Matter of Part 60 RMBS Put-Back Litig.
2017 NY Slip Op 32161(U)
October 13, 2017
Supreme Court, New York County
Docket Number: 777000/2015
Judge: Marcy Friedman

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, defendants move, pursuant to the Case Management Order dated December 7, 2015 (CMO), for an order reversing a May 17, 2017 ruling (Ruling or Interim Order #3) of Hon. Theodore H. Katz (Ret.), the Special Discovery Master for the RMBS putback and monoline cases. The Ruling determined plaintiffs' renewed 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 information provided by borrowers at the time they applied for the loans (borrower information).[1]

Background

In the Ruling, Judge Katz identified three major disputes between the parties regarding verification of borrower information: "(1) the sufficiency of borrower authorizations; (2) the use of publicly available information; and (3) the potential issuance of subpoenas." (Interim Order #3 at 2-3 [NYSCEF Doc No 238][2].) The Ruling was the third in a series of interim orders by Judge Katz addressed to plaintiffs' proposals to verify borrower information by contacting borrowers, employers, or other third parties. In considering plaintiffs' renewed request, Judge

[1] As used in this decision, the term borrower information means information provided by borrowers in their loan applications regarding income and employment.

[2] Docket Numbers refer to NYSCEF Docket Numbers in the Put-Back Master File, Index No. 777000/15.

Katz relied on the record developed on the prior applications and his prior Interim Orders, dated October 3, 2016 (Interim Order #1 [NYSCEF Doc No 245]) and March 27, 2017 (Interim Order #2 [NYSCEF Doc No 249]).

Plaintiffs initially sought to contact and to request information from borrowers' employers or, if they were self-employed, from their accountants; from the borrowers' banks; and from the borrowers themselves. In denying plaintiffs' first application without prejudice to renewal, Judge Katz found that this request was "likely to impose a significant burden upon thousands of individual borrowers and non-parties that is not justified by the present record" (Interim Order #1 at 5), and that plaintiffs had not provided a structure to "ensure that solicitation is minimally inconvenient, non-prejudicial, and lacks the capacity for harassment." (Id. at 3.) Reasoning that "[p]erhaps the most crucial shortcoming in the present record is the absence of any cogent explanation regarding Plaintiffs' authorized use of publicly available information as part of the verification process" (id.), Judge Katz further found that plaintiffs had not shown that "publicly available information is inadequate to reasonably meet [plaintiffs'] reunderwriting needs." (Id. at 4.) Judge Katz concluded:

> "While the verification of borrower information via some form of direct solicitation with appropriate safeguards may ultimately be authorized in some or all of the Part 60 cases, particularly the direct solicitation of employers via a standardized written instrument, that or any other form of direct solicitation shall not be authorized by the Special Master absent: (1) a more complete record that is sufficient to vitiate the various concerns expressed above; and (2) a showing of good cause that must, at a minimum, more clearly explain the inadequacy of the various sources of publicly available information that Plaintiffs have been authorized to leverage."

(Id. at 5.)

After issuance of Interim Order #1, the parties submitted a letter in advance of a status conference, proposing that further applications for verification discovery be made on a case-by-case basis. (See Joint Letter dated Dec. 2, 2016, at 3 [NYSCEF Doc No

188].) At the conference, the court stated that it would be "problematic" to consider these applications on a case-by-case basis, and requested that the parties work toward a general protocol that set standards, with a view to avoiding adverse impacts on the borrowers. (Dec. 6, 2016 Tr. at 10-11 [NYSCEF Doc No 216].)

Following this appearance, and a renewed application by plaintiffs to Judge Katz, the Special Master issued Interim Order #2. He characterized this court's comments at the December 6, 2016 appearance as clarifying the following points: "(1) a Part-60-wide protocol for the verification . . . should be effectuated if practicable, but a case-specific approach to that discovery is not acceptable; (2) the primary considerations for such a protocol are protecting individual borrowers' confidential information and minimizing the intrusion on and harassment of individual borrowers; and (3) designated Counsel for the Parties should negotiate earnestly and in good faith to design such a protocol." (Interim Order #2 at 2.) In response to defendants' objections as to relevance, Judge Katz stated: "[T]hose objections – while perhaps appropriate within the context of an evidentiary objection at trial – are plainly antithetical to the letter and spirit of the CPLR's discovery rules and the Court's commentary during the December 6 Hearing, which viewed reasonably, assumed the general relevance, for purposes of discovery, of the information Plaintiffs proposed to obtain through a borrower verification process and encouraged the adoption of a Part-60-wide protocol for the discovery at issue." (Id.)

On this renewed application, plaintiffs limited the scope of the requested third party information. They no longer sought authorization to make direct contacts with borrowers and, instead, sought authorization to contact employers through a standardized form. The proposed form (Mazin Aff. In Supp., dated Feb. 10, 2017, Ex 3 [Mazin Aff.]) identified the borrower by name and a partial social security number, and requested information limited to the borrower's position; dates of employment; income; whether income included bonuses, overtime, merit pay,

or commissions; and employment status as full- or part-time employee, or contract, seasonal, or on call worker. If a loan file indicated that a borrower was self-employed and contained a statement supplied by an accountant regarding the borrower's income, plaintiffs sought authorization to contact the accountant to confirm the accuracy of the statement at the time it was provided, also through a standard form.

