Rubinstein's experience – acknowledged by Respondent – “working in the research groups at credit rating agencies and financial institutions.” (Motion to Strike at 4). One need not have actual experience purchasing CMBS securities to offer these opinions.² Rather, Dr. Rubinstein's experience working for two different ratings agencies, including developing ratings models for Morningstar during the period in question, provides a solid foundation for his opinions regarding changes made to the S&P CMBS ratings model and disclosure of and proper procedures for making such changes.

Respondent's citation to *Williamson ex rel. At Home Bondholders' Liquidating Trust v. Verizon Commc'ns Inc.*, No. 11 Civ. 4948 (LTS), 2012 WL 5425033, at *2 (S.D.N.Y. Nov. 7, 2012) (Motion to Strike at 5), while inapplicable as a district court case adjudicated under the Federal Rules of Evidence, is nonetheless illustrative. There, as stated by Respondent, the complaint was that Plaintiff had “failed to show that Dr. Cooper has any experience in actually

² But, in fact, Dr. Rubinstein has extensive experience working with and advising CMBS investors and Respondent should feel free to explore that experience while examining him at the hearing. See Rubinstein Report paragraphs 3, 10, 14-16.

designing or otherwise working with the technical aspects of computer networks.” (Motion to Strike at 5). In contrast, Dr. Rubinstein has extensive experience working with ratings models while employed by rating agencies, financial institutions, and as a consultant. *See, e.g., Rondout Valley Cent. School Dist. V. Coneco Corp.*, 321 F. Supp. 2d 469, 475 (N.D.N.Y. 2004) (“Rather than relying upon rigidity, demanding that an expert’s qualifications match perfectly with the issues at hand, liberality and flexibility in evaluating qualifications should be the court’s guide.”) (citation omitted); *McCulloch v. H.B. Fuller Co.*, 61 F.3d 1038, 1042-43 (2d Cir. 1995) (“quibbles” with expert’s qualifications “were properly explored on cross examination and went to [the expert’s] testimony’s weight and credibility—not its admissibility”).

Respondent’s Motion to Strike goes on to contend that “Dr. Rubinstein’s ‘experience’ provides no valid basis on which to opine—as he does many times in the Report—from the perspective of a CMBS investor, *see* ¶¶ 37, 52, 58, 69, 72, 91, 98.” (Motion to Strike at 5). Yet, for the majority of the cited paragraphs, Duka either does not seek to exclude the paragraphs reflecting Dr. Rubinstein’s opinions or Dr. Rubinstein is opining from the viewpoint of the ratings agency or issuer, as opposed to a CMBS investor. And the few references to CMBS investors found in his report are well supported by Dr. Rubinstein’s extensive experience working closely with CMBS investors. (*See* Rubinstein Report at ¶¶ 3, 10, 14-16).

In paragraph 37, Dr. Rubinstein discusses the design or structure of a CMBS deal and opines that “[i]ssuers seek triple-A ratings because most CMBS investors prefer to buy triple-A rated bonds.” This statement is (i) uncontroversial and (ii) well-supported by Dr. Rubinstein’s industry experience. Moreover, Respondent does not seek to exclude any of this paragraph, as it is not highlighted in her Exhibit 1. Only three sentences in paragraph 52 are highlighted. The first two, at page 23, state “Issuers use Presales to help sell the bonds. Investors use Presales to help

evaluate the credit risks in transactions.” Both statements are uncontroversial. Further, the first is from the viewpoint of an issuer and the second is acknowledged as true by Respondent’s expert. (See Expert Report of John Richard, CFA (“Richard Report”) filed October 14, 2016, at 17, ¶ 40 “[CMBS investors] use available data and information from various sources, including the offering materials, ... as well as data and information from ... rating agencies” and at 20, ¶43 “[r]ating agency reports and opinions were a source of information that investors could potentially factor into their own analyses and related decisions to varying degrees”). The third highlighted sentence in paragraph 52 is clearly from the perspective of rating agencies.³

