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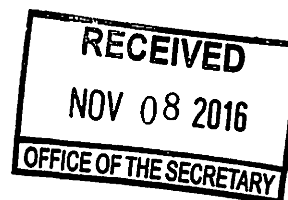

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16349

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In the Matter of

BARBARA DUKA

Respondent.

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PRE-HEARING BRIEF OF RESPONDENT BARBARA DUKA

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Respondent Barbara Duka hereby respectfully submits her prehearing brief.[1]

INTRODUCTION

The evidence at the hearing will demonstrate that Barbara Duka, a long-respected commercial loan and ratings credit analyst, is not liable in respect of any of the charges leveled in the OIP.

This case – premised on flawed factual allegations and application of the law – rests fundamentally on a claim that Duka and the CMBS Group plotted to relax Criteria for the purpose of generating new issuance conduit fusion ("CF") engagements. After years of investigation, in which witnesses were pressed hard to speculate to assist the SEC, the Division has no credible evidence to support this claim. To the contrary, the credible testimony will confirm that Duka, supported by the CMBS analytical team, sought approval from the then CMBS Criteria Officer before it incorporated the use of analytically more appropriate constants in the S&P conduit fusion CMBS model, and that this improved application of methodology was both approved by the Criteria Officer at the time as a permissible interpretation of Criteria and reviewed by a compliance officer (termed a "Quality Officer" at S&P) several weeks later. Meanwhile, the documents the Division would use to show commercial motive – monthly reports of neutral facts required by CMBS supervisors more senior than Duka – are not probative and indeed, with other public information, reflect the opposite inference to that suggested by the Division. Nor was there any pressure by S&P on CMBS New Issuance to generate more CF new issuance business, yet another Division assertion for which there is no evidentiary support.

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[1] We describe in this memorandum certain expected evidence, expressly preserving all legal arguments in favor of dismissal of the charges alleged in the OIP. Such reservation includes but is not limited to that a proceeding in which the OIP is litigated must be in accordance with the Appointments Clause of Article II of the United States Constitution.

Stripped of the unsupported commercial motive claim, the Division's fraud case, specifically its scienter allegation, otherwise reduces to an implausible and speculative averment that Duka allegedly intended to mislead when she in good faith approved disclosure of a change in application of ratings methodology in the eight presales. The disclosure called out a change in S&P's application of its ratings methodology, and none of the highly sophisticated investors in CMBS – a market community that no one would call shy – raised any question or request for clarification concerning this disclosure. Further, as the CMBS Group and Duka considered the matter further, they augmented this disclosure twice to add useful information to the reports, evidence that reinforces Duka's good faith. The Division questions why Duka did not cause the reports to include specific data that resulted from the CMBS model's debt service coverage ratio based on the alternative constants. Such different and perhaps more lawyer-like, hypothetical disclosure, however, cannot prove that the disclosure Duka approved arose from scienter, especially when compared to the disclosure-related practices at S&P throughout the relevant period. She directly interacted with Quality before S&P published any of the Presale Reports, and there is no evidence that she would have done anything but welcome constructive disclosure advice from that source or any other. Likewise, the post-event statements of Summer 2011 that are attributed to Duka are consistent with her good faith thinking at the time concerning the questioned disclosure. Notably, meanwhile, the Division's theory of scienter runs counter to common sense. Duka, under the Division's theory of commercial motive, had every reason to disclose the approved change in methodology; and the Division's contrary position is creative and guilt-assuming but bereft of evidentiary support.

Equally important, the Division cannot establish materiality in connection with the disclosures in this case. Given, among other things, (a) the manner in which the reasonable

investor makes a determination whether to invest, (b) the multiple aspects of the Criteria that fail to particularize the credit enhancement analysis, and (c) the specific transactional features in the eight relevant transactions, the evidence will show that disclosure of the data that the Division asserts was missing from the Presale Reports would not have significantly altered the mix of information considered by the reasonable investor in making a decision to invest in the specific CMBS securities here. Under the standard materiality test, this is the question presented, not, as the Division would have it, whether use of a different constant in the CMBS model would or might have resulted in different credit enhancements.

The evidence concerning the non-fraud charges will also fall far short of establishing any violation of rule or regulation. Duka did not violate the SEC Rule prohibiting a modification of established ratings agency procedures and practices for the purpose of gaining ratings assignments, both for the above reasons and because (a) Criteria did not require use of the Table 1 constants and (b) the application of Criteria by CMBS in late 2010 and 2011, and the internal process it followed, were consistent with S&P's application of Criteria and S&P's internal process since at least July 2009. Next, Duka did not prepare or approve the RAMPS, so is not liable for their preparation or approval. Additionally, Duka provided the Model Quality Group with the information it acknowledges it needed to perform its assigned task and thus did not do anything to frustrate the internal MQR process.

Based on the evidence to be adduced at the hearing, no merit will be shown to the charges, and each should be dismissed.

* * *

As a general matter, we note that although the term "Blended Constants" is used by the Division and below, when we use the term, we mean: the higher of the Actual Constant or a

50/50 average of the Actual Constant and the Table 1 Constants (see below), with the principal exceptions that (1) partial interest only loans in the pools of the relevant CMBS were generally evaluated under assumed constants for non-amortization periods, and (2) constants for property types not included in Table 1 were employed as determined in the judgment of the CMBS Group with consultation with the Criteria Group.

FACTUAL BACKGROUND

The summary below focuses first on the nature of credit ratings, the organization of S&P as it relates to the CMBS analytic group, and facts concerning both the content and background to the 2009 Criteria.[2] We then provide an overview of the principal events as to which evidence will be offered, as well as some context for this evidence.

I. Credit Ratings are Opinions Regarding Creditworthiness

From May 2009 through September 2011 (the "Relevant Period"), S&P was a Nationally Recognized Statistical Rating Organization ("NRSRO") that provided rating opinions concerning CMBS.

On June 3, 2009, S&P published "Understanding Standard & Poor's Rating Definitions" ("Ratings Definition Article"), an article "designed to help market participants better understand the nature of Standard & Poor's credit ratings."[3] Credit ratings express "forward-looking opinions about the creditworthiness of issuers and obligations, with the "likelihood of default [serving as] the single most important dimension of creditworthiness."[4] For each rating category – AAA, AA, A, BBB, *etc.* – the Rating Definitions Article provided a qualitative definition and a

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2 The term 2009 Criteria refers to the "Criteria" publication titled "U.S. CMBS Rating Methodology And Assumptions For Conduit/Fusion Pools" that was published by S&P on June 26, 2009.

3 Respondent's Exhibit 91.

4 *Id.*

corresponding "stress scenario," *e.g.*, the AAA rating means that "[t]he obligor's capacity to meet its financial commitment on the obligation is extremely strong" and thus "should be able to withstand an extreme level of stress[, akin to the Great Depression] and still meet its financial obligations."

In CMBS transactions, as in other structured finance transactions, NRSROs assign credit ratings and a credit enhancement level to each tranche of a transaction.[5]

II. **S&P's Organizational Structure And Control Functions During the Relevant Period**

A. **CMBS Group**

S&P's CMBS analytical ratings function consisted of (1) a group of analysts who formulated ratings as to new CMBS issuances ("New Issuance" or "NI"), and (2) a group of analysts who formulated ratings relating to issued securities ("Surveillance"; together with New Issuance, the "CMBS Group"). The CMBS Group was part of S&P's Structured Finance division, led by David Jacob during the Relevant Period. From in or around August 2010 to the end of the Relevant Period, Grace Osborne, who reported to Jacob, was responsible for overseeing CMBS and Residential Mortgage Backed Securities ("RMBS").

Duka, after working at United Jersey Bank and PNC Bank on, among other things, commercial loan origination and underwriting, joined the CMBS Group at S&P in 1998. As a result of her conscientiousness and analytical skills, Duka was progressively elevated through the ranks and eventually was appointed Analytical Manager ("AM") assigned to oversee New Issuance. Eric Thompson was Duka's counterpart in Surveillance until he left S&P in January 2011 to join Kroll Bond Rating Agency, Inc., a competitor of S&P; and, in March 2011, Duka was assigned to oversee Surveillance as well as New Issuance.

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[5] Credit enhancement levels may also be referred to as credit support levels or subordination levels.

In New Issuance, David Henschke and Kurt Pollem served as Duka's two lead senior analysts until Mr. Henschke left S&P in January 2011 to join in an investment firm that invests in and originates, *inter alia*, CMBS. In March 2011, James Digney, who, before joining New Issuance, had been assigned to Surveillance, replaced Mr. Henschke. A number of additional primary analysts were assigned to New Issuance during the Relevant Period, including among others Brian Snow, Lucienne Fisher, Natalka Chevance, Adria DeFalco, Michael Nelson, and Louis Ciccerchia.

B. S&P's Separation of Analytical and Commercial Functions

To maintain the integrity of its credit ratings, and to comply with applicable laws and regulations governing NRSROs, S&P implemented a formal separation between employees in the "analytical" function, who conducted analyses to formulate rating opinions, and employees in the "commercial" function, who, *inter alia*, managed revenue-generation and negotiating engagements with S&P's customers. In this structure, Duka, on the analytical side, reported to Osborne, on the commercial side, but Osborne did not supervise the CMBS Group's analytical work.