Although noting that plaintiffs had addressed certain issues raised in Interim Order #1—"most notably, eliminating direct contacts with individual borrowers"—Judge Katz found that the parties had not addressed other significant concerns, including "[w]hether publicly available information shall be utilized in all cases and as a first recourse," and the need for a "streamlined process whereby Counsel can certify to the Special Master that publicly available information has reasonably been sought." (Interim Order #2 at 2.) He instructed the parties to meet and confer in an attempt to narrow disagreements and address his specific concerns, and to report the results of negotiations by a joint submission. (Id. at 3.) The parties responded by letter dated April 7, 2017 (April 7, 2017 Joint Letter [NYSCEF Doc No 250]), which identified areas of agreement and disagreement, including disagreement as to whether plaintiffs should be required to demonstrate the insufficiency of publicly available sources of information before proceeding with third party verification.

In Interim Order #3, the Ruling which is the subject of this appeal, Judge Katz ruled on two disputed issues relevant to plaintiffs' application to contact third parties to verify borrower information. First, he held that a mortgage application form completed by many borrowers, the Uniform Residential Loan Application Form 1003 (Form 1003), and various "Borrower Authorization Forms," authorize plaintiffs' reverification of borrower information. (Ruling at 3-4.) Form 1003 (Mazin Aff., Ex 2) includes a provision that the borrower "acknowledges that any owner of the Loan, its servicers, successors and assigns, may verify or reverify any information

contained in this application or obtain any information or data relating to the Loan, for any legitimate business purpose through any source. . . ." Judge Katz held that plaintiffs are the "effective owners of the loans"; and that they "have an objectively legitimate business purpose in seeking the repurchase of the loans and/or damages from Defendants" based on alleged breaches of obligations related to the loans. (Id. at 3.) Judge Katz also held that the other Borrower Authorization Forms authorize the verification at issue. (Id. at 3-4.)

In Interim Order #3, Judge Katz further held that, independent of the borrower consents, the existing Part 60 confidentiality safeguards and the court's supervisory authority over the verification discovery are "sufficient to accord with any arguably-applicable provisions of the federal Gramm-Leach-Bliley Act" (GLBA), which restricts disclosure of consumer information by financial institutions. (Id. at 4.)

Second, Judge Katz required that plaintiffs' counsel "certify that publicly available information was reasonably pursued as part of the verification process." (Id. at 5.) Judge Katz rejected defendants' contention that the unavailability or inadequacy of public information must serve as a predicate to direct solicitation of borrower information, and that plaintiffs must explain the inadequacy of publicly available information before contacting borrowers' employers. (See April 7, 2017 Joint Letter at 3 [Defendants' Position].) He reasoned that "[b]ecause Defendants will (understandably) not stipulate to either the accuracy or admissibility of any borrower information Plaintiffs may obtain from publicly available sources, Plaintiffs cannot – as a matter of law, logic or fairness – be foreclosed from pursuing that information in a reasonable fashion from other sources." (Interim Order #3 at 4.) Finally, Judge Katz declined to determine the appropriateness of the issuance of subpoenas on a litigation-wide basis. (Id. at 5.)

Use of Publicly Available Information

The court agrees with Judge Katz's ruling that contacts with borrowers' employers must be conditioned upon certification by plaintiffs that publicly available information was reasonably pursued as part of the verification process.[3] This court has repeatedly emphasized, in connection with plaintiffs' requests for authorization to verify borrower information, that a primary concern must be to avoid detrimental impacts on the borrowers as a result of the verification process. To this end, the court required a showing, even prior to authorizing plaintiffs to verify borrower information from publicly available sources, that resort to such sources would not result in such impacts. In considering plaintiffs' subsequent request to contact third parties to verify borrower information, the court again stressed the need for a protocol setting forth standards for determining whether verification should be authorized, and procedures for minimizing adverse impacts on borrowers.[4]

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[3] As discussed later in the text, however, third party verification discovery must be further conditioned on a showing that the verification of borrower information is relevant to prove breaches of representations and warranties with respect to the specific loans as to which verification is sought.

[4] More particularly, in the first Case Management Order to address verification, the court directed that the use of publicly available sources be addressed in the first instance with the Special Discovery Master, and that the parties make an "evidentiary showing, to the extent reasonably practicable, that use of such publicly available sources will not have an effect on borrowers' privacy or credit." (CMO #2, dated Mar. 24, 2016, at 3 [NYSCEF Doc No 96].) The CMO further provided that before any party contacted third parties to verify borrower information, a determination must be made "on an appropriate evidentiary record, as to whether such contacts are authorized." (Id.) Judge Katz subsequently issued an order, dated June 13, 2016, determining that plaintiffs have made the requisite evidentiary showing that the use of publicly available information will not have an effect on borrowers' privacy or credit.