Paragraph 58 – concerning context and background on “ratings shopping” – is not highlighted and, in any event, this section of Dr. Rubinstein’s report is based on his undisputed years of experience in the CMBS industry. Exhibit 1 highlights one sentence of paragraph 69 that merely states an allegation and admission, and also a phrase that notes that the change in credit enhancement was, in Dr. Rubinstein’s opinion, in an amount that would be significant to both issuers and investors. The significance to issuers is apparently unchallenged, and the significance to investors is well supported by Dr. Rubinstein’s experience “presenting research at conference, investor road shows, and one-on-one meetings with investors” (Rubinstein Report at 6, ¶14); “meeting with investors” while at Realpoint-GMAC Institutional Advisors (*id.* at 6, ¶15); meeting “frequently with investors to help guide the development of analytical and data products on the Bloomberg terminal” while at Bloomberg (*id.* at 6, ¶ 16); and speaking at Morningstar events (*id.*

³ Respondent drops a footnote to say that Dr. Rubinstein’s opinions offered from the perspective of a CMBS issuer should also be struck and cites his statement that “Issuers use Presales to help sell the bonds.” There is no basis, however, to strike this undisputed statement. See Richard Report at 30, ¶ 64 “Presale reports are essentially another source of information and reflect another analysts opinion” and 31, ¶ 66 “reasonable investors review the information in presale reports at a very general level as a complement to their own analysis.”

at 6-7, ¶ 17). The Court should reject Respondent's argument that an expert with over 30 years of plainly relevant industry experience somehow has no basis to state that a massive and undisclosed change in credit enhancement supporting a CMBS rating would be significant to investors.

The highlighted portions of paragraph 72 of Exhibit 1 concern background/context facts that are undisputed and, in any event, do not purport to opine from the perspective of a CMBS investor. The highlighted sections of paragraphs 91 and 98 are amply supported by Dr. Rubinstein's experience in the CMBS industry. Moreover, any challenges to Dr. Rubinstein's qualifications should go to the weight accorded his opinions as opposed to their admissibility. *See e.g., McCulloch*, 61 F.3d at 1042-43.

Respondent's citations to other SEC cases are of no avail because, as discussed above, Dr. Rubinstein's background "does [] encompass the proposed subject matter of [his] testimony." (*See* Motion to Strike at 5, *quoting* Plaintiff Securities and Exchange Commission's Memorandum of Points and Authorities in Support of its Motion to Exclude or Limit Expert Testimony of Lisa L. Troe Under Rules 403 and 702 of the Federal Rules of Evidence). Moreover, the two district court cases Respondent cites are inapplicable in this administrative proceeding, and in the one administrative proceeding cited, Judge Patil allowed the testimony over the undersigned's objection. *See In the Matter of Dennis J. Malouf*, Initial Decision Release No. 766, dated April 7, 2015, at 21-22 (referring to testimony of Alan Wolper).

III. Respondent's Motion to Strike Mischaracterizes Dr. Rubinstein's Opinions and Report

A. Applicable Law

The Division does not dispute that the Scheduling and General Prehearing Order in this matter provides that "expert reports should be as specific and detailed as those presented in

federal district court pursuant to Federal Rule of Civil Procedure 26.” (See Motion to Strike at 8). Nor does it dispute that Dr. Rubinstein’s report, as well as Mr. Richard’s, must provide the basis and reasons for their opinions, and, where applicable, must be the product of reliable principles or methods. (See Motion to Strike at 8-9).⁴

B. Respondent’s Claim that Dr. Rubinstein Fails to Explain Why S&P’s CMBS Ratings were “Materially Inflated” and Does Not Identify his Applied Methodology is Baseless.

Respondent claims, without any valid support, that “Dr. Rubinstein does not offer any analysis in support of his opinions.” (Motion to Strike at 9). But Appendix 1 to Dr. Rubinstein’s Report is a detailed description of the analysis Dr. Rubinstein performed on the applicable ratings models used by Duka’s CMBS group. While Respondent has highlighted portions of Appendix 1 in an effort to exclude them – on a basis that the Division was unable to discern – the various screenshots of the models Dr. Rubinstein evaluated using the higher of the criteria constant and the actual loan constant as well as the 50/50 blend of the higher of and the actual loan constant Duka switched to are unchallenged. This analysis forms the basis for the table at page 10 of Appendix 1, as well as Table 4 of Dr. Rubinstein’s Report (p. 50), both of which are also unchallenged. Thus it is unclear why Respondent contends that Dr. Rubinstein “does not offer any analysis.”