To assist Osborne, in executing her duties, including her efforts to keep Jacob timely informed of the activities of Structured Finance, she received regular informational updates from her direct reports, as had her predecessor Kim Diamond. Duka and Thompson (and later Duka, after Thompson left S&P) provided such information in monthly reports of activity and emails. The monthly "Activity Reports" noted observations concerning the CMBS market generally, work within S&P on policy and Criteria matters, CMBS transactions of all kinds that CMBS Group was currently rating or had rated, and ratings assignments received and not received with explanations. These reports provide, *inter alia*, contemporaneous evidence explaining briefly

reasons that various new issuance assignments were not finalized, including that some issuers would not accept S&P's terms and conditions letter (a business matter), some did not agree with S&P's approach to informational access under Regulation 17g-5 (a business/legal matter) and/or some reportedly were not satisfied with the results from application of S&P's criteria.

C. S&P's Criteria Group

S&P explained that "[r]atings criteria are published principles, methodologies, and assumptions that our analysts use to assign ratings; they provide the framework by which our analysts assess creditworthiness."[6] The Criteria Group was structured to be independent from the groups within S&P that issued rating opinions, such as the CMBS Group. It was led by a Chief Credit Officer. 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." Within Global Structured Finance, Criteria Officers ("COs") for CMBS, CDO, ABS, and RMBS reported to a CCO. "Criteria officers [were] primarily responsible for managing the development, approval and periodic review of criteria that are used by our analysts in the ratings process."[7]

Throughout the Relevant Period, Mark Adelson served as the Chief Credit Officer. Thomas Gillis was the CCO for Global Structured Finance until October 2009, when Frank Parisi assumed this role through March 2012. James Palmisano was the CMBS CO from the beginning of the Relevant Period until the fall of 2009. He was followed by James Manzi, who was CMBS CO until the summer of 2010. On Manzi's transfer to a different assignment, in

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6 Respondent's Exhibit 102.

7 *Id.*

about September 2010, Parisi was named Acting CMBS CO. In mid-December 2010, Majid Geramian became the CMBS CO, reporting to Parisi, CCO of Global Structured Finance.

D. S&P's Quality Group

The Quality Group served to monitor compliance by S&P's analysts with published Criteria and internal ratings processes. S&P described the function of the Quality Group as follows:

> The primary responsibility of our quality officers is to support the overall quality of our ratings and the proper application of criteria in the ratings process. Quality officers concentrate on specific analytical teams and/or regions and are responsible for the overall quality of the ratings and ratings surveillance. Among other things, quality officers help to assess the reasons behind unexpected ratings performance to determine if these occurrences are individual outliers or if they indicate a potential issue with the criteria or how the criteria were calibrated and applied. They are also responsible for ratings-related policy compliance.[8]

In performing its control function, the Quality Group conducted two types of reviews, Level 1 and Level 2. "A Level 1 review assesse[d] whether an electronic and/or a print file contain[ed] documents required to meet the minimum analytical documentation standards, and also assesse[d] adherence with other policies and guidelines."[9] 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."[10] In particular, a Level 2 review involved an assessment of "[t]he quality of the RAMP" and "[t]he proper application of criteria methodologies."[11] During the Relevant Period, the Quality Group

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8 *Id.*

9 Joint Exhibit 15.

10 *Id.*

11 *Id.*

was led by Chief Quality Officer Neri Bukspan. Susan Barnes was the Quality Officer for Structured Finance, and also the Quality Officer for CMBS.

E. S&P's Model Quality Review Group

Separate from the Quality function, a Model Quality Review ("MQR") group at S&P was in place "to independently assess and validate the quality of models used in Standard & Poor's Ratings Services analytical processes in order to determine whether a model is suitable for its intended use."[12] During the Relevant Period, the MQR Group was led by Martin Goldberg. Haixin Hu was a subordinate of Goldberg who reviewed the CMBS ratings model in late 2010 and early 2011.

III. S&P's Policies and Procedures

A. Criteria Process Guidelines

The Criteria Process Guidelines ("CP Guidelines") applied to the process for creating and amending criteria by providing "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."[13] Criteria, per the CP Guidelines, "encompasses all *published* guidance that governs the analytic basis for determining ratings," and "include all fundamental quantitative and qualitative elements, analytical principles, methodologies and assumptions that we use in the ratings process to produce our opinions."[14]

Introductory Section 2.1 provided that the CP Guidelines "**do not apply to interpretations of the application of our criteria to a particular circumstance which are**

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12 Joint Exhibit 13.

13 Joint Exhibit 10.

14 *Id.* (emphasis added).

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.[15]

Where a proposed methodology constituted not an interpretation but a change in criteria, rendering the CP Guidelines applicable, the CP Guidelines set forth a four-step process of Initiation, Research, Approval, Dissemination to implement a proposed criteria change, and also identified a fifth-step, Periodic Review, that occurred once new or amended criteria were initiated, researched, approved, finalized, and published. The Initiation phase included, *inter alia*, "identifying the criteria issue," appointing "a member of the practice criteria committee to serve as a Criteria Champion for the issue" and allocating resources for criteria projects.[16] The Research phase included, *inter alia*, "researching the issue," "formulating recommendations," "writing documentation for internal vetting and approval," with the "research sub-process end[ing] with bringing documentation to the relevant practice criteria committee for approval."[17] The Approval phase described how proposed criteria were to be formally approved, with "[p]ractice criteria committees [*e.g.*, the CMBS Criteria Committee] serving as the primary criteria decision makers," unless the proposed criteria changes required escalation.[18] The

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[15] *Id.* (emphasis added). The instruction to employees in Section 2.1 to seek guidance concerning criteria interpretations is supplemented by a general recommendation to seek guidance regarding the CP Guidelines in Section 2.3 of the Guidelines.. That Section directs employees with questions about the CP Guidelines **"to any Practice Criteria Officer or any departmental or regional senior credit officer (DRSCO)."** The term "Practice Criteria Officer" refers to, *e.g.*, the CO for CMBS, and the term "DRSCO" refers to, *e.g.*, the CCO for Global Structured Finance.

[16] *Id.*

[17] *Id.*

[18] Sections 3.13, Section 3.14, 3.15, and 3.26 detail matters that are required to be escalated.

Dissemination phase included, *inter alia*, "publication of approved criteria internally and externally," with external publications to appear on sandp.com and RatingsDirect.[19]

B. Ratings Analysis and Methodology Profile ("RAMP") Guidelines

According to S&P's RAMP Guidelines, a RAMP is 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."[20] The objective of the RAMP "is to explain the rating recommendation to voting committee members through the application of criteria," capturing "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."[21] The RAMP Guidelines directed the primary analyst for a transaction to complete the RAMP for that transaction, and mandated that the chairperson of the Rating Committee review and approve the RAMP upon its completion by the primary analyst.[22] After completion of the RAMP, the Quality Group, as part of its control function, was assigned to review certain of the RAMPs.

IV. CMBS Conduit-Fusion Transactions Generally

CMBS transactions are of several varieties and include conduit-fusion transactions ("CF Transactions"), large loan/single borrower transactions, and REREMIC transactions. S&P defined a CF transaction, the type of CMBS transaction relevant to the OIP, as one that included

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19 *Id.*

20 Joint Exhibit 16.

21 *Id.*

22 *Id.*

"a pool of at least 40 loans that is diversified by both property type and geography, which may or may not contain several relatively larger-sized loans."[23]

A. Loan Collateral

Loans included in conduit-fusion transactions ("CF Loans") have certain common features. They are governed by fixed (and not floating) interest rates, meaning that, with the exception of partial-interest only loans, the required payment amount under the mortgage does not change during the term. CF Loans generally carry terms of between 5 and 10 years, and are amortized over a thirty-year period if fully amortizing.[24] Because the loan term is shorter than the amortization period, the borrower, to repay the loan balances at maturity, is expected to refinance or sell the properties underlying the loan.[25]

B. Debt Service Coverage and Loan-to-Value Ratios

Debt Service Coverage ("DSC") or Debt Service Coverage Ratio ("DSCR") is a ratio that is designed to assess whether a property is generating annual cash flow sufficient to sustain its annual debt burden. Chapter 3 of "CRE Finance Council CMBS E-Primer," published by the Commercial Real Estate Finance Council, defines DSCR as follows:

> The DSCR is the ratio of the annual net cashflow generated by the collateral (more about this later) over the annual debt service (principal and interest) of the loan. Obviously, the DSCR must be greater than 1.0x or the property cashflow is not covering the debt service. For underwriting purposes, just covering debt service is not enough—there should be sufficient cushion to withstand changes in collateral performance during the

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23 Joint Exhibit 2.

24 CF Loans can be interest-only, where the borrower is only required to pay interest during the term, or partial interest-only, where the borrower's payments are amortized for a certain portion of the term and interest-only for the remainder of the term.

25 For example, IAC Portfolio, the fourth largest loan in the JPMCC 2011-C3 transaction, had a loan balance of $104,769,653 in December 2010 and annual required debt service of $7,481,181.12. The maturity date is in December 2020, at which time the entire balloon balance of $88,808,264 is due. To repay the debt at maturity, the borrower of IAC Portfolio will either need to sell the property or refinance the $88,808,264 debt.