In an early conference at which plaintiffs' request to verify borrower information with third parties was raised, the court advised that it would not authorize the "very sensitive disclosure" of borrower information to employers for purposes of pursuing verification, "absent an evidentiary showing at a later stage in the litigation that re-underwriting . . . cannot be properly conducted without such disclosure." (May 13, 2015 Tr. at 15 [NYSCEF Doc No 239] [transcript of conference on proposed master orders in the coordinated litigation, including the case management and confidentiality orders].) At a conference held after Judge Katz issued Interim Order #1, the court declined to approve a proposed protocol, which appeared to provide that the parties could stipulate on a case by case basis to third party verification, and that stipulations to that effect would be presented to the court or Judge Katz for approval. As discussed further below, the court directed the parties to negotiate with a view to developing a protocol that would set standards for determining when verification should be authorized and that would minimize detrimental impacts on borrowers. (Dec. 6, 2016 Tr. at 10-21 [NYSCEF Doc No 216].)

In Interim Order #3, Judge Katz aptly noted that, throughout the history of these coordinated proceedings, the court and he have "intended that publicly available information would serve as a temporal and logical predicate to any direct solicitation of borrower information." (Interim Order #3 at 4.) In light of defendants' unwillingness, however reasonable, to stipulate to the accuracy or admissibility of publicly available borrower information, the court holds that Judge Katz correctly determined that plaintiffs should not be required to make any further evidentiary showing, prior to seeking verification from third parties, that publicly available information is inadequate for purposes of reunderwriting. The court further holds that Judge Katz reasonably exercised his discretion in permitting plaintiffs' counsel, who will oversee and take responsibility for their reunderwriting firms, to "certify that publicly available information was reasonably pursued as part of the verification process." (Interim Order #3 at 5.)

Borrower Consents

The court also approves Judge Katz's ruling, for the reasons stated in Interim Order #3, that borrower consent Form 1003, which was apparently signed by most borrowers, constitutes consent to reverification of borrower information, where reverification is sought by trustee plaintiffs.[5] The record is undeveloped as to whether, or to what extent, monoline insurer plaintiffs, under the governing agreements or otherwise, acquired the rights of owners, and therefore whether they are also owners within the meaning of Form 1003. As to Borrower Authorization Forms that may have been signed by borrowers who did not sign Form 1003, the record before Judge Katz contained an inadvertent error as to the Forms, which was brought to

[5] The authorities cited by defendants, interpreting the term "legitimate business need" under the Fair Credit Reporting Act (15 USC §1681b]), are not persuasive, as they involve factually dissimilar circumstances. (See Defs.' Memo. In Supp, at 8, citing e.g. Bakker v McKinnon, 152 F3d 1007, 1012 [8th Cir 1998] [asserted need by a plaintiff for the defendant's credit report was not a legitimate business need].)

this court's attention on the appeal but not to Judge Katz's attention. The Borrower Authorization Form that was quoted in the briefs to Judge Katz, and based on which he concluded that it also constituted a consent to reverification, permitted "the lender, its successors and assigns, and any investor or mortgage guaranty insurer to verify information 'either before or after the loan is closed or as part of its quality control program.'" (See Interim Order #3 at 3-4.) The Borrower Authorization Form that was in the record before Judge Katz contained different language. Moreover, it became clear on the appeal that the Borrower Authorization Forms are not uniform and may omit the critical words "or after" on which Judge Katz relied. (Defs.' Memo. In Supp. Of Appeal at 6-7; Pls.' Memo. In Opp. at 5-6; Defs.' Reply Memo. at 2-3.) To the extent that plaintiffs may need to rely on Form 1003 to secure employers' cooperation in obtaining verification information in monoline insurer cases, or to the extent they may need to rely on other Borrower Authorization Forms to secure such cooperation where borrowers did not sign Form 1003, plaintiffs must further address with Judge Katz the sufficiency of the Forms to evidence borrower consent to reverification.[6]

Gramm-Leach-Bliley Act

The court also approves Judge Katz's alternative holding that the Gramm-Leach-Bliley Act (GLBA) does not preclude third party verification of borrower information, given the

[6] It is noted that the form that plaintiffs propose to submit to employers to obtain verification of borrower information includes a statement regarding the borrower's consent to the release of the information, and provides for the consent to be attached to the form. (Mazin Aff., Ex. 3 ["Verification of Employment Form," stating, in part: "The information requested is information that the borrower agreed to release, both during the mortgage application process and afterwards, as established by the attached certification form signed by the borrower"].)

This language must be removed from the form where verification is sought by monoline insurers or is sought for any loan for which the borrower signed a Borrower Authorization Form other than Form 1003, unless and until Judge Katz finds (subject to any appeal) that the Forms are sufficient to evidence borrower consent to reverification in such instances.

In addition, to the extent that the form that is submitted to employers attaches the borrower consent form, all information in the borrower consent form must be redacted, except the borrower's name and the authorization provision.

confidentiality safeguards in place in the Part 60 actions and the court's exercise of supervisory authority over the verification process.