To the extent Respondent is taking issue with the term “materially inflated” she ignores Table 4, which shows inflation in credit enhancement as a result of the switch to blended constants ranging between 437 and 750 basis points. Duka herself has testified that a 25-50 basis point change could be material, providing a more than ample basis for Dr. Rubinstein’s opinion.

⁴ Mr. Richard’s report does not specify any reliable principles or methods that form the basis for his opinions, and the Division will address that at the hearing.

(Ex. A, Duka Transcript at 292:7-24 (noting that to Deutsche Bank a 25-50 basis point change “would be a material number”).

Respondent’s complaint that “Dr. Rubinstein does not support his opinion that the ratings were ‘inflated’ by pointing to downgrades of the securities or losses experienced by the holders of the securities” is a red herring. (See Motion to Strike at 9). First, the issue is not whether or not the credit enhancement levels resulting from S&P’s model were correct – the Division takes no position in that regard and is in fact prohibited by statute from doing so.⁵ The issue is publishing credit enhancement levels based on a 50/50 blend of loan constants that were inflated over the credit enhancement levels S&P’s models produced by using the criteria constants and resulting debt service coverage ratios featured prominently and repeatedly in S&P’s Presale reports. Second, S&P’s criteria were designed to stress various factors – including net income and debt service – to levels commensurate with the Great Depression. In the absence of Great Depression like conditions in the past five years, the lack of downgrades is meaningless.

Similarly, the CMBS team’s self-serving conclusion that they did nothing wrong does not undermine Dr. Rubinstein’s analysis of the impact of switching the loan constants used in the models. (See Motion to Strike at 9-10).

Finally, the fact that Morningstar published the same preliminary ratings and credit enhancement levels as S&P also does not undermine Dr. Rubinstein’s opinion. Again, neither the Division nor Dr. Rubinstein is arguing that S&P’s (or Morningstar’s) ratings were right or wrong. The issue is Duka’s scheme to change her methodology and use less conservative loan

⁵ See 15 U.S.C. § 78o-7(c)(2) (prohibiting the Commission from regulating the substance of credit ratings).

constants than those disclosed to the public. The credit enhancement levels reached by Morningstar – using Morningstar’s own models and criteria – have no bearing on this.

C. Dr. Rubinstein’s Opinion that a 437 and 750 Basis Point Change in Credit Enhancement Levels Would Matter is Neither Conclusory Nor Baseless.

As noted above, Dr. Rubinstein analyzed the models used by Duka’s CMBS group to determine the change in credit enhancement levels that resulted from the switch to using a 50/50 blend of criteria and actual loan constants. As a result of this analysis, Dr. Rubinstein determined that the change in credit enhancement levels ranged from 437 to 750 basis points on six CMBS deals S&P rated in 2011, *i.e.* 4.37% to 7.50%. (Rubinstein Report at p. 50, Table 4). This massive change in credit enhancement levels is far from “irrelevant.” (*Cf.* Motion to Strike at 11). Duka’s own expert, Mr. Richard, acknowledges repeatedly in his report that CMBS investors consider credit enhancement levels and ratings in their investment analysis. (*See* Richards Report at ¶¶ 17a, 35, 41, 42, 45, 56, 65, 66).

Dr. Rubinstein’s analysis is also not the result of hindsight. Respondent’s switch in the loan constants used to rate CMBS deals took place in real time, and so did the change in credit enhancement levels that resulted from that switch. CMBS investors made real time decisions to purchase CMBS while considering the inflated ratings resulting from the switch in loan constants published by S&P.

Respondent contends that:

Dr. Rubinstein does not explain any reason(s) investors ‘would have been skeptical of the reason for the change,’ and does not explain any reason(s) ‘many investors would have concerns that the transactions rated with the blended constants, had they known about the blend, might have insufficient credit enhancement’ or the methodology he purportedly applied to reach that conclusion.

