Matter of Part 60 RMBS Put-Back Litig.
2018 NY Slip Op 30627(U)
April 10, 2018
Supreme Court, New York County
Docket Number: 777000/2015
Judge: Marcy Friedman
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK – PART 60

PRESENT: Hon. Marcy Friedman, J.S.C.

IN RE: PART 60 RMBS PUT-BACK LITIGATION	Index No. 777000/2015
IN RE: PART 60 MONOLINE INSURER LITIGATION	Index No. 779000/2015
THIS DOCUMENT APPLIES TO ALL CASES	DECISION/ORDER

In the coordinated Part 60 RMBS litigation, the put-back and monoline insurer plaintiffs move for leave to reargue and renew an appeal from a May 17, 2017 ruling of Hon. Theodore H. Katz (Ret.), the Special Discovery Master for these cases. The appeal was determined by this court's decision and order dated October 13, 2017 (prior decision), which modified Judge Katz's ruling. (2017 NY Slip Op 32161 [U], 2017 WL 4569727.) The prior decision addressed plaintiffs' request for the court's authorization to contact employers or other third parties, in connection with reunderwriting of securitized mortgage loans at issue in this litigation, to verify borrower information—i.e., information provided by borrowers in their loan applications regarding income and employment.

Plaintiffs move for leave to reargue and renew with respect to two restrictions imposed by the prior decision on verification of borrower information: 1) the requirement that the plaintiff make a showing that such verification may be relevant to prove breaches of representations with respect to the particular loans as to which the plaintiff seeks verification discovery, by certifying that the plaintiff has identified red flags that borrower information in the loan files may be incorrect; and 2) the prohibition on reverification where the loan file contains documentation from the employer verifying borrower information at the time of the loan application, or, for self-employed borrowers, where the loan file contains an accountant

statement provided at the time of the loan application, if the statement is regular on its face. (See Pls.' Memo. In Supp. at 5.)

Leave to reargue and renew is granted in the interest of ensuring that the parties have a full and fair opportunity to address the issue of the required showing of the relevance of the borrower verification discovery sought, in light of its sensitive nature and the widespread impact of the relevance ruling on the coordinated Part 60 RMBS cases. (See generally Corporan v Dennis, 117 AD3d 601, 601-602 [1st Dept 2014] [whether a motion is treated as one for reargument or for renewal, it is addressed to the sound discretion of the court]; The Rancho Santa Fe Assn. v Dolan-King, 36 AD3d 460, 461 [1st Dept 2007] [authorizing renewal, even if based on facts in existence at the time of the prior motion, "so as not to defeat substantive fairness," quoting Tishman Constr. Corp. of N.Y. v City of N.Y., 280 AD2d 374, 377 (1st Dept 2001)].)

Upon reargument, the court adheres to the central holding of the prior decision that a party seeking authorization to verify borrower information must make a two-prong showing of relevance: First, the relevance standard requires a showing that verification of borrower information is relevant to prove that the specific representations and warranties at issue were breached by defendant securitizers and/or originators. (2017 WL 4569727, at * 7.) Second, the standard requires allegations, as to the specific borrowers selected for verification, that verification of the information provided by those borrowers in their loan applications may lead to relevant evidence. (Id.) As also held in the prior decision, the first prong of the standard was met by plaintiffs' showing that verification of borrower information may be relevant to prove breaches of the "exemplar" representations. (Id. at * 9.) The prior decision held, however, that the second prong was not met, and that a protocol must be developed, after negotiation between the parties and subject to the Special Discovery Master's approval, which sets standards that can

be applied across the Part 60 coordinated cases for selecting a reasonably limited subset of loans for verification. (Id. at * 10.) The decision further held that such standards must set forth criteria for determining whether verification may lead to relevant evidence, including criteria for identifying red flags that borrower information in the loan file may be incorrect, thus warranting third party verification for particular loans. (Id.)

In discussing an example of a possible protocol, the prior decision stated that the protocol might involve a certification by a plaintiff's counsel that it, or a reunderwriter acting under counsel's supervision and for whose actions counsel agrees to be responsible, has undertaken a full review of the relevant loan file; consulted publicly available information, if any; and identified a red flag or flags justifying further inquiry into the borrower's income or employment. (Id.) In discussing the certification, the decision stated that the loans to be verified should be identified in the certification, but that the extent of the other detail to be included in the certification—e.g., detail as to the criteria met in selecting the loans for verification—should be addressed with Judge Katz in the first instance. (Id.)

