State of N.Y. ex rel. Edelweiss Fund, LLC v JPMorgan Chase & Co.
2022 NY Slip Op 30532(U)
February 18, 2022
Supreme Court, New York County
Docket Number: Index No. 100559/2014
Judge: Andrew Borrok
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 53

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STATE OF NEW YORK EX REL. EDELWEISS FUND, LLC,

Plaintiff,

- v -

JPMORGAN CHASE & CO., CITIGROUP, INC.,M&T BANK CORPORATION, WELLS FARGO & COMPANY, MERRILL LYNCH & CO., INC.,MORGAN STANLEY SMITH BARNEY LLC,JPMORGAN CHASE BANK, N.A., J.P. MORGAN SECURITIES LLC,J.P. MORGAN SECURITIES, INC.,CITIBANK, N.A, CITIGROUP GLOBAL MARKETS, INC.,CITIGROUP FINANCIAL PRODUCTS, INC.,CITIGROUP GLOBAL MARKETS HOLDINGS, INC.,M&T BANK, BANK OF AMERICA CORPORATION, BANK OF AMERICA N.A., BANC OF AMERICA SECURITIES LLC,MERRILL LYNCH, PIERCE, FENNER & SMITH INC.,BOFA MERRILL LYNCH ASSET HOLDINGS, INC.,MORGAN STANLEY, MORGAN STANLEY & CO. LLC,MORGAN STANLEY BANK, N.A., MORGAN STANLEY CAPITAL SERVICES INC.,MORGAN STANLEY CAPITAL GROUP INC.,

Defendant.

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INDEX NO. 100559/2014

MOTION DATE _____

MOTION SEQ. NO. 040 041 052 053 054 055

DECISION + ORDER ON MOTION

HON. ANDREW BORROK:

The following e-filed documents, listed by NYSCEF document number (Motion 040) 690, 691, 692, 693, 694, 695, 696, 697, 698, 699, 700, 701, 702, 703, 704, 705, 706, 707, 708, 709, 710, 711, 712, 713, 714, 715, 716, 717, 718, 719, 720, 721, 722, 1003, 1004, 1005, 1006, 1007, 1008, 1009, 1010, 1014, 1015, 1016

were read on this motion to/for RENEWAL.

The following e-filed documents, listed by NYSCEF document number (Motion 041) 746, 747, 748

were read on this motion to/for SEAL.

The following e-filed documents, listed by NYSCEF document number (Motion 052) 1012, 1013, 1173

were read on this motion to/for SEAL.

The following e-filed documents, listed by NYSCEF document number (Motion 053) 1041, 1042, 1172

were read on this motion to/for SEAL.

The following e-filed documents, listed by NYSCEF document number (Motion 054) 1056, 1057, 1174

were read on this motion to/for SEAL.

The following e-filed documents, listed by NYSCEF document number (Motion 055) 1069, 1070, 1071, 1175, 1179, 1180, 1181
were read on this motion to/for SEAL.

The motion for leave (the **Motion**) to renew their motion to dismiss the second amended complaint (the **Complaint**; NYSCEF Doc. No. 29) or, in the alternative, to remedy a fraud on the court by dismissing the Complaint has been withdrawn without prejudice. Had it not been withdrawn, upon the foregoing documents, the Motion would have been denied in its entirety.

The Motion must be denied because the Defendants' request is based (i) on a mischaracterization of the *qui tam* action as being based on bucketing of variable debt rate obligations (**VRDOS**) which it is not and (ii) the incorrect assumption that the court on a CPLR 3211 motion to dismiss could resolve this case based on what amounts to the impeachment of a *non-testifying* expert opinion using interest rate reset information that the Defendants have always had in their possession.