> term of the loan. Since different property types have different patterns of cashflow volatility, the lender's required DSCR will typically differ based on the property type.[26]

The denominator of the DSCR, which is referred to as debt service, is the annual loan payment required by the terms of the mortgage, and can be calculated by multiplying the original loan balance by a figure called a loan constant. As Dr. Rubinstein, the Division's expert, explains:

> A loan constant is a number which, when multiplied by the original face amount of a loan, produces the periodic fixed payment required on the loan. The formula for a loan constant, assuming an amortizing loan with equal monthly payments, is:
>
> Loan Constant = (Annual Interest Rate/12) / (1 – ([1/ (]1 + Annual Interest Rate / 12)^n), where "n" is the term of the loan in months.[27]

Thus, a loan's "Loan Constant" bears a direct relationship to a loan's interest rate. For example, a loan with a 7% interest rate and a thirty-year amortization schedule has a loan constant of 7.9836%, which means that if the loan amount is $600,000, the annual debt service is $47,901.60 ($600,000 * .079836). Were the loan amount to increase to $800,000, then the loan's annual debt service would be $63,868.80 ($800,000 * .079836).

V. S&P's Post-Financial Crisis Methodology for Rating CF Transactions

A. 2009 RFC

By way of background, in or around April 2009, when S&P decided to revise its methodology for rating CF Transactions, members of the CMBS Group and the Criteria Group met in CMBS Criteria Committee meetings and discussed possible changes to CMBS rating methodology. This process culminated in the May 26, 2009 publication of a "Request for

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[26] Respondent's Exhibit 671.

[27] Expert Report of Peter D. Rubinstein, PH.D at ¶ 2 n. 5. We believe that Dr. Rubinstein made an error in omitting the bracketed portion of the formula. We will refer to constants that are computed by using this formula as Actual Constants.

Comment" publication titled "U.S. CMBS Rating Methodology And Assumptions For Conduit/Fusion Pools" ("2009 RFC"). Numerous comments from market participants, including investors and issuers, followed. After conducting meetings with investors and performing additional review and analysis, on June 26, 2009, S&P issued a "Criteria" publication titled "U.S. CMBS Rating Methodology And Assumptions For Conduit/Fusion Pools" ("2009 Criteria") -- S&P's post-financial crisis methodology for rating CF Transactions.

B. **2009 Criteria Overview**

The 2009 Criteria introduced the concept of an "Archetypical Pool," to be "used as a general benchmark against which other conduit/fusion deal pools can be compared," and showing a AAA credit enhancement level of 19%.[28] Table 1 of the 2009 Criteria listed the features of the Archetypical Pool, including an S&P LTV of 90%, an S&P DSC of 1.2X, property mix concentration, loan concentration by size, geographic distribution, and loan constants for Retail (8.25%), Office (8.25%), Multifamily (7.75%), Lodging (10%), and Industrial (8.5%) property types ("Table 1 Constants").[29]

The 2009 Criteria then described the methodology by which S&P would apply stress assumptions to the issuer's net cash flow figure ("Issuer's NCF") to calculate BBB and AAA credit enhancement levels. This methodology encompassed the following general steps:

- Applying stresses to the Issuer's NCF to arrive at S&P net cash flow for the BBB stress ("S&P NCF");

[28] Joint Exhibit 2 ("We would expect actual CMBS pools that closely resemble the archetypical CMBS pool to have credit support of approximately 19% at the 'AAA' rating level.").

[29] S&P, during the RFC period, received strong criticism for its use of the Archetypical Pool. *See* Joint Exhibit 2 ("Many respondents to the RFC stated that we appeared to be 'backing into' a 'AAA' credit enhancement level of 20% [for the Archetypical Pool] and commented that the selection of this figure seemed 'arbitrary.'").

- Capitalizing S&P NCF to determine a value for each property based on a BBB stress ("S&P Value");[30]

- Determining BBB credit enhancement levels;[31]

- Applying rental declines to S&P NCF to arrive at AAA NCF;[32]

- Capitalizing AAA NCF to determine a value for each property based on a AAA stress; and

- Calculating AAA Alternate NCF for Office, Retail, and Industrial Properties.

The detailed description of these steps was followed by Table 6, which illustrated how S&P would calculate these metrics in connection with a hypothetical $600,000 loan on a suburban office building with a 7% fixed rate and 30-year amortization schedule:

Table 6

Suburban Office Building Analysis

($600,000 balance, 7% rate, with 30-year amortization)

	S&P NCF for DSC and Value ('BBB')	'AAA' NCF	'AAA' Alternate NCF
Effective gross income ($)	100,000	80,000	88,000
Fixed expenses ($)	31,000	31,000	31,000
Variable expenses ($)	11,500	9,200	10,120
NCF ($)	57,500	39,800	46,880
Value ($)	621,622	430,270	not applicable
LTV (%)	97	139	not applicable
DSC (x)	1.20	not applicable	0.98

NCF--Net cash flow. LTV--Loan-to-value.

To further explain the adjustments in table 6, the S&P NCF derived in the second column represents our basic analytic approach to commercial real estate. NCF is determined by subtracting fixed and variable expenses from effective gross income (EGI). The S&P Value is derived by dividing S&P NCF by a cap rate (9.25% in the example). The LTV is determined by dividing the loan balance by the S&P Value. The DSC is determined by dividing the NCF by the annual debt service ($47,902 in the example).

After AAA NCF, AAA Alternate NCF, and AAA Value were calculated, the 2009 Criteria provided that S&P would conduct two "default tests," a term default test and a maturity default

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30 A capitalization rate is the rate of return on a property based on the income that the property generates.

31 The manner in which BBB credit enhancement levels were calculated will be explained in detail during the hearing.

32 The 2009 Criteria listed rental declines for Office, Retail, Industrial, Multifamily, and Lodging that ranged from 10% to 30%.

test. The term default test would assess the ability of the borrower using the described S&P's metrics, to meet its debt service obligation during the term of the loan; and the maturity default or balloon default test would assess whether the loan would default at maturity.

The 2009 Criteria provided that a loan would default during its term if it satisfied either of the following two conditions:

> **1. If LTV > 100% and DSC < 1.0; or**
>
> **2. If 90% ≤ LTV ≤ 100% and DSC ≤ LTV.**

If a loan passed the term default test, it would be tested for default at maturity. Here, a loan would be deemed to have defaulted at maturity where the loan's LTV at maturity, again under the S&P metrics previously described, was greater than 100%.

The 2009 Criteria then provided formulas for calculating term and maturity losses:

1. 'AAA' term loss
The 'AAA' term loss = 'AAA' Value – (outstanding principal balance + two years of lost interest + foreclosure expenses)

2. 'AAA' balloon (maturity) loss
The 'AAA' balloon loss = 'AAA' Value – (outstanding principal balance + two years of lost interest + foreclos expenses)

Once these calculations were performed, the 2009 Criteria provided that S&P would compute so-called "raw" AAA credit enhancement levels using the following formula:

$$\frac{\text{Dollar Amount of Term Losses} + \text{Dollar Amount of Maturity Losses}}{\text{Total Pool Balance}}$$

And, the raw AAA credit enhancement levels that resulted would then be used to interpolate raw credit enhancement levels for the AA, A, BB, and B rating categories.[33]

[33] If the calculations set forth above yielded raw credit enhancement levels that were below certain thresholds, the 2009 Criteria provided minimum levels of raw credit enhancement necessary for each rating category.

The final step of the analysis was application of a "concentration adjustment" to the raw credit enhancement levels for each rating category – an adjustment intended to account for geographic concentration and loan concentration by size that generally had the effect of increasing credit enhancement levels.[34]

C. The 2009 Criteria Contemplated That Actual Constants Would be Used to Compute DSCs for the Term Default Test

Relevant to several of the charges, the Division contends that the 2009 Criteria mandated the use of Table 1 Constants to compute debt service, the denominator of the DSC in the term default test.[35] The hearing evidence, including testimony and documents, will show, however, that the Division's contention is unsupported. The text of the 2009 Criteria, as well as it structure, design, and drafting history, manifest that the 2009 Criteria all contemplated that Actual Constants would be used to determine debt service. This is an issue in this case because it is claimed that the determination in December 2010 to permit the CMBS Group, as a matter of Criteria interpretation, to use its analytical judgment to employ "Blended Constants" (see pages 9-10, supra) was not in keeping with the Criteria, because the CMBS Group was required by the Criteria to use the Table 1 Constants. This position rests on a misreading of the Criteria, and in all events a reading of the Criteria that was not publicly disclosed and thus could not be "Criteria" under the Criteria Process Guidelines.

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[34] Joint Exhibit 2 ("Standard & Poor's will measure the relative loan and geographic concentration of the CMBS pools it rates to the archetypical pool and make adjustments in credit support, either up or down, for pools that differ from the archetypical pool. Note that the archetypical pool is already well diversified by loan balance, and there will be little extra benefit for further diversification. However, a lack of diversification may result in significantly higher pool-level credit enhancement figures.").

[35] Division of Enforcement's Motion for Partial Summary Disposition, at 2 ("This change to the CMBS ratings model was inconsistent with S&P's publicly disclosed CMBS ratings criteria"); *id.* at 12 ("This new methodology was inconsistent with the CMBS Criteria").