The court now clarifies that it was not the court's intention to require that the certification include details as to the specific facts underlying the determination that red flag(s) had been raised pursuant to the protocol, justifying verification of borrower information for the selected loans. Nor was it the court's intention to suggest that a certification of the type approved by Judge Katz with respect to resort to public information would not be appropriate for the relevance showing in support of verification of borrower information.[1] Rather, as held in the prior decision, the criteria for determining what constitutes a red flag remain for negotiation by

[1] In the May 17, 2017 ruling which is the subject of this appeal, Judge Katz cited plaintiffs' counsels' proposal that they will affirm, as part of the verification protocol, "that they will oversee and take ultimate responsibility for the actions of their [third-party reunderwriting firms]." He then ruled that "Plaintiffs' counsel shall certify that publicly available information was reasonably pursued as part of the verification process." (May 17, 2017 Ruling at 5.) In the prior decision, this court agreed with that ruling. (2017 WL 4569727, at * 3-4.)

the parties under Judge Katz's supervision. (Id.) The loans selected for borrower verification discovery should be identified in the certification. (Id.) However, the extent to which the certification should set forth other detail, if any, as to the criteria met in selecting specific loans for borrower verification, should be addressed with Judge Katz in the first instance. Put another way, the prior decision did not impose a requirement that the certification should set forth the nature of the red flag, or the basis for finding a red flag, with respect to the loans as to which borrower verification is sought. Rather, the prior decision left for consideration by Judge Katz in the first instance whether, or to what extent, such information should be included in the certification.

Moreover, contrary to plaintiffs' contention (see Pls.' Memo. In Supp. at 14), the prior decision did not contemplate litigation at the discovery stage as to the propriety of a plaintiff's certification that criteria have been met for third party verification discovery with respect to specific loans.[2]

In adhering to its holding that a showing of relevance must be made as to the specific borrowers selected for verification, the court rejects plaintiffs' contention that this requirement will impose an undue burden upon them. (Pls.' Memo. In Supp. at 12-14; Pls.' Reply Memo. at 11-12.) Although plaintiffs claim that the requirement "will double the time, effort, and expense associated with reunderwriting" (Pls.' Reply Memo. at 12 [emphasis in original]), they do not submit any evidence to this effect. Rather, although their reunderwriting expert states that verification of borrower information is "one of the first tasks performed" in reunderwriting and typically occurs before the review begins, he does not state, let alone suggest, that the effort

[2] Although the court will not, and could not feasibly, assess at the discovery stage whether red flag(s) warrant verification of borrower information for the specified loans, each plaintiff will, of course, ultimately be required to prove that the evidence supports its claim that breaches of representations and warranties materially and adversely affected the value of the loans at issue—whether or not the plaintiff has verified borrower information for such loans.

would be doubled merely because the review was conducted in two steps. (Aff. of Robert Hunter, ¶ 4.) In any event, as discussed further below and in the prior decision, the requirement is necessary to strike a proper balance between plaintiffs' need for borrower verification information and avoidance of prejudice to borrowers. (2017 WL 4569727, at * 11.)

The court also rejects plaintiffs' claim that the required showing of relevance will result in premature disclosure of expert opinion. (Pls.' Memo. In Supp. at 13-14.) Defendants represent, and plaintiffs do not dispute, that in many of the Part 60 actions, expert reports have already been disclosed, although they may be supplemented. (Defs.' Memo. In Opp. at 14; Pls.' Reply Memo. at 12, n 7.) Moreover, a certification of relevance will not detail an expert's breach analysis.

Contrary to plaintiffs' further contention, this court has not applied a "heightened relevance" standard to the verification discovery. (See Pls.' Memo. In Supp. at 5-11.) As plaintiffs correctly argue, under the Court of Appeals' decision in Matter of Kapon v Koch (23 NY3d 32, 38 [2014]), the "material and necessary" standard is applicable to third party as well as party discovery and is a "liberal" standard that requires that "the requested discovery is relevant to the prosecution or defense of an action." (Id. at 37-38.) In adopting this standard, the Court of Appeals rejected a higher standard, which had been followed in some Departments, but not the First, that a party seeking third party discovery must show that the disclosure cannot be obtained from sources other than the nonparty. (Id.) As discussed in the prior decision, the Appellate Division's decision in MBIA Insurance Corp. v Credit Suisse Securities (USA) LLC (103 AD3d 486, 487 [1st Dept 2013]) is the sole appellate authority to have considered the standards for authorization of third party verification of borrower information in the RMBS context. That decision remains good law after Kapon to the extent that it held that the plaintiff had not shown that the third party borrower information it sought was "material and necessary to

its fraud and breach of contract claims" because it had not made "particularized factual allegations specific to any of the borrowers selected for this disclosure." (Prior Decision, 2017 WL 4569727, at * 7, quoting MBIA, 103 AD3d at 487.)[3] As the MBIA Court also noted, the request for extensive amounts of "personal and confidential financial information . . . constitute[d] an undue burden and expense on the responding nonparties." (Id.)