(Motion to Strike at 12). But Respondent's own expert acknowledges that CMBS investors exercised diligence in their CMBS investment decisions and considered, among other things, DSCRs that were directly dependent on loan constants (whether actual or stressed). (Richard Report at ¶ 42). Mr. Richard also admits that many CMBS investors were constrained in the bonds they could purchase, *e.g.*, only able to purchase AAA rated bonds. (*Id.* at ¶ 35). Such investors are necessarily concerned with credit ratings. And, again, Dr. Rubinstein's methodology is his analysis of the S&P models used by Duka's CMBS group and the credit enhancement levels output by those models using criteria loan constants and the 50/50 blend of criteria and actual loan constants Duka surreptitiously employed.

D. Dr. Rubinstein's Opinion Regarding the Adequacy of Disclosure in S&P's Presales is based on His Experience Working for Credit Rating Agencies and Does Not Seek to Usurp the Hearing Officer's Fact Finding Role.

Dr. Rubinstein has over 30 years' experience "working in the research groups at credit rating agencies and financial institutions." (Motion to Strike at 4). As such, he is very familiar with disclosures issued by credit ratings agencies, such as Presale reports. Here, outside of her strained immateriality argument, Duka's defense consists of her claim that her disclosure on page 18 of the Presale reports that "Standard and Poor's will consider both the loan's actual debt constant and a stressed constant based on property type as further detailed in our conduit/fusion criteria" was full disclosure of her switch to using blended loan constants, despite the dozens of references to criteria constants that remained in the Presale reports. Based on his expertise and experience with CMBS transactions, Dr. Rubinstein opines "the switch to blended constants was not adequately disclosed." (Rubinstein Report at 52). The two district court cases Respondent cites are inapplicable in this administrative proceeding and readily distinguishable. In *SEC v.*

Das, the expert's testimony was found not to be an aid to the jury because the expert "does not claim to have any expertise or training in determining what factors are significant to investors." 10 Civ. 102 (LSC), 2011 WL 4375787, at *10, n.7 (D. Neb. Sept. 20, 2011). In *SEC v. Leslie*, the proffered expert cited judicial opinions and referenced "'fraudulent' conduct and the intentions of the parties." 07 Civ. 3444, 2010 WL 291038, (N.D. Cal. July 29, 2010).

E. Respondent's Attacks on Dr. Rubinstein's Market Share Analysis Are Misguided and, at Most, Should Go to the Weight Accorded His Opinions, Not their Admissibility.

Respondent attacks Dr. Rubinstein's "simplistic narrative" regarding S&P's loss of market share after implementing its more conservative criteria in 2009. (Motion to Strike at 13).⁶ All Dr. Rubinstein does in the objected to paragraphs of his report (¶¶ 82-84, 92), however, is note the Division's allegations and Duka's own e-mails, along with actual conduit/fusion market share data from Commercial Mortgage Alert, a resource used extensively in the CMBS market. (Rubinstein Report at ¶¶ 82-84, 92).

Respondent's complaint that Dr. Rubinstein focused on conduit-fusion CMBS deals, as opposed to 'single-borrower' transactions, ignores the fact that Duka's scheme to inflate ratings by switching loan constants related to conduit-fusion deals, as well as the fact that conduit-fusion deals comprised the lion's share of the CMBS market in 2011.⁷ Respondent should feel free to cross-examine Dr. Rubinstein about why he focused on conduit-fusion CMBS deals, but his focus on the type of CMBS deals at issue is no basis for excluding his opinions.

⁶ Respondent is apparently unfamiliar with Occam's razor.

⁷ The fact that S&P held a leading market share in the single-borrower CMBS space obviated any need to change the model to attract business.

IV. Dr. Rubinstein's Opinions Regarding S&P's Criteria Process Guidelines Address Technical Issues that Are Appropriate for Expert Testimony.

Dr. Rubinstein's experience working for CMBS rating agencies provides specialized knowledge that can assist the hearing officer in determining whether Duka's change in loan constants complied with S&P's Criteria Process Guidelines. As noted in Dr. Rubinstein's report, those Guidelines provide a five step process for making changes to existing criteria. (Rubinstein Report at 56, ¶ 101). The Guidelines also specify five conditions under which a prospective criteria change or analytical issue must be "escalated, evaluated, and (if adopted) published as set forth in the Guidelines." (Rubinstein Report at 57-59, ¶¶ 104-106). Dr. Rubinstein does not seek to usurp the hearing officer's role in making factual findings, he merely offers an insider's perspective on a credit rating agency's criteria and appropriate ways to make changes thereto.