The GLBA provides important safeguards for the "nonpublic personal information" of the customers of financial institutions, in order to protect the customers from "substantial harm or inconvenience" as a result of unauthorized access to or use of such confidential information. (15 USC § 6801.) The Act prohibits a financial institution from disclosing nonpublic personal information to a third party, unless it first provides the consumer with notice and an opportunity to opt out of the disclosure. (15 USC § 6802 [a], [b].) The notice and opt-out provisions are, however, subject to numerous exceptions, which include, but are not limited to, disclosure:

> "(1) as necessary to effect, administer, or enforce a transaction requested or authorized by the consumer, or in connection with . . . (C) a proposed or actual securitization . . . ; (2) with the consent or at the direction of the consumer . . .; or (8) to comply with Federal, State, or local laws, rules, and other applicable legal requirements; to comply with a properly authorized civil, criminal, or regulatory investigation or subpoena or summons by Federal, State, or local authorities; or to respond to judicial process or government regulatory authorities having jurisdiction over the financial institution for examination, compliance, or other purposes as authorized by law."

(15 USC § 6802 [e].) Defendants do not cite authority applying the GLBA to bar discovery in an RMBS action. Moreover, there is persuasive general authority that disclosure of nonpublic personal information, within the context of civil discovery proceedings, is authorized under the GLBA pursuant to the judicial process exception set forth in 15 USC § 6802 (e) (8). (Alpha Funding Group, Inc. v Continental Funding, LLC, 17 Misc 3d 959, 965-967 [Sup Ct, Kings County Oct. 23, 2007] [Demarest, J.] [allowing disclosure in response to civil discovery demands, without prior notice to the consumer, based on a review of national authority, and stating that "the courts that have addressed [the issue] have concluded that the GLBA should not bar a proper discovery request so long as the disclosure is made subject to an appropriate protective order"]; Marks v Global Mtge. Group Inc., 218 FRD 492, 495-497 [SD W Va 2003]

[same, stating that "the mere fact that a statute generally prohibits the disclosure of certain information does not give parties to a civil dispute the right to circumvent the discovery process"]; see also Freeman v Seligson, 405 F2d 1326, 1349 [DC Cir 1968] [holding that the Commodity Exchange Act did not bar discovery, under court supervision, of protected information, given the absence of a clear provision in the Act prohibiting disclosure in judicial proceedings].)

Further Limits on Third Party Verification

Review of the record confirms that the Special Master insisted on, and the parties made significant efforts toward, minimizing intrusiveness, potentially harmful impacts on borrowers, and burden on nonparties from whom verification discovery would be sought. These protections included plaintiffs' narrowing of their request to apply only to employers and accountants, not to borrowers themselves or their banks; the use of a standardized form revealing and requesting a sharply limited amount of information (see Pls.' Brief In Supp., dated Feb. 10, 2017, at 1); the inclusion of a disclaimer in the contact form stating that the "inquiry is not being made for the purpose of any investigation, legal action, or collections against the borrower" (Verification of Employment Form, Mazin Aff., Ex. 3); the agreed to limitations on the number of attempts at contact permitted; and a requirement that counsel provide certifications regarding supervision of their underwriting consultants and reasonable pursuit of publicly available information. (Interim Order #3 at 5.)

Nevertheless, the court cannot approve the blanket authorization of verification of borrower information across the tens of thousands of loans at issue in this coordinated RMBS litigation, which Interim Order #3 would apparently countenance. Although the restrictions on verification discovery to which the parties have agreed have significantly alleviated concerns

about prejudice to third parties, the court finds that the relevance of the verification discovery has not yet been fully addressed before Judge Katz.

As noted above, in discussing the relevance issue, Judge Katz concluded that this court had proceeded on the assumption that the borrower verification information that plaintiffs sought was generally relevant across the loan pools.[7] This court's intention at the December 6, 2016 conference was not, however, to make a litigation-wide finding as to the relevance of verification, or to approve verification of borrower information for every loan as to which a plaintiff elected to verify information. Rather, the court sought to impress upon the parties to this coordinated litigation the need to develop a protocol, setting forth both standards for determining the circumstances in which verification is reasonably necessary—i.e., would lead to relevant information—and should therefore be authorized, as well as procedures for minimizing detrimental impacts upon borrowers and undue burden on employers as a result of such requests. Put another way, the intention was to develop a protocol for applying common standards to the individual cases, which would ensure that resolution of overlapping and recurring issues in these cases would occur in a consistent and efficient manner. (See Dec. 6, 2016 Tr. at 10-21.)

To the extent that Judge Katz made an independent finding that the requested third party verification meets the liberal relevance standard for discovery under the CPLR, that finding is not supported by a particularized showing by plaintiffs that verification of borrower information may be relevant to prove breaches of representations and warranties regarding the specific loans as to which verification is sought. This court thus holds that third party verification may not be

[7] Judge Katz discussed the relevance of the requested third party verification, without deciding the issue, in his first ruling. (Interim Order #1 at 2.) He determined the relevance issue in the second ruling (Interim Order #2 at 2), and summarized and incorporated that determination in the ruling at issue. (Interim Order #3 at 2.)

authorized across the loan pools, but only for a more limited subset of loans as to which relevance is shown.