Summary of Holding

As the Defendants well know, bucketing is not the alleged harm that forms the gravamen of the Complaint. The Plaintiff-Relator's well-pled Complaint alleging violation of the New York False Claims Act (**NYFCA**) is based on the Defendants' alleged failure to secure the lowest possible rate for each VRDO as the Defendants were required to do. This, Relator, alleges cost New York State hundreds of millions of dollars. The Relator is and will continue to use discovery to adduce evidence relating to how Defendants set the rate for each VRDO, and whether the lowest possible rate was secured. The facts at issue will then be conformed to the

evidence, which evidence presumably will include expert discovery relating both to consulting *and* testifying experts.

In the Complaint, Relator alleged that Dr. Thomas Wesson observed that the vast majority of VRDOs that the Defendants managed were grouped into "bucket" collections of unrelated bonds where the interest rate was allegedly set collectively and in violation of the Defendants contractual obligation to obtain the lowest possible rate, and that the Defendants failed to take into account the unique and specific characteristics and risk profiles of each VRDO in setting the rates. As this Court previously noted in the Prior Decision (hereinafter defined), it does not matter whether an algorithm was used by the Defendants in setting prices if the lowest possible rate was achieved. Nor does it matter if some of the bonds in the buckets do not move in lock-step. The decision and order of this Court, dated March 27, 2020, (67 Misc.3d 1204[A] [Sup Ct, NY County 2020], *aff'd* 189 AD3d 723 [1st Dept 2020]; the **Prior Decision**) established that the Complaint adequately stated a cause of action and what matters is whether the Defendants met their obligation in setting the lowest possible rate as to each individual VRDO and whether there was a violation of the NYFCA. This is the basis for the claim in the Complaint.

In support of the Motion, the Defendants proffer the expert opinion of Dr. Kristin Willard who interprets the forensic examination of Dr. Wesson and suggests that the analysis should have been done differently, or otherwise does not in every case suggest that the VRDO pricing of dissimilar bonds moved in lock-step, or otherwise suggests that the analysis done by Dr. Wesson compares the data points to a different metric in analyzing the movement of rates. To be clear, Dr. Willard does not conclude that the lowest possible rate as to each of the VRDOs was

obtained. Were this the case, the battle of experts would present a factual dispute not capable of determination on a CPLR 3211 motion to dismiss. **But, this is not even that.** This is merely an attack on the methodology employed by Dr. Wesson and the suggestion that certain data points in buckets did not move as much in lock-step as the Relator has suggested to this Court in satisfying CPLR 3016(b). Stated differently, although the code may have been provided to the Defendants a year ago, the code is not a new fact warranting reconsideration of this Court's Prior Decision because, at most, what is presented by Dr. Willard's analysis is impeachment material.[1] It also does not matter that the code for Dr. Thomas Watson's report which Relator indicates that it relied on in bringing this lawsuit was not available to the Defendants when they filed their previous motion because the methodology that forms the analysis underlying the Complaint was, and the raw data and how *Defendants* set the rates was in their exclusive possession and control. Accordingly, on the record before the Court no fraud has been committed by Relator and dismissal of the Complaint is entirely inappropriate (*cf. CDR Creances S.A.S. v Cohen*, 23 NY3d 307, 321 [2014]).

The motions to seal documents in connection with the Defendants' motion to renew (mtn. seq. nos. 052, 055) and the motion to seal documents (mtn. seq. no. 053) in connection with the Relator's discovery motion (mtn. seq. nos. 046) must be granted in accordance with Part 216 of the Uniform Rules for the Trial Courts for good cause shown. The motion to seal documents (mtn. seq. no. 054) in connection with the Defendants' discovery motion (mtn. seq. no. 043) must be dismissed for lack of good cause shown. For completeness, mtn. seq. no. 041 is

[1] This type of disagreement is not resolvable on a CPLR 3211 motion to dismiss as where a plaintiff brings a lawsuit in New York and the Defendants in their opposition papers adduce an agreement which includes a choice of forum provision designating another forum as the exclusive venue where the dispute must be litigated.

withdrawn and mtn. seq. nos. 052 and 055 are granted as set forth in the parties' stipulation, so-ordered on February 16, 2022.

