SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

MBIA INSURANCE CORPORATION, Plaintiff, - against - CREDIT SUISSE SECURITIES (USA) LLC, DLJ MORTGAGE CAPITAL, INC., and SELECT PORTFOLIO SERVICING, INC. Defendants.	Index No. 603751/09

PLAINTIFF MBIA INSURANCE CORPORATION'S
MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION TO COMPEL

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Plaintiff MBIA Insurance Corporation ("MBIA") respectfully submits this memorandum of law in support of its motion to compel disclosure from defendants Credit Suisse Securities (USA) LLC ("CS Securities"), DLJ Mortgage Capital, Inc. ("DLJ"), and Select Portfolio Servicing, Inc. ("SPS") (collectively "Defendants" or "Credit Suisse"). DLJ and SPS are wholly-owned subsidiaries of Credit Suisse Group.

PRELIMINARY STATEMENT

MBIA brings this motion to compel Credit Suisse to comply with the plain terms of this Court's prior discovery orders. The documents MBIA has obtained from third parties, and from Credit Suisse's piecemeal productions (containing documents that Credit Suisse initially denied it possessed, and then only belatedly and begrudgingly produced after several requests by MBIA for court intervention), reveal that Credit Suisse still has not produced documents and information fundamental to MBIA's core allegations. It should be ordered to do so.

This action arises out of a transaction Credit Suisse sponsored in which it issued, marketed, and sold securities collateralized with more than 15,000 residential mortgage loans it aggregated (the "Transaction" or "HEMT 2007-2"). MBIA alleges (i) that CS Securities fraudulently induced MBIA to insure certain securities issued in the Transaction with misrepresentations and omissions about Credit Suisse's business practices and about the securitized loans (the "Loans"), and (ii) that its affiliate DLJ breached its contractual warranties and commitments contained in the Transaction documents, including but not limited to its obligation to repurchase defective loans from the Transaction trust ("Trust") pursuant to the contractual "Repurchase Protocol."

MBIA seeks compliance in particular with the Court's June 24, 2010 Order setting forth the required scope of disclosure. Contrary to the precise terms of the Court's Order, Credit Suisse refuses to produce (i) "all data and documents relating to securitized loans [Credit Suisse] sold back to the originating banks," (the "Repurchase Documentation") and (ii) "all data relating to sampling of loans for performance on a monthly basis in buckets that included any of the securitized loans and all documents relating [to] the manner in which the performance of the sampled loans were evaluated, for the period beginning with the first securitized loan purchased by [Credit Suisse] through April 30, 2007" (the "Quality Control Documentation").

First, contrary to the Court's Order that Credit Suisse produce all Repurchase Documentation, Credit Suisse refuses to produce documents reflecting the proceeds it received from demands Credit Suisse made on the originators of the Loans. As further described below, the limited disclosure MBIA has obtained in this case thus far establishes what Credit Suisse previously denied, namely, that it engaged in a scheme to defraud the Trusts and enrich its own coffers by (i) issuing repurchase demands on defective Loans that belonged to the Trusts, (ii) pocketing the recoveries from the loans' originators on the ensuing "repricing" transactions or "settlements," and (iii) failing to send the proceeds to the Trust or repurchase the defective loans affected by these transactions. Indeed, emails disclosed by Credit Suisse evidence that Credit Suisse was aware that those repricing proceeds should have been—but were not—credited to the corresponding securitizations that owned the loans.

This Court specifically required Credit Suisse to produce this data (in the January 31, 2011 Order) when MBIA pointed out that Credit Suisse had not complied with the June 24,

2010 Order, but vacated that portion of the Jan. 31, 2011 Order based on Credit Suisse's now-discredited representation that there was no factual support for MBIA's allegations. But the Court also granted MBIA leave to file this motion to afford it the opportunity to support its demands, which we do below. Because the evidence establishes Credit Suisse's self-dealing repurchase scheme, the Court should reinstate its prior ruling requiring Credit Suisse to produce all of its repurchase accounting records so that MBIA can establish the full scope and breadth of this fraud.