MBIA Ins. Corp. v Credit Suisse Secs. (USA) LLC (103 AD3d 486, 487 [1st Dept 2013] [MBIA], affg Sup Ct, NY County, May 24, 2012, Kornreich, J., index No. 603751/09 [May 24, 2012 Decision on Record]), the sole appellate authority in New York to have considered the standards for authorization of third party verification of borrower information in the RMBS context, addressed the required showing of relevance. There, an RMBS insurer sought verification discovery from borrowers and their employers and banks. The trial court denied the plaintiff-insurer's motion for an open commission to obtain disclosure from employers and from the borrowers in reduced documentation programs, citing concerns about intrusiveness, adverse impacts on borrowers, and relevance. The Appellate Division affirmed the trial court on two principal grounds. First, the Court held that the plaintiff had "failed to make a strong showing of necessity and demonstrate that the information . . . is unavailable from other sources." (103 AD3d at 487 [internal quotation marks and citation omitted].) Although this requirement has been eliminated by the Court of Appeals' subsequent decision in Matter of Kapon v Koch (23 NY3d 32, 38 [2014]),[8] the MBIA Court, in an alternative holding, affirmed the denial of the commission on the ground of relevance. As to relevance, the Court reasoned:

> "Since the parties offer conflicting interpretations of the warranties and representations found in the parties' insurance agreement, the relevance of the requested material is, at best, still yet to be established. Furthermore, in seeking extensive amounts of duplicative, personal and confidential financial information from over five years ago, the discovery request constitutes an undue burden and expense on the responding nonparties. Plaintiff's contention that this discovery is material and necessary to its fraud and breach of contract claims because it could

[8] In Matter of Kapon, the Court of Appeals, citing "this state's policy of liberal discovery," held that CPLR 3101 (a) (4) imposes no requirement that a party seeking third party discovery "demonstrate that it cannot obtain the requested disclosure from any other source." (23 NY3d at 38.) The Court further held that, as in the case of party discovery, "so long as the disclosure sought is relevant to the prosecution or defense of an action, it must be provided by the nonparty." (Id.)

> potentially yield evidence that a borrower fraudulently or negligently misrepresented the financial information provided on his or her mortgage loan application is not supported by particularized factual allegations specific to any of the borrowers selected for this disclosure."

(MBIA, 103 AD3d at 487.)[9]

The plaintiffs in MBIA sought verification discovery by means of depositions of borrowers and employers, and document disclosure including borrowers' personal investment and bank account statements and tax returns. Plaintiffs here seek verification discovery by far more limited means—i.e., a verification form to be submitted to employers with limited follow-up telephone contracts—but over a potentially much larger number of loans, due to the large number of coordinated cases. Notwithstanding this factual difference, the relevance standard articulated in MBIA remains applicable. First, this 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. 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. As discussed below, the first but not the second showing has been made on the record before Judge Katz.

[9] In MBIA, the trial court precluded any discovery of nonparty employers, reasoning that contacts to employers could lead to harassment by employers of the borrowers, if the employers were told that the employees had not been paying their mortgages, that they were in debt, or that there was a possibility that they had lied. (May 24, 2012 Decision on Record at 5.) The trial court did, however, permit discovery of borrowers unless the borrowers had obtained loans in reduced documentation loan programs (including no asset/no income and stated income programs). (Id.) In affirming the decision, the Appellate Division did not hold that plaintiffs should not under any circumstances be permitted to seek verification from employers. Nor did the Appellate Division hold that verification of borrower income is not relevant where loans are made under reduced documentation programs. Rather, as the quoted portion of the decision shows, the decision centered on the absence of any showing of the relevance of the requested verification.

As noted by Judge Katz, plaintiffs have asserted that verification is relevant to proof of four representations[10] typical in RMBS securitizations and referred to by Judge Katz as "exemplars," one or more of which is present in the governing agreements for each Part 60 case. These are the Underwriting Guidelines representation—that the loans complied with the originator's applicable underwriting guidelines; the Mortgage Loan Schedule (MLS) representation—that the information in each trust's mortgage loan schedule is true and correct; the No Fraud representation—that there was no fraud on the part of the borrower or any other party involved in the origination or servicing of the loans; and the No Default representation—that there was no default existing under the mortgage or mortgage related note. (Interim Order #1 at 2.)[11]

In the parties' April 7, 2017 letter to Judge Katz, outlining their continuing disputes, defendants assert that "where the data at issue was not verified at origination (i.e., for stated or reduced documentation loans), and the deal contains no warranty against borrower fraud, direct verifications are unwarranted." (Apr. 7, 2017 Joint Letter at 5.) Defendants assert generally, however, that even where data was verified at origination, third party verification is "still not relevant." (Id.)[12] Plaintiffs in effect counter that a determination of the relevance of the verified

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[10] The words "representations" and "representations and warranties" are used interchangeably in this decision.

[11] Judge Katz noted that a fifth representation, the "No Untrue Statement Covenant," is also present in the agreements for some of the Part 60 cases. (Interim Order #1 at 2.)