The Relevant Facts and Circumstances

In this *qui tam* action brought pursuant to the NYFCA, the Relator alleges in the Complaint that the Defendants were required to reset the VRDOs at the lowest interest rate possible (NYSCEF 29, ¶ 43). However, Relator alleges that, instead of resetting the VRDO rates and remarketing the VRDOs on an individual basis as required, the Defendants reset the VRDO rates mechanically and collectively, without considering any unique attributes of an individual bond (*id.*). As a result, bond holders retained their holdings at substantially greater expense to New York where alternate investors would hold the same bond at a lower interest rate (*id.*).

The Relator alleges that he performed a forensic analysis of the interest rates and market data and determined that, for the majority of VRDOs, the Defendants grouped the VRDOs into "buckets" of unrelated bonds and set their interest rates collectively (*id.*, ¶44). This method, the Relator alleges, means that the Defendants never made an individual determination of what the appropriate rate for a particular bond should be, nor did they ever make an effort to secure the lowest possible rate for the bond (*id.*):

> "45. Relator's forensic analysis covers over 20,000 CUSIPs and nearly 5 million data points from several data sources, including non-public, proprietary sources. It also involved a substantial expenditure of resources and time, well in excess of 1,000 hours.
>
> 46. For the purposes of this pricing analysis, a particular bond was considered to be part of a bucket if it had the identical week-over-week rate change as the other bonds in the bucket for at least twenty-six weeks (but typically much longer) and at least 80 percent of the time (but typically much higher). These two bucket threshold "qualifiers" were necessary to account for the periodic sale of the bonds

> or their departure from the market as a result of being paid off or converted to fixed rates. They were also necessary to most accurately capture the extent of the robo-resetting in which Defendants have engaged.
>
> 47. Relator's pricing analysis for each Defendant included all VRDOs it managed with weekly reset dates and for which there were at least twenty rate resets within one twenty six-week interval during the April 1, 2009 through November 14, 2013 period. This represents the lion's share of each Defendant's total VRDO portfolio for the period.2 To avoid doublecounting, once a VRDO was identified as part of a particular bucket, it was removed from the data set even though many of these bonds fell into more than one bucket over the four-and-a-half-year study period."

(NYSCEF Doc. No. 29, ¶¶ 45-47).

In the Prior Decision, the Court denied the Defendants' joint motion to dismiss (mtn. seq. no. 007) and M&T Bank Corporation's motion to dismiss (mtn. seq. no. 006). The Court held that the Relator stated a claim under NYFCA by alleging that the Defendants "bucketed VRDOs that had different characteristics and applied the algorithm without taking into account the differences between the VRDOs in the buckets" (*id.*, at 13). The Court also found that the Relator's forensic analysis was sufficient to withstand a motion to dismiss (*id.*, at 14).

The Defendants now move to renew the motion to dismiss based upon production of the Relator's **Forensic Analysis Documents**, consisting of the **Code**, input files, and output files. Defendants hired Dr. Willard as an expert in computer code and statistical analysis to review and "translate" the Code and the Forensic Analysis Documents. According to Dr. Willard's analysis, the Code did not identify all weeks where bonds in a bucket had the same incremental change. The Defendants allege that the Forensic Analysis did not compare weekly rate changes of bonds in a bucket to each other in those same weeks at all. In fact, according to the Defendants, if the Code worked as the Relator alleged, over a 26-week period the only bonds in one bucket would

be those whose rate changes matched for 80% of those 26 weeks. Dr. Willard's analysis showed a different result than that suggested by Dr. Watson and Relator – *i.e.*, substantial deviation in the bond rate resets in a bucket.

In their opposition papers, the Relator argues that its forensic analysis, conducted by Dr. Wesson, confirms that the Defendants reset rates for the VRDOs at higher rates than comparable securities. Dr. Wesson reviewed the frequency and duration with which the Defendants appeared to apply the same interest reset rates to multiple VRDOs and examined the extent to which the Defendants reset each particular bond with the same reset rate over a 26-week period, subject to qualifiers for irregularities. The Relator alleges that this analysis shows that these resets could not have occurred under ordinary market conditions and that the rates were reset for large numbers of dissimilar bonds in lockstep fashion.