Second, contrary to the Court's order that Credit Suisse produce all Quality Control Documentation, Credit Suisse refuses to complete its production of quality control data for the collateral pools that include the Loans. Credit Suisse maintains a "Put Back System" database (the "PBS System") as part of its quality control function. According to Credit Suisse's own polices (obtained through disclosure) the PBS System data will reflect Credit Suisse's understanding as to the breach rate in pools that include the HEMT 2007-2 Loans, what constitutes a loan breach, the analysis of those loans for breaches, and Credit Suisse's determination as to whether there is a basis for Credit Suisse to issue its own repurchase demand to an originator. In Credit Suisse's own words, "PBS is primarily used to keep track of loans which have gone delinquent or have some other violation . . . [L]oans are analyzed and those identified as 'not good' [are] put back for reselling to sellers and brokers." This evidence thus promises to provide crucial admissions as to the central issues in the case, *i.e.*, the quality of the Loans, and Credit Suisse's knowledge regarding the quality of the HEMT 2007-2 Loans. Credit Suisse has wrongfully engaged in machinations to avoid proper disclosure.

Credit Suisse initially failed to disclose the existence of the PBS System—in contravention of this Court's order from more than a year ago to identify all relevant databases. In fact, Credit Suisse expressly denied its existence until *after* MBIA found references to the PBS System elsewhere in Credit Suisse's production. Remarkably, Credit Suisse continues to refuse to provide all of the data necessary from the PBS System to evaluate Credit Suisse's quality control process. In particular, although Credit Suisse has belatedly committed to produce all PBS System data for the Loans, it refuses to produce the analysis of samples drawn from pools that include Loans in the Transaction if the Loans were not included in such samples. That is unacceptable. Credit Suisse represented that the quality control of those sampled loans was the basis for determining whether the Loans should be securitized. Indeed, Credit Suisse's own policies state that Credit Suisse used the results of those quality control samples to identify potential problems permeating the balance of the unsampled loans—including the Loans in the Transaction. In other words, the PBS data for the loans sampled from pools including the Loans reflects, in the Court's words, "the manner in which the performance of the sampled loans were evaluated," and should accordingly be produced pursuant to the Court's June 24, 2010 Order.

MBIA has gone to great effort and expense to demonstrate Credit Suisse's deliberate refusal to comply with this Court's long-standing orders to produce the Repurchase Documentation and Quality Control Documentation. Enough is enough. Credit Suisse should be ordered to comply immediately and fully with its obligations.

BACKGROUND

A. Credit Suisse Obtained and Retained Recoveries on Repurchase Demands for Loans Owned by the HEMT 2007-2 Trust

The first disclosure dispute centers upon Credit Suisse's pre-contractual representations, and its obligations under the Repurchase Protocol, concerning the repurchase of defective loans from the Trust. This is central to this litigation, as Credit Suisse has denied *each and every repurchase demand* made by MBIA—more than 3,750 at this point—stating that defects cited by MBIA do not warrant repurchase, while at the same time brazenly demanding that the originators or sellers of Loans bearing the same defects repurchase those loans *from Credit Suisse* (even though they belong to the Trust). The requested disclosure is material to show (i) that Credit Suisse knew about and obtained repurchase recoveries for defective Loans that it failed to repurchase from the Trust; (ii) the magnitude of the recoveries and the fraudulent intent with which Credit Suisse operated (doubly benefiting from securitizing defective loans and then refusing to repurchase them, all the while obtaining recoveries from the loan originators); and (iii) damages to the Trust, and thus to MBIA, in the form of unremitted recoveries, as well as the basis for an award of punitive damages given the egregiousness of Credit Suisse's conduct.

1. Credit Suisse Committed To MBIA that it Would Identify and Repurchase Defective Loans – But Did Not Do So

In its pitch to MBIA to induce MBIA's participation in the Transaction, Credit Suisse represented that it would diligently seek out and repurchase defective loans it conveyed to the Trust. Indeed, in the pitchbook it presented to MBIA, Credit Suisse represented an entire "credit and compliance organization" dedicated to this function:[1]

[1] *See* Affirmation of Erik Haas, dated Mar. 24, 2011 ("Haas Aff."), Ex. 1, MBIA_CS54369-93 ("Credit Suisse Pitchbook"), Slide 14.