The general descriptions of the "exemplar" representations set forth above are those provided in an initial letter to this court from plaintiffs' liaison counsel, seeking authorization to contact third parties to verify borrower information. (Pls.' Letter, dated Aug. 5, 2016, at 2 [NYSCEF Doc No 242].) Defendants' liaison counsel's responsive letter does not dispute the descriptions of the representations, but contests the relevance of verification of borrower information to proof of breaches of the representations. (Defs.' Letter, dated Aug. 26, 2016, at 4-6 [NYSCEF Doc 243].)

[12] It is unclear whether defendants now take the position that verification is not relevant even where the governing agreements for the securitizations contain No Fraud representations. In earlier submissions to Judge Katz, defendants asserted that discovery should not be available as to stated income loans, even if breaches of the No Fraud representation were asserted. (See Defs.' Brief In Opp., dated Feb. 24, 2017, at 6 [stating that most of the loans in the Part 60 cases were reduced documentation loans, where no income information was verified, and "[f]or that reason alone," plaintiffs' verification request should be denied]; Defs.' Letter, dated Aug. 26, 2016, at 4-6.)

information to the claims of breaches of representations and warranties is premature. They further contend that, even if borrower information may not have been verified at the time of origination, there are representations in addition to the No Fraud representation, such as the Mortgage Loan Schedule and No Default representations, which "ensure the accuracy of borrower information" and therefore make verification relevant. (Id.)

In disputing the relevance of verification of borrower information to plaintiffs' claims of breaches of representations, the parties advance conflicting interpretations of the meaning of the various representations. For example, the Mortgage Loan Schedule contains information about each of the pooled loans in a securitization, including the debt to income ratio (DTI) for each loan. Plaintiffs contend that an incorrect DTI, calculated based on a false stated income, will result in a breach of the Mortgage Loan Schedule representation. (See Pls.' Letter, dated Sept. 2, 2016, at 3 [NYSCEF Doc No 244]; Pls.' Brief In Supp., dated Feb. 10, 2017, at 8 [NYSCEF Doc No 246].) Defendants contend that this representation, which typically states that the information on the MLS, including the DTI, is true and accurate, is merely a representation that the DTI, calculated based on stated income, is accurately transcribed from the loan file onto the MLS. (Transcript of Sept. 12, 2016 Oral Argument before Judge Katz, at 50-52.) With respect to the Underwriting Guidelines representation, defendants assert that, under the underwriting guidelines for loans issued in reduced documentation programs, the need for income and employment verification was eliminated and that stated income loan programs assumed that verification would be impossible. (Defs.' Aug. 26, 2016 Letter at 5.) Plaintiffs counter that for stated income loans, "virtually every set of underwriting guidelines required originators to assess the reasonableness of the income stated." (Pls.' Sept. 2, 2016 Letter at 3.) Plaintiffs further contend that for no income loans, "originators had an obligation to consider the borrower's ability to repay the loan by verifying certain information, such as the borrower's employment

history." (Id.) Defendants do not appear to specifically dispute that obligations to assess reasonableness existed under the guidelines even for reduced documentation loans, and have acknowledged that as to loans made under guidelines that did not require verification, underwriters "instead made judgment calls about whether a borrower was qualified for a particular loan. . . ." (Defs.' Aug. 26, 2016 Letter at 5.)

Since the time the MBIA Court reasoned that the relevance of verification had not been established, in part because the parties had offered "conflicting interpretations" of representations similar to those here (103 AD3d at 487), significant authority has developed, in this Department and in other jurisdictions, as to the meaning of these representations and as to the record that should be developed in order to determine such meaning.

There is authority that the MLS representation—that the information in the Mortgage Loan Schedule is "true and correct" as of a specified date or dates—warrants the "truth" or "veracity" of that information. (Bank of New York Mellon v WMC Mtge., LLC, 136 AD3d 1, 7-8 [1st Dept 2015], affd no opinion 28 NY3d 1039 [2016] [on a motion to dismiss, in the course of determining whether the sponsor's MLS representation was a "gap warranty," the Court held that the sponsor warranted the "truth" or "veracity" of the information in the Mortgage Loan Schedule during the specified period for which the sponsor made the warranty, regardless of when the defects in the loans arose and the information in the Schedule became incorrect—whether before or after the sponsor's warranty period]; MBIA Ins. Corp. v Credit Suisse Secs. (USA) LLC, 2017 NY Slip Op 50389 [U], 2017 WL 1201868, * 8-11 [Sup Ct, NY County Mar. 31, 2017] [Kornreich, J.] [on a summary judgment motion, determining the meaning of an MLS representation as a matter of law, and holding that it "guaranteed the accuracy of the information in the MLS," as the plaintiff had argued, and not merely "that the information in the MLS was accurately transcribed from the loan file," as the defendant had argued]; U.S. Bank, Natl. Assn

(2006-OA2, 2007-1, 2006-3) v UBS Real Estate Secs. Inc., 205 F Supp 3d 386, 456 [SD NY 2016] [Castel, J.] [UBS] [after a bench trial, holding that an MLS representation breach relating to DTI "may be established by proving the income information was untrue as of the Closing Date. . ."].)

