Basis Yeild Alpha Fund (Master) v Goldman Sachs Group, Inc.
2014 NY Slip Op 31899(U)
July 18, 2014
Sup Ct, New York County
Docket Number: 652996/2011
Judge: Shirley Werner Kornreich

[* 1]

SHIRLEY WERNER KORNREICH
J.S.C

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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BASIS YIELD ALPHA FUND (MASTER),

Plaintiff,

-against-

GOLDMAN SACHS GROUP, INC., GOLDMAN SACHS & CO., GOLDMAN SACHS INTERNATIONAL, and GOLDMAN SACHS & PARTNERS AUSTRALIA PTY, LTD.,

Defendants.

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Index No.: 652996/2011

DECISION & ORDER

SHIRLEY WERNER KORNREICH, J.:

In motion sequence numbers 006 and 007, which are consolidated for disposition, plaintiff Basis Yield Alpha Fund (Master) (BYAFM) moves to compel (1) defendants Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs International, and Goldman Sachs & Partners Australia Pty Ltd. (collectively, Goldman); and (2) non-party Clayton Holdings, LLC (Clayton) to produce due diligence materials from Goldman sponsored residential mortgage backed securities (RMBS) transactions. Goldman and Clayton oppose the motions. The motions are denied for the reasons that follow.

The court assumes familiarity with its decision on the motion to dismiss. *See* 37 Misc3d 1212(A) (Sup Ct, NY County 2012), *aff'd in relevant part* 115 AD3d 128 (1st Dept 2014). In short, BYAFM alleges that Goldman fraudulently induced it to invest in two CDO-squared transactions, Point Pleasant and Timberwolf. These securities, unlike garden-variety RMBS, are not simply pass-through certificates that generate income from mortgage loan pools (i.e., mortgage bonds).[1] Rather, they are RMBS derivatives that, essentially, are side bets on the performance of other CDOs.[2] This difference is critical to the discovery requested by BYAFM on this motion.

Clayton's due diligence materials supposedly prove that banks knew that the loans placed into RMBS trusts were far worse than represented to investors. Even though banks allegedly knew, because Clayton's reports told them so, that loans contemplated for securitization were non-conforming under the PSAs being issued, the truth, allegedly, was kept concealed and whitewashed with AAA ratings from the ratings agencies. This theory, as most courts, including this one, have held, states a claim for fraudulently inducing an investment in RMBS. *See, e.g., Phoenix Light SF Ltd. v Ace Secs. Corp.*, 39 Misc3d 1218(A), at *7 (Sup Ct, NY County 2013) (Kornreich, J.) ("the allegations that Deutsche Bank made false representations in the RMBS offering materials that flatly contradict the reality depicted in Clayton's report to induce

[1] *See generally HSH Nordbank AG v Barclays Bank PLC*, 42 Misc3d 1231(A), at *2-3 (Sup Ct, NY County 2014) (Friedman, J.).

[2] The securities, which were purchased on margin, were based on the performance of other securities issued by CDOs called Point Pleasant 2007-1, Ltd and Timberwolf 2007-1, Ltd. For instance, BYAFM, through credit default swaps (CDS), sold protection on certain tranches of Timberwolf. BYAFM's fraud allegations, *inter alia*, include that Goldman knew and should have told BYAFM about Timberwolf's poor collateral. BYAFM also alleges other improprieties on the part of Goldman, such as margin calling deception relating to Point Pleasant that allegedly induced BYAFM to later invest in Timberwolf. In numerous discovery conferences, BYAFM's counsel fleshed out its fraud allegations with a level of specificity that was not clear on the motion to dismiss. These issues must be sorted through with the help of the parties' experts. Theories of securities "designed-to-fail" or sold for the purpose of facilitating Goldman's shorting of the RMBS market are not, **on their own**, sufficient for a sophisticated, multi-billion dollar hedge fund to get its money back via a fraudulent inducement claim. Instead, BYAFM must proffer specific misrepresentations about the collateral that were not verifiable by BYAFM (e.g., via its own available RMBS performance data that it had by virtue of being a collateral manager) or other material misrepresentations about the collateral (e.g., where it was sourced, assuming, of course, that improper sourcing caused BYAFM's loss) relied on by BYAFM.

plaintiffs to purchase RMBS are sufficient to state a claim for fraud"); *see also Allstate Ins. Co. v Credit Suisse Secs. (USA) LLC*, 42 Misc3d 1220(A), at *14 (Sup Ct, NY County 2014) (Friedman, J.) ("Allegations based on credit ratings have been upheld, however, where the complaint focused not on the subjective belief of the ratings agency *but on the knowledge of the defendants as to the support for the ratings*") (emphasis added). In RMBS fraud cases, discovery of Clayton reports is not only relevant, it is some of the most important discovery in the case.