Great N. Ins. Co. v. John Watson Landscape Illumination, Inc., 12 Civ. 25 (JED), 2015 WL 1222161 (N.D. Okla. Mar. 17, 2015), cited by Respondent, is readily distinguishable. There, "the opinion was not admissible because it is not dependent upon any scientific, technical, or specialized knowledge, but only upon the testimony of other witnesses." *Great N. Ins. Co.*, 2015 WL 1222161, at *5. Similarly, in *Jimenez v. Sambrano*, 04 Civ. 1833 (PCL), 2009 WL 2382622, at *2 (S.D. Cal. July 31, 2009), the defendant could not show that the proffered expert "testimony is needed to assist the jury's understanding of the policies and procedures" at issue. Here, Dr. Rubinstein has specialized knowledge that he applies to the issue of Duka's undocumented and undisclosed change to S&P's criteria.

Respondent's objection to Dr. Rubinstein's reference to Mark Adelson's testimony is baseless. It is black letter law that experts may base their opinions on facts or data that need not necessarily be admissible. *See Fed. R. Evid. 703.*

V. Dr. Rubinstein's Recitation of the Factual Bases Supporting His Opinions Is Appropriate.

Respondent seeks to strike all Dr. Rubinstein's citations to the investigative record and investigative testimony in this matter. (Motion to Strike at 16-20). Dr. Rubinstein reviewed the investigative record to familiarize himself with the facts on which he based his opinions, and recited certain largely undisputed facts in his report as background and to provide context for his opinions. To the extent Respondent believes those facts are in error, she is free to bring that out in her examination of Dr. Rubinstein – or, alternatively, in cross-examining the witnesses who testified during the investigation, since virtually all witnesses whose testimony is quoted by Dr. Rubinstein will testify live at the hearing. But there is no basis to strike those facts from Dr. Rubinstein's report.

Moreover, Respondent's claim that "Dr. Rubinstein offers a highly filtered, tendentious version of the chronology, in which he summarizes and improperly vouches for selective portions of the investigative record," is ill-founded. (Motion to Strike at 18). For example, there is no dispute that S&P revised its CMBS Criteria in 2009 to be more conservative (*id.*) and no basis to strike Dr. Rubinstein's recitation of that fact. And, while Respondent objects to Dr. Rubinstein's description of a "'controversy' that arose within S&P that led to a meeting on July 31, 2009, at which it was decided to use the Table 1 Constants to compute debt service," she admitted in her answer that there was a controversy and a decision to use criteria constants. (Duka's Answer at ¶ 19). To the extent she believes the investigative testimony is "untested" or Dr. Rubinstein's review was "one-sided," (Motion to Strike at 18) she is free to raise the issue at the hearing, through cross-examination of the witnesses themselves or of Dr. Rubinstein.

Respondent's belabored contention that Dr. Rubinstein "misleadingly tries to link the DSCR calculation using the Table 1 Constants to the actual annual payment required under the terms of the mortgage" (*id.* at 19) is mere obfuscation. There is no dispute that the Table 1 or criteria constants were stressed beyond the actual loan payments required under the terms of the loans. Whether or not that was an "analytical flaw" is not a basis for any opinion offered by Dr. Rubinstein or any claim being pursued by the Division. It is certainly not a basis to exclude any of Dr. Rubinstein's opinions.

As for the practice of rating agencies using stressed loan constants for the denominator of DSCRs (Motion to Strike at 20), that practice is amply evidenced by S&P's own, undisputed, decision to do so.

CONCLUSION

For the reasons stated, Respondent's Motion to Strike should be denied.

Dated this 31st day of October, 2016.