Other authorities, including the Appellate Division of this Department, have, however, held that the interpretation of certain representations involving borrower information should be decided on a fully developed factual record. (Ambac Assur. Corp. v Countrywide Home Loans, Inc., 151 AD3d 83, 89-90 [1st Dept 2017] [holding that the trial court "erred in interpreting the 'No Default' and 'No Material Monetary Default' representations and warranties, as a matter of law, to include borrower misrepresentation," and citing Bear Stearns Mtge. Funding Trust 2007-AR2 v EMC Mtge. LLC, 2014 WL 2469668, * 2 [Del Ch, CA No. 6861, June 2, 2014] [Laster, VC] for the proposition that the "better course is to hold a trial to inquire into and develop the facts to clarify the relevant legal principles and their application to" these representations]; see also UBS, 205 F Supp 3d at 458, 456 [after a bench trial, finding that "the guidelines required the Originators to determine the reasonableness of stated income, and that the failure to do so constituted a breach of the Guidelines Warranty", and distinguishing between the MLS Warranty and the Guidelines Warranty, on the ground that an MLS Warranty breach relating to the DTI ratio "may be established by proving the income information was untrue as of the Closing Date, regardless of whether the Originator's underwriter or UBS knew or should have known the untruth at that time. A Guideline Warranty breach, however, requires proof of the actions and inactions of the underwriter at the time the loan 'was underwritten'"].)

At the discovery stage of this litigation, this court need not, and does not, finally determine the meaning of the exemplar representations. Under the liberal standard for disclosure imposed by the CPLR, the above authorities are sufficient to show that verification of borrower

information may be relevant to proof of breaches at least of the MLS and Underwriting Guidelines representations. Given defendants' acknowledgment that underwriters were required to make judgment calls as to the sufficiency of information provided by borrowers even on applications for loans issued under reduced documentation programs, a sufficient showing has also been made that verification of borrower information may be relevant to prove breaches of representations regarding such loans. Moreover, the potential relevance of verification of borrower information to proof of the No Fraud representation, if not conceded, is also not persuasively disputed on this record. The court thus holds that plaintiffs have shown that their interpretation of the meaning of the exemplar representations is viable and that verification of borrower information may be relevant to prove breaches of these representations. It is not necessary for plaintiffs, in order to obtain authorization for discovery, to conclusively demonstrate the meaning of the representations and then to make an additional showing that verification of borrower information is relevant to prove the breaches.

In contrast, plaintiffs have made no showing on the record before Judge Katz that verification of borrower information may be relevant to prove breaches of representations with respect to the particular loans to be selected by plaintiffs for verification. An example of a possible protocol for limiting the subset of loans for which verification would be authorized would permit contacts with employers, based on certifications by plaintiffs' counsel that they, or reunderwriters acting under their supervision and for whose actions they agree to be responsible, have undertaken a full review of the relevant loan file; that they have compared the borrower's income and job title, as documented in the loan file, with publicly available data as to statistical salary averages (e.g., data compiled by the Bureau of Labor Statistics or other acceptable public source), or with a publicly available source, if any, of salary information specific to the borrower; and that the comparison has revealed a discrepancy sufficient to raise a red flag

justifying further inquiry into the borrower's income or employment. Such a showing by plaintiffs would be consistent with the requirement imposed by Judge Katz and approved by this court above, that plaintiffs' counsel certify that publicly available information was reasonably pursued as part of the verification process. This showing would also satisfy the requirement that there be "particularized factual allegations specific" to the borrowers for which third party borrower verification discovery is sought. (See MBIA, 103 AD3d at 487; see also UBS, 205 F Supp 3d at 456 [holding that proof that a loan application was underwritten in violation of the underwriters' guidelines involves determination, in the case of a stated income loan, of "whether the stated income raised red flags for the underwriter"].)

In giving this example of a possibly acceptable protocol for limiting the subset of loans for verification, the court does not intend to impose the exact terminology to be used in the protocol or to eliminate other possible protocols. Rather, the development of the protocol remains a matter for further good faith negotiation between the parties, and for approval by Judge Katz in the first instance. The protocol must, however, set standards that can be applied across the Part 60 coordinated cases for selecting a reasonably limited subset of loans for verification. 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.[13] These criteria should not permit employer reverification where the loan file contains documentation from the employer verifying borrower information at the time of the loan application. Similarly, in the case of self-employed borrowers, the criteria should not permit verification of borrower

[13] The criteria might, for example, include the percentage, which should be required to support verification, of the deviation of a borrower's stated income from the statistical average for the borrower's type of employment.

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.

The protocol must also specify procedures for obtaining verification information that will protect borrowers' confidential information and minimize prejudice to borrowers and burden on employers—for example, use of a standard form for submission to employers and stringent limits on the types and content of communications with employers. Although a certification by plaintiffs' counsel as to compliance with the protocol may be appropriate, the loans to be verified should be identified in the certification. The extent of 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.