Discussion

Pursuant to CPLR 2221(e), a motion for leave to renew must (i) be specifically identified as such, (ii) be based upon new facts not offered on the prior motion that would change the prior determination or demonstrate a change in the law that would change the prior determination, and (iii) contain reasonable justification for the failure to present such facts on the prior motion. A fraud upon the court requires a showing that "a party has sentiently set in motion some unconscionable scheme to interfere with the judicial system's ability impartially to adjudicate a matter by improperly influencing the trier or unfairly hampering the presentation of the opposing party's claim or defense" (*CDR Creances S.A.S.*, 23 NY3d at 321 [internal quotation marks and

citation omitted]). Dismissal for alleged fraud upon the court is an extreme remedy to be exercised with restraint and discretion (*id.*).

The Forensic Analysis Documents Do Not Constitute New Facts; Renewal is Improper

As an initial matter, it does not matter whether the Relator at this stage offered the analysis of Dr. Wesson. The Prior Decision established that the Complaint adequately stated a cause of action. Moreover, the Forensic Analysis Documents do not constitute new facts to warrant renewal. The data that the Relator and Dr. Wesson in the Forensic Analysis were all within the Defendants' possession. The facts necessary for the analysis were the reset dates and amounts, all of which were not only held by, but were *created* by, the Defendants. The Forensic Analysis Documents are not new facts, but rather indicate how the facts were used to establish a methodology by which a non-testifying expert in this case calculated the rate resetting practices upon which certain of the Relator's claims rest. For purposes of a CPLR 3211 motion to dismiss those facts were taken as true.

However, even if the Forensic Analysis Documents were properly considered new facts, they would still not form the basis for renewal of a motion to dismiss. If the Forensic Analysis Documents and Dr. Willard's analysis had been presented to the Court when the original motion to dismiss was heard, the dispute between experts would still have been inappropriate to address on the motion to dismiss. As the court held in the Prior Decision, the Defendants' contention that the Relator "cherry-picked" the time period for its analysis is better suited for summary judgment, not a motion to dismiss (NYSCEF Doc. No. 159, at 14). The proper methodology for a forensic analysis to determine whether or how the Defendants bucketed dissimilar bonds is not

appropriate for a CPLR 3211 motion to dismiss and therefore not grounds to renew that motion. Rather, the Relator is and will continue to use discovery to adduce evidence relating to how the Defendants set the rate for each VRDO, and whether the lowest possible rate was secured. The facts at issue will then be conformed to the evidence, which evidence presumably will include expert discovery relating both to consulting *and* testifying experts. This has not happened yet, underscoring how premature the pending Motion is. Tellingly, the court notes that the Defendants have not framed their Motion as a motion for summary judgment, underscoring the fact that the Defendants know that the Motion is premature and relates to information that may or may not be central to the ultimate evidence in the case.

Based on the above, the additional contention that the Complaint should be struck due to a fraud on the court is wholly meritless, and indeed, borders on the frivolous. The parties fundamentally disagree on the modality for using the Code and the Forensic Analysis Documents to determine how the VRDOs were bucketed and how rates were reset. That disagreement does not render the Complaint fraudulent, and it is inappropriate for the Defendants to force the Court to expend judicial resources because they felt like shouting "fake news" at their adversary having not completed discovery and in fact having cancelled the deposition of Dr. Wesson in what amounts to be another transparent attempt to limit discovery. The Defendants have not established that the Relator has perpetuated a fraud on the Court because there has yet to be full discovery in this action, including as to consulting *and* testifying experts. Nor has the Court weighed and determined the expert reports and analyses at issue, which is precisely the type of process that occurs on a properly framed motion for summary judgment. The extreme measure of striking the complaint and awarding sanctions is improper, and the motion is denied in its entirely.