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CERTIFICATE OF SERVICE

On October 31, 2016, the foregoing Notice 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, D.C. 20549
(Original and three copies by UPS)

Honorable James E. Grimes
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S&P CMBS Ratings

Duka, Barbara - 10-23-13

10/23/2013

Condensed Transcript

Prepared by:

SEC

Thursday, November 21, 2013

1 UNITED STATES SECURITIES AND EXCHANGE COMMISSION
 2
 3 In the Matter of:)
 4)
 5 STANDARD & POOR'S CMBS) File No. D-03302-A
 6 RATINGS)
 7
 8 WITNESS: Barbara Duka
 9 PAGES: 265 through 502
 10 PLACE: Securities and Exchange Commission
 11 100 F Street, NE
 12 Testimony Room 1
 13 Washington, D.C. 20549-7553
 14 DATE: Wednesday, October 23, 2013
 15
 16 The above-entitled matter came on for hearing,
 17 pursuant to notice, at 9:08 a.m.
 18
 19
 20
 21
 22
 23
 24 Diversified Reporting Services, Inc.
 25 (202) 467-9200

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11 81	Summary Record	469
12 82	E-mail	473
13 83	E-mail	473
14 84	E-mail	483
15 85	E-mail	491
16 86	Presale K701	493
17 87	RAMP K701	493
18		
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1 see that?

2 A I do.

3 Q Okay. And then Ms. Osborne forwards that
4 to you Monday morning asking if you can help respond,
5 and then you provide an answer at 9:14 a.m. on
6 October 11th. Do you see that?

7 A I do.

8 Q Your response starts out, sure, I just
9 caught up with Scott on a few things and we went
10 through these deals. Do you see that?

11 A I do.

12 Q Who is the Scott there?

13 A He -- he was the CBM potentially at the
14 time. So Scott, Scott is a CBM. I just had several
15 during a period of time, and I just don't remember
16 who it was at this particular point in time, but it
17 was likely Scott.

18 Q The way I read this, it looks like you got
19 together with Scott who had relevant information
20 about these deals. Is that what you're conveying
21 here?

22 A That -- that would be how I would read it.
23 Yes.

24 Q Do you recall your conversation with Scott?

25 A I don't.

1 narrow range, Deutsche Bank just considered us to be
2 so far out of the range. That was the communication
3 that they were giving us. You're not even, you know,
4 anywhere with -- you know, within close distance to
5 the range, and that -- that was probably the most
6 information I had.

7 Q Okay. So sitting here today, what would
8 you consider to be much more conservative levels?

9 A I would consider something much more
10 conservative being just something that you were
11 looking at so differently than everyone else that --
12 I don't know that I can necessarily put it into a
13 number.

14 Q Again, I understand that you made clear
15 that you can't give me a precise number. I'm just
16 looking for a ballpark, an approximation, a range?

17 A Well, to Deutsche Bank it would be small.
18 It could be 25 or 50 basis points. To them would be
19 a material number. So it would be a fairly small
20 number, particularly if three or four other people
21 were somewhere in that range, so it just -- I think
22 it's difficult to give you an answer because it could
23 change from deal to deal, so to them, it's probably a
24 pretty small number.

25 Q How could it change from deal to deal?

1 Q You then report back to Grace on some deals
2 and the Deutsche deal, you say in part, the Deutsche
3 deal we looked at and lost because our feedback was
4 much more conservative than the other rating
5 agencies. Do you see that?

6 A Uh-huh.

7 Q Is that a yes?

8 A Yes. Sorry.

9 Q Thank you. What does much more
10 conservative mean in terms of percentage points or
11 basis points?

12 A Just -- I don't know if I can tangibly give
13 you a number. It was just -- I just looked at
14 whatever the -- whatever I knew and considered it
15 much more conservative. I don't know if I can give
16 you a tangible 1 percent, 2 -- I don't know the
17 answer to that.

18 Q Just do the best you can. Just give me a
19 range. Give me your best approximation. You made
20 clear you can't be precise.

21 A I would probably say so far different from
22 everyone else that it was just informational to find
23 out why, why we were different.

24 Q That doesn't really respond to my request.

25 A If everyone else would have been in a very

1 A Because depending on different deals and
2 how people viewed deals, some deals could have a much
3 closer distribution between feedback than other
4 deals.

5 Q So again, and I want to get off this topic.
6 Sitting here today, could you give me a range of what
7 difference in basis points you would consider to be
8 much more conservative?

9 A I can't. I would probably just take what I
10 was hearing from the -- from whatever feedback I was
11 hearing and say it was much more conservative.

12 Q Okay, I'm not asking you -- I think this is
13 where our disconnect is. I'm no longer asking you to
14 put yourself back in 2010?