Credit Suisse Mortgage Business

Credit and Compliance Organization

- **Group formally established in mid-2004**
- **Directly staffed with 6 professionals having an average of 12+ years of mortgage banking/lending experience**
- **Group grew to oversee 2 key risk areas of the mortgage business – credit and compliance**
- **Current responsibilities include: underwriting, credit policy, quality control, whole loan sale, whole loan acquisition, repurchases and regulatory compliance (20 employees)**

Credit Suisse further represented that it would "be responsible for repurchasing mortgage loans from the Trust in the event of a breach of any representation or warranty relating to a mortgage loan that materially and adversely affects the interests of the certificate holders in that mortgage loan."[2]

In fact, as described more fully below, Credit Suisse implemented its quality control practices in a fraudulent manner. Unbeknownst to MBIA, Credit Suisse designed its quality control processes to minimize the identification of breaches in Transaction Loans, while making its own put back demands to originators of Transaction Loans, obtaining recoveries on those demands, and turning a blind eye towards its obligation to repurchase these same defective loans from the Trust. In other words, as MBIA has alleged, Credit Suisse doubly benefited from these defective loans: it profited on the securitization of the defective loans into the Trust, and it profited again when it demanded that the originators repurchase the Loans, *even though the Loans at that point belonged to the Trust.*

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[2] *Id.*, Slide 23.

2. Credit Suisse Has Refused to Provide Discovery of Its Improper Put Back Practices

At the parties' January 27, 2011 Status Conference, MBIA sought an order requiring Credit Suisse to produce documents sufficient to show its books-and-records entries for recoveries on repurchase demands it (i.e., Credit Suisse) issued to originators in connection with Loans.[3] MBIA argued that these records are material to show (i) that Credit Suisse knew about, and obtained repurchase recoveries for, defective Loans that it failed to repurchase from the Trust; (ii) that Credit Suisse has acted with fraudulent intent and bad faith in obtaining recoveries on defective Loans while refusing to repurchase them from the Trust pursuant to the Repurchase Protocol; and (iii) damages to the Trust, and thus to MBIA, in the form of unremitted recoveries.

In its January 31, 2011 Order, the Court required Credit Suisse to "produce documents concerning monies received from loan originators for buybacks of loans included in the Transaction that remained in the Trust after the buyback or for which the Trust did not receive all of the monies paid to [Credit Suisse]."[4] Upon Credit Suisse's suggestion that MBIA lacked a factual basis for the request, however, the Court subsequently vacated that portion of the January 31, 2011 Order, citing the absence of "evidence that [Credit Suisse]

[3] MBIA demanded these materials in its initial document requests. *See* Haas Aff., Ex. 2, MBIA's First Set of Requests for Disclosure, Request 39 (seeking documents and data "concerning . . . the entry into [Credit Suisse's] books, records and financial and computer systems of the Transaction, the HEMT Loans, and all related payments and payment obligations"), Requests 30 and 52 (calling for "documents sufficient to show any actual or considered demand or claim on any Originator for repurchase or repricing of any RMBS loan" and "[a]ll documents concerning any actual or contemplated demand or claim on any Originator for repurchase or repricing of any HEMT loan.") Credit Suisse agreed to produce the information to the extent the information was "related to the Transaction, HEMT 2007-2." Haas Aff., Ex. 3, Letter from D. Teshima to D. Slarskey dated Apr. 21, 2010.

[4] Haas Aff., Ex. 4 (Jan. 31, 2011 Order) ¶ 4.

received money from loan originators for loans in the Transaction that were not refunded to [the Trust]."[5] MBIA sought permission to provide evidence of such receipts in this motion.

3. The Evidence Confirms Credit Suisse's Improper Conduct

As set forth below, and *even without the benefit of the disclosure requested* (i.e., book entries and accounting records reflective of Credit Suisse's receipts on its repurchase demands for Loans), MBIA has adduced evidence that, in fact, Credit Suisse has recovered millions of dollars on repurchase demands for Loans that remained within the Trust. The discovery to date, however, only paints part of the picture. Additional discovery is necessary to complete the story and establish crucial elements of MBIA's claims, including the materiality of Credit Suisse's fraudulent practices. Accordingly, the January 31, 2011 Order—which was vacated upon the representation by Credit Suisse that it was unaware of such evidence—should be reinstated.