As discussed on the record, this Court understands the Defendants' objections to the theory of the Complaint, and has been mindful of the scope of discovery in this case and has taken a measured approach. Discovery must go forward without further delay and come to its conclusion including, without limitation, full expert discovery, which will include the depositions of Dr. Wesson and Dr. Willard. The parties shall submit a deposition to this Court for those depositions at the status conference on Monday, February 28, 2022 @ 9:30 am. As the Court discussed, should the Defendants want to bring wish to bring a CPLR 3212 motion because they believe that the record is sufficiently clear and developed to resolve all material factual disputes, they of course may do so. Although the court indicated that it would consider whether a second summary judgment motion would be permitted at a later date, upon further reflection, the court will not permit a second bite at the apple. There is no "disadvantage" to the Defendants if the factual record is as clear as to the facts as the Defendants suggest.

Good Cause for Sealing Exists

The Defendants and the Relator seek to seal documents in connection with the motion to renew that set forth information on the VRDOs, the methodology of the rate resets at issue in this case, and each of the expert analyses of the VRDOs and the Forensic Analysis Documents. They allege that these documents contain personal identifying information and other sensitive business information that would be detrimental to their businesses if made public. These motions should be granted and the documents sealed for good cause shown. The Defendants also seek to seal documents filed in connection with the Relator's discovery motion seeking, among other things, all relevant documents related to the bonds, and bond transcript documents, all relevant invoices,

all rate resetting documents, etc. They allege that these documents contain sensitive business information that would be detrimental to their businesses if made public. This motion should also be granted and the documents sealed for good cause shown. However, good cause does not exist for the sealing of the retainer agreements and as such this motion must be denied.

It is hereby ORDERED that the motion to renew (mtn. seq. no. 040) and the motion to seal the moving papers in connection with the motion to renew (mtn. seq. no. 041) are withdrawn; and it is further

ORDERED that the motion to seal documents (mtn. seq. no. 054) in connection with the Defendants' discovery motion is denied; and it is further

ORDERED that the remaining motions to seal (mtn. seq. nos. 052, 053, 055) are granted in accordance with Part 216 of the Uniform Rules for the Trial Courts for good cause shown as specified herein; and it is further

ORDERED that the conference scheduled for March 7, 2022 at 11:30am is rescheduled to February 28, 2022 at 11:30am and at that conference the parties shall provide to the court a copy of the deposition schedule for Drs. Wesson and Willard to be completed no later than April 29, 2022; and it is further

ORDERED that if the parties email the deposition schedule to Part 53 in advance of the February 28, 2022 conference, the conference will be adjourned; and it is further

ORDERED that the Clerk of the Court is directed, upon service on him (60 Centre Street, Room 141B) of a copy of this order with notice of entry, to seal NYSCEF Doc. Nos. 1003, 1004, 1014, and 1017 and to separate these documents and to keep them separate from the balance of the file in this action; and it is further

ORDERED that thereafter, or until further order of the court, the Clerk of the Court shall deny access to the said sealed documents to anyone (other than the staff of the Clerk or the court) except for counsel of record for any party to this case and any party; and it is further

ORDERED that the parties shall cause to be uploaded redacted versions of the documents sealed hereby; and it is further

ORDERED that service upon the Clerk of the Court shall be made in accordance with the procedures set forth in the *Protocol on Courthouse and County Clerk Procedures for Electronically Filed Cases* (accessible at the "E-Filing" page on the court's website at the address www.nycourts.gov/supctmanh).

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2/18/2022
DATE

ANDREW BORROK, J.S.C.

CHECK ONE:	[ ]	CASE DISPOSED		[X]	NON-FINAL DISPOSITION		
	[ ]	GRANTED	[ ] DENIED	[X]	GRANTED IN PART	[ ]	OTHER
APPLICATION:	[ ]	SETTLE ORDER		[ ]	SUBMIT ORDER		
CHECK IF APPROPRIATE:	[ ]	INCLUDES TRANSFER/REASSIGN		[ ]	FIDUCIARY APPOINTMENT	[ ]	REFERENCE