D. Rating Actions Following the Issuance of the 2009 Criteria

At the time the 2009 Criteria were published, the financial markets remained highly stressed, and CMBS new issuances were absent from the market; nor were CMBS new issuances foreseen for some time. Accordingly as a practical matter, for many months, adoption of the 2009 Criteria exclusively affected CMBS surveillance ratings.

Notwithstanding that the 2009 Criteria contemplated use of Actual Constants to calculate debt service, see above, Surveillance, headed by Thompson, immediately used the Table 1 Constants to calculate debt service and took numerous rating actions—primarily downgrades.[36] The market's reaction was quick, strong, and adverse.

VI. Undocumented July 2009 Meeting to Address Constants

When it came to light that Surveillance was using Table 1 Constants to calculate debt service, Gillis, the then-CCO for Global Structured Finance, and Manzi, who was then in S&P's Research Group, agreed Surveillance was acting in error. They believed that use of the "archetypical" Table 1 Constants to compute debt service was analytically unsound, and that Actual Constants should be used to compute debt service. As they reasoned in substance, if Table 1 Constants were used instead of Actual Constants, in circumstances in which the Actual Constant was significantly lower than the Table 1 Constant, the model might determine that a loan would default during its term, when, because debt service was fixed, such default was not realistic even under highly stressful economic circumstances.

Internal debate followed. Eventually – after Surveillance had issued downgrades of numerous CMBS securities – a meeting was convened on July 31, 2009 on the 47th Floor of S&P's offices in New York. The invitees to the meeting included Deven Sharma, President of

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[36] Respondent's Exhibit 93 ("we placed 1,584 ratings on Credit Watch negative today").

S&P, Jacob, Adelson, Gillis, Thompson, Manzi, Palmisano, and Diamond. Although Duka and Pollem were members of the CMBS Criteria Committee at the time, neither of them was invited, and their opinions were not solicited prior to the meeting.[37] There are no minutes of this meeting with the S&P President. Nor is there any documentation memorializing the debate or decisions made. The testimony will establish however that at the meeting, it was decided that the CMBS Group would use the Table 1 Constants to calculate DSCs ("July 2009 Decision").

As is undisputed, the July 2009 Decision was not documented, was not made by the CMBS Criteria Committee, and did not result from the five-step process outlined in the CP Guidelines. Lastly, there was no public disclosure of the decision.

On November 2, 2009, Thompson emailed Duka and others a "CMBS Framework Model" (the "CMBS Model"), that incorporated the Table 1 Constants in the debt service calculation.

VII. March 2010 Decision Concerning Constants

Throughout the remainder of 2009 and through mid-2010, CF new issuance continued to be moribund. From time to time, nonetheless, in 2010, NI was occasionally asked by third parties for NI's views of hypothetical pools of recent loans. In some of these instances, Actual Constants were higher than Table 1 Constants.

In March 2010, the CMBS Group made several enhancements to the CMBS Model including corrections of certain errors made by Surveillance when it first developed the Model. Additionally, given the observations referred to above, the CMBS Group, in consultation with Manzi, the CMBS CO, determined to change the formula for the Loan Constant in the CMBS

[37] Craig Brundage was also a member of the CMBS Criteria Committee, and was also not invited to the meeting.

Model such that the Model would use the higher of the Actual Constant or the Table 1 Constant ("March 2010 Decision").

As the evidence will show, the March 2010 decision did not result from the five-step process described in the CP Guidelines. No publication was made of the March 2010 decision,

VIII. By the Middle of 2010, S&P, Including Duka, Expected CF New Issuance to Increase

As noted, there were no CF Transactions issued in 2009, and, according to Commercial Mortgage Alert, "a resource used extensively in the CMBS market,"[38] there were but five CF Transactions issued in 2010, including JPMCC 2010-C2, which S&P rated.

It nonetheless became clear as the year progressed that (1) CF new issuance would increase markedly in the latter part of 2010 and into 2011, as market conditions improved, and (2) S&P would receive more CF rating engagements as a result. As activity grew, Duka (and others) documented observations of this market revival in emails and activity reports sent to her superiors, Osborne and Jacob.

IX. December 2010 Meeting With Parisi

In the fall of 2010, Henschke, as CMBS was reviewing certain transactions, expressed the view – the same view voiced by Gillis and Manzi in July 2009 – that there appeared to be no analytic warrant under the 2009 Criteria to use constants other than Actual Constants to calculate fixed rate debt service and to test term-default probabilities under the CMBS Model. Per that view, use of the Table 1 Constants, where they were higher than Actual Constants, would inappropriately overstate such defaults in the CMBS Model. As interest rates continued to decline in 2010, the Table 1 Constants diverged increasingly from Actual Constants –

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38 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, at 11.

exacerbating the effect of the analytical flaw. As reflected in a contemporaneous document dated in December, Duka came to agree with Henschke's view.

Duka, consistent with Section 2.1 of the CP Guidelines, raised the issue with Acting CMBS CO Parisi in mid-December. After Duka and Parisi discussed the analytic case for use of the "Blended Constant," the evidence will show that Parisi approved this approach as an interpretation of Criteria ("Parisi Decision").[39] Duka told Parisi that CMBS would document the use of the "Blended Constant" in applicable presale reports and RAMPs.

X. 2011 CF Transactions

Pursuant to the Parisi Decision, from February 2011 through July 2011, the CMBS Group used "Blended Constants" in its modeling and analysis of the 2011 CF Transactions. For each of the 2011 CF Transactions, the CMBS Group published a presale report (collectively, the "2011 Presale Reports") and members of the CMBS group prepared a RAMP ("2011 RAMPs").

A. 2011 Presale Reports

With respect to disclosure of use of the "Blended Constants," Duka focused on the Methodology section of the Presale Report. This section of the presale report was used to describe applications of methodologies used in S&P's analysis, and highlight analytical considerations that were not addressed in the 2009 Criteria.

The Methodology section generally and qualitatively described factors considered by the CMBS analytic team without translating the CMBS Model's mathematical components or inputs into words. S&P's practice (in presales published prior to the 2011 Presale Reports), thus

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[39] As explained in Respondent's Opposition to the Division's Motion *in Limine* to Exclude Testimony and Exhibits Referencing the Findings and Conclusions of Standard & Poor's Internal Investigations and in Response to the Division of Enforcement's Objections to Respondent's Exhibits, filed on October 31, 2016, the Parisi Decision is corroborated by discussions that Barnes had with Parisi in January 2011.

employed general descriptions of factors that S&P "considered" or "took into account" without precisely detailing the quantitative role such factors played in formulas within the CMBS model for the transaction.[40] As the evidence will also show, historically, this generic "factors considered" formulation was used even in instances where an alternative, more specific disclosure would not necessarily have been cumbersome verbally but would have provided the kind of precision concerning the workings of the CMBS Model that alternative language avoided.

In addition, Duka thought the disclosure should be broad enough to describe the DSC calculations for all loans in the pools that S&P was reviewing so the disclosure would be accurate and sufficiently encompassing to apply in future transactions. At the time, for example, NI was evaluating loans as to which it was not the case that the DSC calculation employed a 50/50 average of the Actual Constant and the Table 1 Constant, *e.g.*, where the Actual Constant was higher than the 50/50 average of the Actual Constant and the Table 1 Constant, the Actual Constant was used to compute debt service.

After consulting with Pollem and Chevance, Duka approved inclusion of the following sentence in the Methodology section of the 2011 Presale Reports:

> In determining a loan's DSCR, Standard & 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.

After publication of the first three of the 2011 Presales -- MSC 2011-C1 Presale (February 4, 2011), FREMF 2011-K701 (February 15, 2011) and JPMCC 2011-C3 (February 18,

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[40] Respondent's Exhibit 6, Credit Suisse Commercial Mortgage Trust Series 2008-C1, dated March 19, 2008 ("Standard & Poor's took the loan structure and all additional debt into consideration when sizing the loan's capital structure and the deal's subordination levels . . . Standard & Poor's took the IO structure into account when determining credit support levels for this transaction.").

2011) – each of which also included a table of DSC ranges calculated using the Table 1 Constants – Brian Snow, an analyst in the CMBS Group, wrote as follows to Duka and Pollem:

> Hey Guys,
>
> Just a thought... after seeing Freddie and JPM presales; we might want to reconsider how we present data tables on DSC< 1.00 and LTV> 100
>
> Would it be helpful if we showed 2 DSC tables: 1 with actual constants; and 1 with S&P constants?
>
> For DSC< 1.00, would it be helpful if we got more specific (e.g. - 0.95 to 0.99; 0.90 to 0.94; etc)?
>
> For LTV> 100, perhaps we can, similarly, provide more specific info.
>
> This data can then feed into strengths/weaknesses and mitigants.
> Your thoughts. . . please share.[41]

In keeping with Mr. Snow' suggestion, in the next three presales – FREMF 2011-K11 (March 15, 2011), FREMF 2011-K13 (May 9, 2011), and JPMCC 2011-C4 (May 17, 2011) – CMBS included the same Methodology section and also presented two tables of DSC ranges, one using Table 1 Constants and one using Actual Constants.