15 A Right. Okay.

16 Q I'm asking you, as you sit at the table
17 now, with all of your CRE and CMBS experience, what
18 would you consider to be feedback that's much more
19 conservative? Something that's 25 basis points? 50
20 basis points higher? 75 basis points higher?

21 A I'm not sure. I'm not sure I can answer
22 that question. I don't know. I don't know what I
23 would consider if I was -- I've never thought it --
24 of it in terms of that much precision. So I'm not
25 sure I feel comfortable throwing -- you know, putting

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1 the data that you were actually using to Morgan
 2 Stanley even though you were disclosing the data that
 3 you were not actually using to the public?
 4 A I wasn't disclosing data, but I was
 5 disclosing what I was doing. So it was important for
 6 me to disclose what I was doing. I don't remember --
 7 I don't remember considering anything other than what
 8 I did was the appropriate thing to do until sometime
 9 later.
 10 Q Okay. But why would you want to disclose
 11 data from the blended constant that you were actually
 12 using to Morgan Stanley, the issuer or in this case
 13 the issuer's representative who was hiring you when
 14 you were disclosing data using the criteria constant
 15 that you were not actually using to disclose that to
 16 the public?
 17 A I'm not sure I realized that those two
 18 things until today, so I don't really have an answer.
 19 I -- it was the disclosure. I didn't give it that
 20 much thought to Morgan Stanley and I didn't -- and I
 21 didn't consider anything more than that.
 22 Q Mr. Pollem in Exhibit 85 was under your
 23 direct supervision. Is that the case?
 24 A He was.
 25 Q And did you do anything to make sure that

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1 the data that he was disclosing to Morgan Stanley in
 2 the preliminary or indicative feedback was the
 3 appropriate data?
 4 A I mean, I don't remember specifically
 5 overseeing him, but Kurt's been doing this for a long
 6 time so he, you know, he understands what needs to be
 7 put together, and I would have felt confident if he
 8 put it together without my seeing it.
 9 Q Okay. Again, this K701 feedback was
 10 probably one of the first feedbacks that would have
 11 been given after you started using the blended
 12 constant, so was there a discussion? Did you have a
 13 discussion with Mr. Pollem about okay what -- what
 14 kind of data are we going to disclose to the
 15 underwriters and the issuer's representatives?
 16 A It's possible. I don't remember. I don't
 17 remember having a discussion. But it's possible.
 18 Q Okay. And as you did with the other
 19 presale and RAMP with the C1 deal that we looked at a
 20 few minutes ago, did you go through the K701 presale
 21 and the K701 RAMP that's Exhibits 86 and 87 and let
 22 me know if there is anything other than the sentence
 23 on page 20 of Exhibit 86 that we've talked about
 24 previously that complies with the representation that
 25 you made to Dr. Parisi?

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1 A I don't see anything different in the RAMP.
 2 I don't, other than page 20.
 3 Q Okay. I think we are going to adjourn for
 4 today, so thank you again for your testimony today
 5 and we will start up again at 9 o'clock tomorrow
 6 morning and we'll go off the record.
 7 THE VIDEOGRAPHER: This is the end of tape
 8 number 4 in the investigative testimony of Barbara
 9 Duka. The time is 5:13 p.m. We are going off the
 10 record.
 11 MR. SMITH: Off the record at 5:13.
 12 (Whereupon, at 5:13 p.m., the examination
 13 was concluded.)
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1 PROOFREADER'S CERTIFICATE
 2
 3 In The Matter of: STANDARD & POOR'S
 4 CMBS RATINGS
 5 Witness: Barbara Duka
 6 File Number: D-03302-A
 7 Date: October 23, 2013
 8 Location: Washington, D.C.
 9
 10 This is to certify that I, Nicholas J.
 11 Wagner, (the undersigned), do hereby swear and affirm
 12 that the attached proceedings before the U.S.
 13 Securities and Exchange Commission were held
 14 according to the record and that this is the
 15 original, complete, true and accurate transcript that
 16 has been compared to the reporting or recording
 17 accomplished at the hearing.
 18
 19 _____
 20 (Proofreader's Name) (Date)
 21
 22
 23
 24
 25