In sum, the court holds that verification of borrower information may be relevant to plaintiffs' proof of breaches of representations and warranties, and that such verification may be permitted for a reasonably limited subset of loans, subject to development of an appropriate protocol. In so holding, the court finds that the parties, at Judge Katz's directive, have significantly limited the verification discovery to be conducted, and agreed to extensive protections to minimize prejudice to borrowers and undue burden upon employers. Significantly, although defendants, in opposing verification discovery, invoked the potential of such discovery to cause harmful impacts on borrowers (June 29, 2017 Tr. of Oral Argument [Tr.] at 5-6), they have not cited any instance in which harm has been claimed by a borrower as a result of such discovery.[14] The absence of any evidence of actual harm is noteworthy, given that

[14] Notwithstanding their expressed concern about prejudice to borrowers, at the oral argument of this appeal, defendants raised the spectre that if the court were to approve the verification discovery requested by plaintiffs, defendants would undertake their own widespread verification discovery—depositions of "borrowers and lawyers." (Tr. at 41, 44.) This position was inconsistent with defendants' representation to Judge Katz that the parties had reached the following, far more measured, agreement as to discovery by defendants: "The parties have agreed that at this time, Defendants do not intend to seek re-verification of any of the results obtained by Plaintiffs via the Protocol. Defendants reserve all rights to challenge any evidence (at summary judgment or at trial), and reserve the

third party verification discovery has been conducted in RMBS litigation in different courts for many years.

It appears to be undisputed that employer verification discovery has been conducted by plaintiffs, without objection, in at least two major federal RMBS litigations. (Federal Hous. Fin. Agency v Nomura Holding Am., Inc., 74 F Supp 3d 639, 647 [SD NY 2015] [Cote, J.] [noting that post-origination information came from various sources, including employment reverifications and other publicly available information]; Assured Guar. Mun. Corp. v Flagstar Bank, FSB, 920 F Supp 2d 475, 489-490 [SD NY 2013] [Rakoff, J.] [same].) In this Court, commissions for employer verification discovery have been approved on motion or by stipulation. (E.g., MBIA Ins. Corp. v Countrywide Home Loans, Inc., Sup Ct, NY County, Feb. 8, 2012, Bransten, J., index No. 602825/08 ["Stipulation And Order Regarding The Admissibility Of Documents Produced In Response To The Employer And Accountant Subpoenas"]; MBIA Ins. Corp. v Residential Funding Co., LLC, 2011 NY Slip Op 34299 [U], 2011 WL 11187297 [Sup Ct, NY County May 9, 2011] [Fried, J.] [Decision and Order].) Other decisions of this Court have precluded employer verification discovery, emphasizing concern about the adverse impacts of such discovery on the borrowers. (Home Equity Mtge. Trust Series 2006-5 by U.S. Bank Natl. Assn. v DLJ Mtge. Capital, Inc., 2017 NY Slip Op 32053, 2017 WL 4315068 [Sup Ct, NY County Sept. 28, 2017] [Scarpulla, J.] [DLJ]; MBIA, Sup Ct, NY County, May 24, 2012, Kornreich, J., index No. 603751/09, affd 103 AD3d 486, supra.)[15] This court

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right to seek re-verification in individual instances if warranted by the circumstances by application to the Special Master, but do not anticipate doing so at this juncture." (April 7, 2017 Joint Letter, at 2.)

[15] To the extent that the trial court's decision in MBIA categorically rejected employer verification discovery (as opposed to discovery of borrowers), the court respectfully disagrees with the decision. As discussed above, the court finds that the Appellate Division did not adopt a per se rule against employer verification but, rather, concluded that the requisite showing of relevance had not been made.

In precluding employer verification discovery, the trial court's decision in DLJ was not based solely on its concerns regarding intrusion into the borrowers' privacy rights as to employment and finances. (DLJ, 2017 WL

shares these concerns, but expects that the protocol to be developed for limiting the subset of loans to those for which the relevance of borrower verification information is shown will allay the concerns, while striking a proper balance between plaintiffs' need for such information and avoidance of prejudice to borrowers.

It is accordingly hereby ORDERED that defendants' motion for an order reversing the May 17, 2017 ruling (Interim Order #3) of Hon. Theodore H. Katz (Ret.), the Special Discovery Master, is granted solely to the extent set forth in the above decision.

This constitutes the decision and order of this court.

Dated: New York, New York
October 13, 2017

MARCY S. FRIEDMAN, J.S.C.

4315068.) The court also found that "the Trustee has not shown that it would be unable to prove its allegations—that the representations and warranties were breached" by other means than the verification. (Id. at * 4.) In addition, the court had earlier struck subpoenas served by the Trustee, on the grounds that they were "overbroad and burdensome," intrusive into borrowers' privacy, and "not shown to be necessary, i.e., the Trustee did not demonstrate that it did not already have the relevant information or could not get the information it sought through other, less intrusive means." (Id. at * 3.) The court noted that, at the time it struck the subpoenas, the court had given the Trustee "the option of coming back with a more targeted list of discovery, to seek information that had no possibility of already being in the mortgage loan file." (Id.) The Trustee, however, did not return to court for authorization to conduct verification discovery, but proceeded to send forms directly to employers seeking information. In precluding the use of information obtained from such forms, the court expressly found that the Trustee "was seeking essentially the identical information" to that sought in the subpoenas, and had therefore "contravene[d]" the court's order striking the subpoenas. (Id. at * 4.)