In addition, before the final two 2011 Presales were published, the CMBS NI team further revised the relevant disclosure to make the opening "Rationale" section parallel to the table data added to the previous three Presale Reports. Thus, in the final two presales -- GSMS 2011-GC4 (July 12, 2011) and FREMF 2011-K14 (July 18, 2011), in addition to the disclosure added in the previous three presales, the Rationale section also included a pool-level DSC figure based on a calculation that employed the Actual Constant.

At the time of the above-described disclosures, Duka believed in good faith that the disclosure in the Methodology section was properly focused on notifying the reader of the

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41 Respondent's Exhibit 419.

CMBS' group's approach to incorporation of both the Table 1 Constants and Actual Constants in its analytic framework (while not inaccurately describing a 50/50 blend as uniformly applicable), consistent with S&P disclosure standards concerning generalized descriptions of CMBS' methodology (without detailing specific elements of the model), and in line with her discussion with Parisi.[42]

B. <u>GSMS 2011-GC4</u>

The evidence will describe a senior management decision in late July 2011 to pull a preliminary rating of a Goldman Sachs CMBS new issue. Respondent had no part in making this decision, and the analytic team, including Duka, viewed the decision as wrongheaded. Subsequent events would establish that the same senior management became comfortable that the preliminary ratings of the GS deal, along with those in the other 2011 Presales, were appropriate, and S&P would re-affirm those ratings. We set forth more detail below because we anticipate that the Division will focus on this intervening senior management decision, an effort that we submit has no bearing on the legal issues at bar.

The GSMS 2011-GC4 Presale, published on July 12, 2011, assigned 14.5% in credit enhancement to the AAA tranche, 10.375% to the AA- tranche, 6.125% to the A- tranche, 3.75% to the BBB tranche, 2.125 to the BB tranche, and 1% to the B tranche. The same day, Morningstar, the other NRSRO selected to rate GSMS 2011-GC4 published a presale report that assigned identical credit enhancement levels to the tranches of GSMS 2011-GC4.

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[42] In an attempt to show that Duka acted with scienter, the Division will introduce a Summer 2011 statement that is attributed to Duka, in which Duka is alleged to have said that she did not want to disclose the use of "Blended Constants" because she did not want to explain the differences between the approaches of New Issuance and Surveillance. This alleged statement, which Duka did not recall in her investigative testimony, does not bear on the reasonableness of her belief that the method of disclosure in the 2011 Presale Reports was appropriate and in line with S&P's practice.

Based on a recent transaction that S&P had not rated, some market participants expressed the view that the 14.5% credit enhancement at the AAA level was low. Others did not draw a deal comparison but joined in the view that the credit enhancement for the AAA tranche was low. Others disagreed. For example, Darrell Wheeler, a well-respected analyst who was then employed by Amherst Securities Group LP, concluded that the 14.5% AAA credit enhancement level fairly reflected the risks posed by the collateral.[43]

This market debate caused discussion within S&P. In this discussion, Mark Adelson, Chief Credit Officer, expressed his view that the analysis of GSMS 2011-GC4 transaction was inconsistent with the 2009 Criteria because it did not use Table 1 Constants but rather "Blended Constants." On July 27, 2011, Adelson caused S&P to issue an Advanced Notice of Proposed Criteria Change ("ANPCC"), stating as follows:

> Standard & Poor's Ratings Services is reviewing the application of our conduit/fusion CMBS criteria in relation to the calculation of debt service coverage ratios (DSCRs). The review was prompted by the discovery of potentially conflicting methods of calculation in use. We intend the review to harmonize the potentially conflicting methods without changing the overall calibration of the conduit/fusion CMBS criteria.
>
> More specifically, Standard & Poor's started using two methods to calculate DSCRs in early 2011. Before that time, DSCRs used in the criteria were based on the worse of (i) actual debt service amounts and (ii) loan constants specified in the criteria article. Starting around January 2011, Standard & Poor's started using a simple average of the two methods in the analysis of new deals. Surveillance continued to use the earlier approach.
>
> The review may result in multiple technical changes to the conduit/fusion CMBS criteria. Because of the early stage of the review, the potential impact on outstanding ratings is uncertain. Until the review is completed, Standard & Poor's will not assign new ratings to transactions that are based on the conduit/fusion criteria.[44]

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[43] Respondent's Exhibit 802 ("As much as we'd like to label S&P an 'aggressive credit rater,' our own subordination work on the triple-A and double-A classes found otherwise . . . Surprisingly, when we applied our 2007 credit support level to this pool we actually came out with credit support levels for the triple A to single-A levels that were lower than the 14.5% credit enhancement assessed by S&P and Morningstar.")

[44] Joint Exhibit 6.

Also on July 27, CMBS Group analytical team members, including Duka, unanimously affirmed as follows regarding the preliminary ratings assigned to GSMS 2011-GC4:

> The members of this committee strongly believe that the preliminary ratings, as originally assigned, were done so correctly, and in full compliance with S&P's then current criteria. However, in light of the Advanced Notice of Proposed Criteria Change and the uncertainty created thereby, we were left with no option but to withdraw the ratings. This in no way changes our opinion regarding this pool. This is the unanimous view of this committee.[45]

The next day, notwithstanding that Goldman Sachs and Citigroup had already offered AAA investors greater credit enhancements to facilitate the transaction in view of the above-described investor inquiries, Sharma, President, at Adelson's urging, made the decision to withdraw S&P's preliminary ratings for GSMS 2011-GC4.[46]

C. Evaluation by the Structured Finance Criteria Committee

On August 5, 2011, Adelson caused S&P to issue a second ANPCC, which stated in part:

> In connection with the review of the application of its conduit/fusion CMBS criteria in relation to the calculation of debt-service-coverage ratios (DSCRs), Standard & Poor's Ratings Services has determined that the approach used for DSCRs on new transactions rated since early 2011 has produced results that are consistent with Standard & Poor's rating definitions.[47]

This statement followed a review by Structured Finance Criteria Committee of the non-Freddie Mac-sponsored 2011 Presales and underlying analyses, including the Goldman Sachs transaction.[48] The review examined various pool-level statistics, including raw credit

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[45] Joint Exhibit 71.

[46] Because S&P made the decision to withdraw the ratings for GSMS 2011-GC4, preliminary ratings were also withdrawn for FREMF 2011-K14.

[47] Joint Exhibit 7.

[48] Freddie Mac engaged ratings agencies to provide so-called "point-in-time" ratings for the AAA tranche of its new issuances of CMBS, meaning that the agencies withdrew their ratings after the date of issuance. This approach applied to FREMF 2011-K701, FREMF 2011-K11, and FREMF 2011-K13. *See, e.g.*, Joint Exhibit 30 ("The preliminary ratings on the class A-1, A-2, and X1 certificates will not be subject to ongoing monitoring, upgrades, withdrawals, surveillance, or any further assessment after the issuance date. As such, the preliminary

enhancement levels based on the Table 1 Constants, and raw credit enhancement levels using the "Blended Constants" for MSC 2011-C1, JPMCC 2011-C3, JPMCC 2011-C4, and GSMS 2011-GC4, and concluded that the "2011 CMBS conduit/fusion results are consistent with the rating definitions."[49]

D. Revised 2011 Presale Reports

On September 2, 2011, S&P published revised versions of the 2011 Presales, including the GSMS 2011-GC4 Presale, with the same credit enhancement levels as were contained in the original version of the Presales, with "supplemental debt service coverage (DSC) and blended loan constant information in the text as well as in an additional table at the end of each report titled 'Deal-Level And Top 10 Loan Constants And DSCRs.'"[50]

E. 2011 RAMPs

As the evidence will show, per the RAMP Guidelines, the assigned primary analysts completed the 2011 RAMPs, with review completed by the assigned secondary analysts. The analysts will explain how they carried out completing the RAMP templates and errors made in including DSC calculations in the RAMP documents only based on Table 1 Constants.

XI. MQR Process

As part of its general remit, the MQR Group began a review of the CMBS Model in the fall of 2010. As of November, Hu of MQR had completed a draft report regarding the model. From November 2010 to June 2011, the CMBS Group provided feedback to Hu concerning the

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ratings on the class A-1, A-2, and X1 certificates will be issued on the closing date and withdrawn the following day."). Accordingly, these transactions were not included in the work carried out by the Structured Finance Criteria Committee.

[49] Respondent's Exhibit 617. Respondent will offer certain S&P lay witness analysis in regard to aspects of the review.

[50] Respondent's Exhibit 107.

draft report's description of the CMBS as used by New Issuance and Surveillance. In April 2011, in relation to a section of the draft MQR report that dealt with the computation of debt service, Duka wrote Hu with copies to Digney, Pollem, and the MQR group email address, that "New Issuance would use the actual (if higher) but look at both if the actual constant is lower than the" the constants listed in Table 6 of the draft MQR Report.[51] Duka and Hu met following this email and discussed that New Issuance calculated DSCs "sometimes us[ing] the average of the actual loan constant and those depicted in Table 6."[52] The final MQR Report approving the CMBS Model described the New Issuance approach as "a combination of the actual loan constants and those depicted in Table 6."[53]

OIP ALLEGATIONS

On January 21, 2015, the SEC issued the OIP, alleging that Duka violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aided and abetted and caused violations by S&P of Section 15E(c)(3)(A) of the Exchange Act (15 U.S.C. § 78o-7(c)(3)(A)), Exchange Act Rule 17g-2(a)(6), and Exchange Act Rule 17g-6(a)(2).[54] The alleged violations presented in the OIP allege categories of allegations as follows:

- Concerning the alleged violation of Rule 17g-6(a)(2), that Duka supported the use of a "Blended Constant," and sought approval to use the same from Parisi, because she was allegedly motivated to assist S&P in increasing the number of CF rating engagements (collectively, the "Commercial Motive Allegations").[55]

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51 Respondent's Exhibit 478.