As an initial matter, evidence from the limited discovery to date has confirmed that Credit Suisse demanded originators repurchase HEMT 2007-2 Loans based on the same types of defects that it later disavowed when MBIA demanded Credit Suisse repurchase Loans. For example, Credit Suisse demanded repurchase of Credit Suisse Loan REDACTED which is a HEMT 2007-2 Loan,[6] from Decision One, its originator, because "[t]he loan was not documented according to the applicable underwriting guidelines."[7] Similarly, Credit Suisse put back to originators other Transaction Loans for reasons such as failure to comply with underwriting standards, misstatements of income and occupancy, and "possible

[5] Haas Aff., Ex. 5 (Feb. 1, 2011 Order).

[6] *See* Mortgage Loan Schedule, previously provided to the Court on February 1, 2011, and available at http://www.sec.gov/Archives/edgar/data/1396301/000088237707001445/d664781-ex4_1.htm, Schedule I (listing loan numbers of Transaction Loans).

[7] *See* Haas Aff., Ex. 6, CS_M0005921311-14 (Email from J. Nordyk to J. Quarto, dated Dec. 11, 2007, and attached Repurchase Demand from Credit Suisse to Decision One, undated).

fraud."[8] Yet when MBIA raised these same types of defects as justifying repurchase of Transaction Loans, Credit Suisse uniformly rejected them.

Just as egregious, Credit Suisse massaged its quality control process and its repurchase demands, with the stated intent to "avoid the previous approach by which a lot of loans were QC'd regardless of opportunity for put-back and a lot of negative results were emailed to [the Credit Suisse put back group] but not widely seen, *creating a record of possible rep/warrant breaches in deals.*"[9] To avoid creating these records, Credit Suisse emphasized quality control review for "early payment defaults," and cited early payment default as the basis for many of its repurchase demands. This avoided creating a paper trail of underwriting defects that would concretely have triggered Credit Suisse's own repurchase obligations under the Transaction documents.

But as Credit Suisse knew full well, these "early payment defaults" (or "EPDs") were red flags of borrower fraud. An EPD occurs when a borrower fails to make a payment within the first few months after obtaining a loan. That is highly irregular, as a mortgage loan typically is the most significant personal obligation undertaken by individuals. It was well understood, both by Credit Suisse and in the industry, that an EPD is an indicator that

[8] *See* Haas Aff., Ex. 7, CS_M0005844157-58 (demanding repurchase of Loan for borrower misrepresentation of income and occupancy); Ex. 8, CS_M0005844198-204 (demanding repurchase of Loan for the borrower's failure to disclose additional debt); Ex. 9 CS_M0005468876-78 (putting back Loan as part of a global settlement with New York Mortgage Company for payment default and "possible fraud situation); Ex. 10, CS_M0005846576-79 (demanding repurchase of Loan for borrower misrepresentation of income and employment history and failure to meet underwriting guidelines). According to the monthly Trustee Investor Reports, *available at* https://trustinvestorreporting.usbank.com, none of these loans were repurchased from the Trust by Credit Suisse. Loan remains in the Trust as of the February 2011 Trustee Report; the other three were, at some point after Credit Suisse found these credit breaches, charged off from the Trust. *See id.*, Trustee Loan Level Data for October 2007, November 2007, and March 2008.

[9] Haas Aff., Ex. 11, CS_M0005775490 (Email from P. Sack to R. Sacco et al., dated Apr. 9, 2007). *See also* Haas Aff., Ex. 12, CS_M0005776348 (Email from P. Sack to M. Daniel, et al dated June 18, 2007) (seeking to avoid "generating inordinate correspondence re potential lo its that we may not repurchase from securitizations").

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a loan was not properly originated to applicable underwriting guidelines, and in particular that the loan was approved based on borrower misstatements or omissions. In fact, a Credit Suisse trader clearly recited his "experience that FPD [first payment default] loans are generally fraud."[10]

Having identified vast numbers of Loans in the Transaction with EPDs, Credit Suisse nonetheless did not live up to its representations to diligently review and repurchase the Loans that breached securitization representations. To the contrary, Credit Suisse deliberately disregarded the obvious defects in order to pursue and preserve its own profitability. That is, rather than diligently seeking out and repurchasing defective loans that were conveyed to the Trust – as Credit Suisse promised MBIA it would do – Credit Suisse surreptitiously demanded the originators of the Loans to "repurchase" them from Credit Suisse.