But this is not such a case. BYAFM does not allege (and this case is not about) the fraudulent structuring of RMBS. Rather, this case concerns specific representations Goldman made to BYAFM regarding the subject securities and whether such representations constitute actionable fraud under New York common law. This is an exceedingly difficult question that both this court and the Appellate Division agreed could not be resolved on a motion to dismiss.

Hence, the Clayton reports – which only goes to Goldman's general view of the RMBS market and its own securitizations, which was only comprised of a portion of the underlying collateral of Point Pleasant and Timberwolf – are not particularly relevant. Nonetheless, strict materiality is not the standard for discovery under New York law. *See MBIA Ins. Corp. v Residential Funding Co.*, 2011 WL 11187297, at *1 (Sup Ct, NY County 2011) (Fried, J.), citing *Hall v 130-10 Food Corp.*, 254 AD2d 22 (1st Dept 1998) ("While materiality and necessity [CPLR 3101(a)] obviously place some limits on the scope of disclosure, disclosure should be permitted as long as the information sought bears on the controversy and will assist in the preparation for trial; the ultimate test is one of usefulness and reason.") (quotation marks omitted).

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That being said, there are numerous reasons why BYAFM should not be entitled to Clayton report discovery in this case. BYAFM wants this discovery to show what Goldman knew about the RMBS market and to prove that Goldman itself did not believe the representations it made about Point Pleasant and Timberwolf. However, BYAFM has already been granted substantial discovery on Goldman's knowledge about the RMBS market and its real views on the securities sold to BYAFM, including voluminous ESI. BYAFM has also been allowed access to discovery of Goldman's alleged fraud in other, similar transactions. For instance, Goldman has produced deposition transactions in a currently pending federal class action. *See Dodona I, LLC v Goldman, Sachs & Co.*, 296 FRD 261 (SDNY Jan. 23, 2014) (Marrero, J.). The requested Clayton discovery, therefore, is duplicative. Also, beyond the Clayton reports themselves, requiring the production of further Clayton ESI would be extremely expensive and has the potential to significantly delay the case.

Furthermore, aside from these issues, the Clayton reports likely would not be admissible at trial since their prejudicial effect ("Goldman committed RMBS securitization fraud" in other transactions) may severely outweigh their probative value of assessing fraud in CDO-squared transactions. Again, the type of fraud alleged in RMBS and CDO-squared cases differs greatly. And, the use of the Clayton reports, even for the purposes of summary judgment, would require extra, incredibly complex and expensive categories of expert discovery on whether the reports evidence RMBS securitization fraud. Simply put, compelling the production of Clayton reports would be the first step down the road to countless tangential issues that will further delay and confuse this case.

Indeed, BYAFM's other pending third-party subpoenas (which are not before the court but were discussed in the parties' briefs) justify this court's concern. While the court will not formally rule on whether such subpoenas should be enforced at this time, the court notes that BYAFM issued subpoenas to numerous big name financial firms that were recently in the headlines, such as Magnetar and Paulson. Such firms will not be compelled to produce discovery in this action if they have no transaction specific material. The production of general scandalous material revealing the inner workings of Goldman, no matter how interesting, will not be compelled simply because such material is relevant to the financial crisis, as opposed to the specific securities at issue in this case. Accordingly, it is

ORDERED that plaintiff's motion to compel is denied; and it is further

ORDERED that the parties shall meet and confer regarding all other outstanding third-party discovery prior to the currently scheduled July 29 conference so that such matters need not require further expensive motion practice, and if such matters are not resolved prior to the conference, a similar expedited briefing schedule will be set such that the motions are fully submitted no later than August 22.

Dated: July 18, 2014

ENTER:

SHIRLEY WERNER KORNREICH