52 Respondent's Exhibit 619.

53 Respondent's Exhibit 535.

54 The OIP also alleged that Duka aided, abetted, and caused S&P's violation of Rule 17g-2(a)(2)(iii). This claim, however, was dismissed on July 2, 2015 by Administrative Law Judge Cameron Elliot, then presiding over this proceeding. *See* Order on Respondent's Motion for Summary Disposition, Barbara Duka, Release No. 2893 (July 2, 2015), available at https://www.sec.gov/alj/aljorders/2015/ap-2893.pdf.

55 OIP at ¶¶ 5, 24-29.

- Concerning the disclosures in the 2011 Presale Reports, that Duka "made false and misleading statements to investors concerning the DSCRs used and the amount of stress S&P applied in ratings or preliminary ratings," in the presales for the 2011 CF Transactions by failing to disclose that the recommended credit enhancements were "based on Blended Constants," thus misleading readers "into believing that the ratings at issue were more conservative than they actually were" (collectively, the "Presale Allegations").[56]

- Concerning the CP Guidelines, that Duka (1) "unilaterally concluded that she obtained" Parisi's approval "for use of the Blended Constants," (2) failed to document Parisi's approval, and (3) concluded unreasonably that Parisi was authorized to interpret the criteria to allow for the use of "Blended Constants" (collectively, the "Criteria Process Allegations").[57]

- Concerning the RAMPs, that the these documents (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").[58]

- Concerning the MQR process, namely, that Duka "used vague language" in discussions with MQR and failed to provide MQR with a model that incorporated a "Blended Constant" (the "MQR Allegations").[59]

ARGUMENT

I. Applicable Law Regarding Aiding and Abetting and Causing Liability

The Division alleges a primary violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as aiding and abetting and causing violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 15E(c)(3) of the Exchange Act ("IC Statute"), Rule 17g-6(a)(2) under the Exchange Act, and Rule 17g-2(a)(6) under the Exchange Act.

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56 *See* OIP at ¶¶ 4, 33, 48,

57 *See* OIP ¶ 27, 30.

58 *See* OIP ¶ 41-43.

59 *See* OIP ¶¶ 38-39. Respondent's post-hearing brief will explain why the Criteria Process Allegations, the RAMP Allegations, and the MQR Allegations are not cognizable under the securities laws as a matter of law.

Under the statutes authorizing the SEC to bring an action against "any person that knowingly provides substantial assistance" to a primary violator of the securities laws, 15 U.S.C. § 78t(e); 15 U.S.C. § 77o(b), the SEC, to establish an aiding and abetting violation, 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. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009) (quoting *Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57, 62 (2d Cir. 1985)). "The knowledge requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or an active participant." *In the Matter of China Ruit Ai Int'l Holdings Co., Ltd., Dian Min Ma, Gang Ma, & 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." *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*, Exchange Act, 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 the Matter of Brandt, Kelly & Simmons, LLC, & Kenneth G. Brandt*, Release No. 289, 2005 WL 1584978, at *7 (June 30, 2005).

I. The Evidence Will Show That the Commercial Motive Allegations, Which Form the Basis for the Alleged Rule 17g-6(a)(2) Violation, are Unfounded

A. Applicable Law

Rule 17g-6(a)(2) under the Exchange Act prohibits "[i]ssuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the nationally recognized statistical rating organization'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 nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization." Rule 17g-6(a)(2) incorporates a *scienter* element because it concerns actions for a particular purpose. *See Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 502 (1982); *In the Matter of Brandt, Kelly & Simmons, LLC, & Kenneth G. Brandt*, Release No. 289, 2005 WL 1584978, at *7 (June 30, 2005).

B. The Use of Table 1 Constants to Calculate Debt Service was not a Part of S&P's "Established Procedures and Methodologies"

The Division must show that use of the Table 1 Constants was a part of S&P's "established procedures and methodologies for determining credit ratings," *i.e.*, that such use was mandated by the 2009 Criteria; otherwise Rule 17g-6(a)(2) cannot have been violated. This showing will fall short because the 2009 Criteria contained no such requirement. Thus, as will be shown at trial, use of the Table 1 Constants to calculate debt service was not part of S&P's

"established procedures and methodologies," and the elements of a Rule 17g-2(a)(6) violation will not be proven.

C. The Evidence Will Show That Rating More Conduit-Fusion Transactions did not Play a Role in Duka's Decision to Support Use of the "Blended Constants"

The evidence will show that the Commercial Motive Allegations are not rationally supported by the evidence. The hearing evidence that will rebut the Commercial Motive Allegations will include, but will not be limited to, the following:

- The July 2009 Decision was analytically indefensible.

- In fall of 2010, Duka and others became persuaded that continuing to use Table 1 Constants was analytically inappropriate (as memorialized as to Duka in a December 2010 document in which Duka wrote that Henschke is "starting to convince me" that use of the Table 1 Constants is inappropriate and causing unintended analytic results); and, as interest rates declined, came to the view that use of the Table 1 Constants would result in term defaults in the CMBS Model of fixed rate loans where such loans would not default in reality – even under the stressed S&P cash flow and other assumptions.

- Duka's analytical view was widely shared by others, including but not limited by James Manzi, Thomas Gillis, David Henschke, James Digney, and Kurt Pollem. The inference that the SEC would suggest – that only Duka's explanation for the changed application of methodology is a pretext – does not hold water.

- We do not expect any member of the CMBS Group to confirm the existence, as charged, of a "scheme to rapidly and materially decrease CE levels."[60] Rather, the evidence will show that after Duka and others became persuaded of the merits of the change to use of "Blended Constants," Duka sought and obtained advice and guidance from Parisi, the Acting CMBS Criteria Officer, who approved use of the "Blended Constants."

- The Division will not produce any contemporaneous evidence showing or suggesting that Duka was concerned about a salary reduction, losing her job, or needing to downsize the CMBS staff or take any like measure should S&P's total CF new issuance engagements fail to increase. To the contrary, throughout 2010, Ms. Duka expected S&P to receive more rating engagements as conduit-fusion issuance increased overall in the market. S&P meanwhile was rating a substantial percentage of the market's large loan/single borrower deals in 2010, undermining the Division's (unsupported) narrative that Ms. Duka committed a securities law violation to help the CMBS Group stay afloat.

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[60] *See* OIP at ¶ 28.

- The Division's allegation of motive will also be contradicted by evidence showing that under Duka, New Issuance of its own accord employed a ratings methodology that was *more* punitive (or "conservative") than required by Criteria – resulting in pressure upward on credit enhancement levels. For example, although not required to do so by the 2009 Criteria, New Issuance scrutinized loans and loan documents to determine if they allowed for the issuance of subordinated debt outside the collateral trust; assumed such debt had been issued even it had not been, and factored the additional cash stress in to its analysis. In this manner, NI imposed an upward stress on credit enhancement levels[]. For example, concerning the Copper Beech Portfolio ("Copper Beech"), loan collateral in the GSMS 2011-GC4 Transaction, loan principal was $119,867,413. After applying the discounts to the NCF in accordance with the 2009 Criteria, CMBS arrived at a AAA NCF of $9,987,330, which was approximately 17% below the issuer's cash flow. Copper Beech also had existing subordinated debt held outside the trust in the amount of $1 million. When analyzing whether the loan would default under the model, the CMBS Group included this $1 million in the denominator of the DSC calculation, *which caused the loan to default* when it would not have otherwise. That NI, under Ms. Duka, without any requirement under the 2009 Criteria, elected to add stress to the analysis of conduit-fusion transactions is flatly inconsistent with an alleged motive to secure New Issuance rating engagements for S&P.

- Duka rejected assignments where she was not satisfied with the underlying fundamentals of the transaction, a step she would not have taken if motivated as the SEC alleges.

- The Division's Commercial Motive Allegations are inconsistent with the Presale Allegations. The claim that Duka was motivated by commercial concerns is inconsistent with the claim that she allegedly obscured the change in application of methodology relating to the constants in the 2011 Presale Reports. Once use of the "Blended Constants" was approved by Parisi, were the Division correct, commercial interests would have called for active publication of the change, so as to attract more interest from issuers.

The Division is expected to cherry-pick statements in monthly activity reports and emails where Duka pointed out that S&P was not engaged to rate certain transactions due to the 2009 Criteria. These statements will not satisfy the Division's burden. There is nothing noteworthy, much less probative of motive, in the fact that Duka explained to her S&P supervisor reasons that S&P was not retained to rate certain transactions; in fact, she was required to do so. The individuals who worked on the commercial side of S&P's business, to do their jobs, wished to know whether a transaction was "lost" because of fees, terms and conditions, or any other reason, including market rejection of the 2009 Criteria.