Although the borrower information sought in the coordinated Part 60 cases is far more limited than that sought in MBIA, the information is of a sensitive, personal nature, and plaintiffs have requested blanket authorization to verify the information for potentially tens of thousands of loans across the Part 60 cases. In applying the "material and necessary" standard to the authorization of this discovery, the court retains its authority to prevent unduly burdensome discovery. CPLR 3103, which applies to both party and nonparty discovery, provides: "The court may at any time on its own initiative, or on the motion of any party or of any person from whom or about whom discovery is sought, make a protective order denying, limiting, conditioning or regulating the use of any disclosure device. Such order shall be designed to prevent unreasonable annoyance, expense, embarrassment, disadvantage, or other prejudice to

[3] The court is unpersuaded by plaintiffs' reading of MBIA as applying a heightened standard only to the MBIA plaintiff's request for borrower tax returns (see Pls.' Memo. In Supp. at 5-9), and not to the extensive other third party disclosure that the MBIA plaintiff also sought—i.e., financial disclosure and testimony from the employers of the borrowers; borrower depositions; and borrower personal investment and bank account statements. (MBIA, 103 AD3d at 486-487.) Although the Court cited two tax cases (Williams v New York City Hous. Auth., 22 AD3d 315 [1st Dept 2005] and Gordon v Grossman, 183 AD2d 669 [1st Dept 1992]) in support of its holding that the plaintiff was required to make a strong showing of necessity and to demonstrate that the information was unavailable from other sources, the Court expressly applied this requirement to all of the requested disclosure, "including" personal investment and bank account statements and tax returns. (MBIA, 103 AD3d at 487.) As indicated in the prior decision (2017 WL 4569727, at *6), this MBIA holding is no longer controlling in light of Kapon (23 NY3d at 38), which has eliminated the requirement that a party seeking third party discovery "demonstrate that it cannot obtain the requested disclosure from any other source." (It is noted that this requirement, although not relevant here, continues to exist for disclosure, even from a party, of tax returns. [See e.g., Pinnacle Sports Media & Entertainment, LLC v Greene, 154 AD3d 601, 601 [1st Dept 2017]; Lee v Lu, 132 AD3d 515, 516 [1st Dept 2015], lv dismissed 27 NY3d 975 [2016].) Kapon does not, however, affect the MBIA Court's alternative holding, which expressly found that the plaintiff had not satisfied the material and necessary relevance standard for the requested borrower verification discovery because the plaintiff had not made particularized factual allegations specific to the borrowers as to which third party discovery was sought. (See holding quoted in the text above; Prior Decision, 2017 WL 4569727, at * 7.)

any person or the courts." The mandate of CPLR 3101 that "[t]here shall be full disclosure of all matter material and necessary in the prosecution or defense of an action" is thus subject to the court's sound exercise of discretion in order to balance the need for discovery against "unnecessarily onerous application of the discovery statutes." (See generally Kavanagh v Ogden Allied Maintenance Corp., 92 NY2d 952, 954 [1998]; accord Forman v Henkin, 30 NY3d 656, 662 [2018].) The court adheres to its holding that this discretion should be exercised here.

Finally, on renewal, the court modifies the prior decision to the extent of rescinding its prior directive that the criteria for reverification should not permit 1) employer reverification where the loan file contains documentation from the employer verifying borrower information at the time of the loan application, or 2) verification of borrower income from accountants, where the loan file includes an accountant statement provided at the time of the loan application, if the statement is regular on its face. Plaintiff has submitted at least some evidence of instances in which such prior verifications have been false. (See Hunter Aff., ¶¶ 6-7.) Such reverifications must, however, be subject to the criteria and certification discussed above for verifications generally.

It is accordingly hereby ORDERED that plaintiffs' motion for leave to reargue and renew is granted and, upon reargument and renewal, the court adheres to its prior decision except to the extent of rescinding its prior directive regarding reverification of borrower information that, at the time of the loan application, was verified by an employer or was the subject of an accountant statement.

Dated: New York, New York
April 10, 2018

MARCY FRIEDMAN, J.S.C.