Notably, moreover, when the record is examined, it will be clear that the Commercial Motive Allegations are simply implausible because, among other reasons, only **two relevant** transactions **of a total of four** transactions were lost in 2010 for reasons that had anything to do with the 2009 Criteria.

II. The Division Will not be Able to Demonstrate That Duka Committed a Primary or Secondary Violation of § 10(b) of the Exchange Act and SEC Rule 10b–5 thereunder or § 17(a) of the Securities Act

A. Applicable Law

"To prevail on each of its claims under § 10(b) of the Exchange Act and SEC Rule 10b-5, the SEC must establish that, in connection with the purchase or sale of securities in a domestic transaction, the defendants acted with scienter, and by means of instrumentalities of interstate commerce, in employing a fraudulent device or in making a material misrepresentation or a material omission as to which they had a duty to speak." *SEC v. Constantin*, 939 F. Supp. 2d 288, 303 (S.D.N.Y. 2013).[61] "Section 17(a) of the Securities Act, requires substantially similar proof, and to show a violation of section 17(a)(1), the SEC must prove (1) material misrepresentations or materially misleading omissions, (2) in the offer or sale of securities, (3) made with scienter." *SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014) citing *Aaron v. SEC*, 446 U.S. 680, 697 (1980) (internal quotation marks omitted). "To show a violation of section 17(a)(2) or 17(a)(3), the SEC need only demonstrate (1) material misrepresentations or materially misleading omissions, (2) in the offer or sale of securities, (3) made with negligence." *Id.* citing *Aaron,* 446 U.S. at 702.

A plaintiff can plead scienter "'either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong

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[61] The SEC's Complaint in *SEC v. Constantin* alleged claims under 10b-5(a), (b), and (c). *See* Complaint, *SEC v. Constantin*, 11 Civ. 4642 (MHD), at ¶71 (Dkt. 1) (July 6, 2011).

circumstantial evidence of conscious misbehavior or recklessness.'" *SEC v. Mudd*, 885 F. Supp. 2d 654, 661 (S.D.N.Y. 2012) (quoting *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 290-91 (2d Cir. 2006)). The requisite "strong inference of fraudulent intent," *see Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 169 (2d Cir. 2000), may arise where the complaint alleges "that the defendants: (1) benefitted in a concrete and personal way from the purported fraud[;] (2) engaged in deliberately illegal behavior[;] (3) knew facts or had access to information suggesting that their public statements were not accurate[;] or (4) failed to check information they had a duty to monitor." *Novak v. Kasaks*, 216 F. 3d 300, 311 (2d Cir. 2000).

"Questions of materiality and scienter are connected." *Flannery v. SEC*, 810 F.3d 1, 9 (1st Cir. 2015). "If it is questionable whether a fact is material or its materiality is marginal, that tends to undercut the argument that defendants acted with the requisite intent or extreme recklessness in not disclosing the fact." *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.*, 632 F.3d 751, 757 (1st Cir. 2011).

B. The 2011 Presales Were not Misleading

S&P's credit ratings of the 2011 CF Transactions constituted S&P's opinions regarding the creditworthiness of the securities that were backed by the collateral contained in the respective transactions. *See Police & Fire Ret. Sys. of City of Detroit v. Goldman, Sachs & Co.*, No. 10 Civ. 4429 (MGC), 2014 WL 1257782, at *5 (S.D.N.Y. Mar. 27, 2014); *Rice v. Charles Schwab*, 10 Civ. 00398 (CJC), 2010 WL 5156654, at *3 (C.D. Cal. Oct. 22, 2010); *Compuware Corp. v. Moody's Inv'rs Servs.*, Inc., 499 F.3d 520, 529 (6th Cir. 2007). The seminal case regarding opinion-based liability under the securities laws is *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 135 S. Ct. 1318 (2015). There, the Supreme Court affirmed that opinion-based liability can arise under the securities laws where the opinion is not

"sincerely held," but also stated that a "a reasonable investor may, depending on the circumstances, understand an opinion statement to convey facts about how the speaker has formed the opinion—or, otherwise put, about the speaker's basis for holding that view." *Id.* at 1328. By way of example, the Court hypothesized an opinion concerning compliance where the issuer writes, "we believe our conduct is lawful." *Id.* The Court explained that this statement of opinion "could be misleadingly incomplete" if the "the issuer makes that statement without having consulted a lawyer." *Id.* Thus, in analyzing whether an opinion was misleading, the "Supreme Court emphasized the need to examine the context of an allegedly misleading opinion." *Tongue v. Sanofi*, 816 F.3d 199, 211 (2d Cir. 2016) (citing *Omnicare*, 135 S. Ct. at 1330). "An investor reads each statement [in a registration statement], whether of fact or of opinion, in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information. And the investor takes into account the customs and practices of the relevant industry. So an omission that renders misleading a statement of opinion when viewed in a vacuum may not do so once that statement is considered, as is appropriate, in a broader frame." *Omnicare*, 135 S. Ct. at 1330.

Here, focusing on the presence of DSCRs based on the Table 1 Constants in the 2011 Presale Reports, the Division argues that S&P's opinions as expressed in those reports, including preliminary ratings and credit enhancement levels assigned to each tranche, were misleading because investors would allegedly have formed the misimpression that S&P exclusively used these DSCRs to arrive at the published credit enhancement levels. As the trial evidence will show, the Division's conclusion can only be reached by viewing selective portions of 2011 Presales in isolation, and not, as *Omnicare* instructs, within the context of the other disclosures in the 2011 Presale Reports, and S&P's disclosures more generally regarding DSCRs during the

Relevant Period. Viewed, as they must be in the light of their full context, the evidence will demonstrate that the 2011 Presales did not misleadingly suggest that only Table 1 constants were being used exclusively in S&P's DSC calculations.

C. The Evidence Will Show That the Alleged Failure to Disclose the use of a "Blended Constant" to Rate the 2011 CF Transactions was not Material

1. Applicable Law

A misrepresentation is material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *see also SEC v. Kelly*, 663 F. Supp. 2d 276, 284 (S.D.N.Y. 2009) ("[a] misrepresentation is material if there is a *substantial likelihood that a reasonable investor would have acted differently* if the misrepresentation had not been made or if the truth had been disclosed.") (emphasis added). Proof of materiality is explicitly required by Rule 10b-5(b) and Section 17(a)(2), and a materiality requirement is implicit in Section 17(a)(1) and (a)(3) and in Rule 10b-5(a) and (c), because materiality is the essence of any kind of "fraud," *see Neder v. United States*, 527 U.S. 1, 22-23 (1999), and those provisions forbid either a "device, scheme or artifice to defraud," or an "act, practice or course of business which operates . . . as a fraud or deceit." 15 U.S.C. § 77q(a); 17 C.F.R. § 240.10b-5; *see also Charal Inv. Co. v. Rockefeller*, 131 F. Supp. 2d 593, 603 (D. Del. 2001) ("Plaintiffs claim pursuant to Rule 10b–5(a) requires a demonstration of materiality even though it is not expressly required in the language of the rule.").

Moreover, the materiality of any alleged misrepresentation, omission, or half-truth must be assessed in light of the sophistication of the class of investors to whom the alleged misrepresentation, omission, or half-truth is directed. *See United States v. Litvak*, 808 F.3d 160,

185 (2d Cir. 2015) (holding that proposed testimony that "minor price variances would not have mattered to sophisticated investors . . . would have been relevant to the element of materiality") (internal quotation marks omitted).

2. The Evidence Will Show That the Failure to Disclose "Blended Constant" was not Material

Duka will demonstrate that the Division's theory of materiality is detached from any real-world foundation in the decision-making process of reasonable CMBS investors and their marginal insight into the S&P model. The evidence strongly weighing against the materiality of the alleged misstatements here will include, but will not be limited to, the following:

- The limited class of purchasers for the 2011 CF Transactions were sophisticated investors;[62]
- The offering documents provided these sophisticated investors detailed information regarding all of the loans contained in each 2011 CF Transactions;
- Using the loan data provided in the offering documents, these sophisticated investors conducted their own due diligence on the 2011 CF Transactions, using their own models, which included running their own customized stress scenarios;
- With the exception of FREMF 2011-K701, each of the 2011 CF Transactions was rated by one or more NRSROs other than S&P;[63]
- By S&P practice known to the market, the 2011 Presales did not explicate the S&P model in all of its particularized analysis, and, in combination with the 2009 Criteria and specific transactions here, did not permit investors to develop a refined understanding of S&P's specific credit enhancement determinations and their derivation; this would not been different under different Constants disclosure.

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[62] For example, investors in the 2011 CF Transactions included AIG, Alliance Bernstein, BlackRock, Blackstone, Charles Schwab, Citigroup, Freddie Mac, Fidelity, Genworth Life Insurance, Guardian Life Insurance, ING, J.P. Morgan, Nationwide Life Insurance, PIMCO, Progressive, T. Rowe Price, U.S. Bank, UBS, and Vanguard.

[63] MSC 2011-C1 was rated by S&P and Fitch, JPMCC 2011-C3 was rated by S&P, Realpoint, and Fitch, FREMF 2011-K11 was rated by S&P and DBRS, FREMF 2011-K13 was rated by S&P and Realpoint, JPMCC 2011-C4 was rated by S&P, Realpoint, and Fitch, GSMS 2011-GC4 was rated by Morningstar and S&P, and FREMF 2011-K14 was rated by S&P and Fitch.

- The offering documents for the 2011 CF Transactions specifically informed investors that the NRSROs selected to rate the particular transaction were selected, in part, because they proposed the lowest credit enhancement levels, *i.e.*, investors knew of the distinct possibility that other NRSROs viewed S&P's credit enhancement levels as insufficient.[64]

D. The Division's Evidence Will not Prove Scienter

The evidence will show that Duka acted in good faith and at no time harbored any intention to defraud investors. Among other probative evidence on this point, two categories of proof are summarized below:

1. The Presale Disclosures Concerning Constants Were Consistent With the Relevant Standard of Disclosure at S&P at the Time

The Division's flawed theory of scienter relies on a view of the disclosures in the Presales in a vacuum, rather than in the context of how S&P disclosed the use of the constants following the publication of the 2009 Criteria. When the first of the 2011 Presale Reports (MSC 2011-C1) was being drafted, New Issuance was acting under standards at S&P and an environment that required no precision whatsoever regarding the disclosure of how the CMBS Group employed constants in its analysis. The absence of standards requiring greater disclosure informs the decision making here both as to intent and materiality.

2. The Methodology Disclosure in the Presales, Combined With the Enhancements to the Disclosures Over Time, Evidence a Lack of Scienter

As noted above, Duka reasonably believed that the Methodology disclosure concerning both Table 1 and Actual Constants was appropriate because the "considering both" formulation – "In determining a loan's DSC, Standard & 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

64 The Division is expected to assert that the use of "Blended Constants" made ratings across CMBS issuances less consistent. The evidence will, in fact, show that use of the "Blended Constants" had the opposite effect.

criteria" – informed the reader that the Actual Constants figured into the analysis and also captured the treatment of all loans in the respective 2011 CF Transactions, including those whose actual constant was higher than Table 1, and partial-interest only loans. Duka also intended to alert the reader through this disclosure that New Issuance was employing a different approach from one that merely drew on Table 1. The evidence will also show that this disclosure was consistent with standard S&P disclosure, repeatedly used in presale reports to describe the consideration of various model and relevant variables.[65] Thus, the Division's suggestion of irregularity or a departure in the 2011 Presale Reports from S&P standards will be unsupported.

Moreover, as explained above, the disclosure in the presales was enhanced in a manner that belies scienter and was consistent with "considering both" constants. At Snow's suggestion, beginning with the fourth of the 2011 Presale Reports, FREMF 2011-K11, the CMBS Group included a table that showed the DSC ranges based on the Actual Constant. This disclosure was also made in the remaining Presales. And, for the seventh and eighth of the 2011 Presale Reports, GSMS 2011-GC4 and FREMF 2011-K14, the Rationale section included pool-level DSC based on the Actual Constant. These serial efforts to improve the relevant disclosure suggest an effort to improve clarity, not an inference of scienter.

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[65] *See, e.g., id.* at Joint Exhibit 37 ("When accounting for all existing additional financing, Standard & Poor's beginning all-in LTV ratio is 87.9%. **We also considered** all existing secondary debt when evaluating the transaction."); *id.* ("We took [environmental reports] **into consideration** when determining the transaction's subordination levels."); *id.* ("The loan has an initial 12-month interest-only period; however, Standard & Poor's DSC and loan analysis was based on the debt service assuming a 30-year amortization schedule. We **considered the loan structure** in our evaluation of the loan and transaction."); Joint Exhibit 46 ("Certain aspects of this transaction do not fully comply with Standard & Poor's legal criteria . . . . **We considered these factors in evaluating the transaction.**"); Joint Exhibit 22 ("We **also considered all existing and potential secondary debt in the subordination levels** . . . In addition, Standard & Poor's reviewed four of the nine loans containing one or more single-tenant properties (9.2% of the pool balance) and **considered the market, tenant rating, lease term, loan structure, and the dark value when evaluating the loan.**").

III. The Criteria Process Allegations Will not be Supported by the Evidence

The Criteria Process Allegations will find no support in the hearing evidence.

As an initial matter, the Criteria Process Allegations are premised on the assumption that the 2009 Criteria mandated use of the Table 1 Constants to compute debt service for the term default test. That assumption will be proven unfounded.

As explained above, the CP Guidelines expressly stated 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."[66] The documentary evidence and testimony will show that Duka reasonably believed that Parisi interpreted the Guidelines to allow for the use of "Blended Constants"; approved the CMBS Group's use of the same; and that such approval was sufficient to rate the 2011 CF Transactions using "Blended Constants."

As an initial matter, one need not look beyond the SEC's own letter to S&P in September 2012, to confirm that the 2009 Criteria did not disclose that CMBS would be required to use Table 1 Constants:

> **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.**[67]

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66. Joint Exhibit 10.

67. Respondent's Exhibit 643.

This description of events by the SEC cannot be squared with the Criteria Process Allegations. If S&P had no written policies and procedures applicable to criteria interpretations, and that sowed "uncertainty" and "internal disagreement," how can the Criteria Allegations now be fairly lodged and pursued?

Further, the consistency of Duka's reasonableness in relying on Parisi's decision with S&P's standard of conduct will be shown by comparison of that decision and process and both the July 2009 Decision and the March 2010 Decision. Both the July 2009 Decision and March 2010 Decision were treated as Criteria interpretations. Neither of those decisions followed the five-step process of Criteria amendment set forth in the Criteria Process Guidelines, and neither resulted in an external publication. Moreover, the July 2009 Decision, **involving the Chief Credit Officer and President of S&P**, was not documented in any form. That Duka did not document Parisi's decision and believed that Parisi's approval permitted the CMBS group to use the "Blended Constants" as a Criteria interpretation was in lock-step with S&P practice at the highest executive levels of the Company. The Criteria Process Allegations nonetheless unfairly attempt to impose a standard of conduct on Duka that did not exist at S&P at the time.

In the end, we expect that in assessing whether Duka violated a standard of conduct, this Court will be asked to weigh the testimony of a single Division witness, Adelson, against numerous other witnesses in the CMBS Group, including in the MQR Group, the Quality Group, and the Criteria Group[68] and the above chronology of S&P's historical process in dealing with the issue of constants. The evidence will not suffice to sustain the Division's burden.

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[68] We expect the Division to claim that Duka violated the CP Guidelines because the use of "Blended Constants" was not escalated pursuant to Section 3.13 of the CP Guidelines. The evidence will demonstrate that this claim lacks merit. For example, the Division will argue that escalation was required because New Issuance's use of the "Blended Constant" was inconsistent with Surveillance's use of the Table 1 Constant. Such a claim would lack merit because, *inter alia*, there were inherent differences in how loans were evaluated at New Issuance as compared to Surveillance, which reviewed actual loan performance data. NI and Surveillance recognized that each had been

III. The RAMP Allegations Will not be Supported by the Evidence at Trial

Per the RAMP Guidelines, Duka was not called on to complete or review the RAMPs. The primary analyst and the chairperson were so assigned. Thus, to the extent that the RAMP Allegations are cognizable as securities violations – a matter we reserve for post hearing briefing – they cannot be pursued or determined against Duka.[69] For this, and other reasons to be explicated at trial, the evidence will show that the RAMP Allegations have no merit.

IV. The MQR Allegations Will not be Supported by the Evidence

The Division alleges that Duka "knowingly allowed MQR to perform its important internal control function" without providing MQR with an excel spreadsheet that incorporated a "Blended Constant."[70] This averment will be rebutted by the expected testimony of Goldberg and Hu that MQR did not require a spreadsheet that used the "Blended Constants" to perform MQR's function in reviewing the CMBS model. The MQR Allegations thus fail: Duka cannot have been negligent for failing to provide to MQR a spreadsheet version that MQR neither sought nor needed to complete the MQR Report.

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using a somewhat different application of Criteria methodology, with the result that NI stressed cash more severely than Surveillance; accordingly, the change in application of the Constants – from the perspective of consistent ratings by NI and Surveillance – was expected to better align the two group's outcomes.

[69] *In the Matter of the Applications of Anthony J. Amato et al.*, 1973 WL 149289, at *4, 45 S.E.C. 282 (June 29, 1973) ("Failure of supervision—which may result in derivative responsibility for the misconduct of others—connotes an inattention to supervisory responsibilities, a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them. That is not the situation here. In view of Bills' active and central role in the whole matter, affirmance of the finding of failure to supervise would entail a confusion of concepts.").

[70] OIP at ¶ 39.

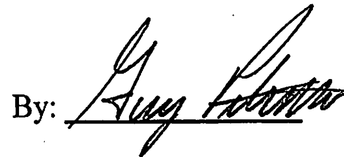
CONCLUSION

For all of the reasons set forth above, and as will further be established at hearing, Duka respectfully requests a ruling in her favor on all charges in the OIP.

Dated: November 7, 2016
New York, New York

Respectfully submitted,

PETRILLO KLEIN & BOXER LLP

By: 

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16349

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In the Matter of :

BARBARA DUKA :

Respondent. :

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CERTIFICATE OF SERVICE

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