Once Credit Suisse demanded repurchase from the originators (which constitutes an admission by Credit Suisse that the Loans were defective), Credit Suisse employed one of several different strategies to obtain recoveries from the originators of defective Loans, *without meeting its obligation to repurchase the Loans from the Trust*. This, of course, was advantageous to Credit Suisse because it obtained a recovery from the originator without incurring a loss on the repurchase from the Trust. For example, rather than completing a repurchase of a loan—which would entail Credit Suisse repurchasing the loan at full value from the Trust, transferring the loan to DLJ, and then from DLJ to the originator—Credit Suisse frequently asked the originators simply to "reprice" the loans. A reprice entailed Credit Suisse "selling" the loans back to the originator at the purchase price, and

[10] Haas Aff., Ex. 13, CS_M0005533719 (Email from T. Cassan to B. Kaisermain, dated Aug. 21, 2006).

simultaneously "buying" those same loans back at a much lower price, reflecting the loan's reduced value based upon the defects that Credit Suisse identified. The effect of these book entries was that Credit Suisse demanded and received a sum of money from the originator to "keep" a defective loan (though it belonged to the Trust), rather than incur the obligation to pay the full value of the defective loan and repurchase it from the Trust. Through this subterfuge, Credit Suisse profited from these transactions, while the Trust (and by extension MBIA) bore the cost of holding defective loans, for as long as Credit Suisse could stave off its obligation to repurchase the defective loans.[11]

The Credit Suisse production provides ample evidence of repricing transactions, even though Credit Suisse has resisted full disclosure. In one example from September 2007 (roughly six months after the Transaction closed), Credit Suisse engaged in a repricing transaction with Decision One.[12] Credit Suisse "sold" to Decision One seventeen loans, including sixteen loans that were owned by the HEMT 2007-2 Trust,[13] for a total of $1,332,229.52. It then—in the same transaction—bought those loans back for $215,868.39, for a profit of $1,116,361.13.[14] The accompanying emails indicate that this net gain recovered by Credit Suisse *was deposited in Credit Suisse trading accounts* and not remitted to the Trust, despite the fact that the Trust owned all but one of the loans in question.[15] Credit

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[11] Credit Suisse also failed to notify MBIA or the Trustee of breaching loans, as it was obligated to do. *See* Pooling and Servicing Agreement § 2.03(e) (provided to the Court on Feb. 1, 2011) (requiring Credit Suisse to notify the Trust of breaching loans).

[12] Haas Aff., Ex. 14, CS_M0005578581-CS_M0005578583 (Email from A. Horn to G. McMillan, dated Sept. 26, 2007, and attached email from J. Quarto to CSFB RMBS Middle Office, dated Sept. 26, 2007, and Repricing Memo to Decision One, settling Sept. 26, 2007).

[13] *See* Mortgage Loan Schedule, *supra*, n. 6.

[14] *See* Haas Aff., Ex. 14 at CS_M0005578583.

[15] *See id.* at CS_M0005578581-82.

Suisse engaged in a similar repricing transaction with Decision One in August 2007.[16] That trade netted Credit Suisse a total of $3,047,060.82 and included thirty-six Transaction loans. MBIA has identified several additional repricing transactions involving Loans. In each case, Credit Suisse profited from "repricing" of Loans, based upon defects Credit Suisse identified that led to Credit Suisse's repurchase demands.[17]

Trades such as these demonstrate Credit Suisse's illicit practice of (i) issuing repurchase demands on defective Loans, (ii) pocketing the recoveries on the ensuing "repricing" transactions or "settlements," and (iii) failing to send the proceeds to the Trust or repurchase the defective loans affected by these transactions. Indeed, emails disclosed by Credit Suisse evidence that Credit Suisse was aware that the corresponding loans should have been reviewed for breaches of Credit Suisse's representations and warranties to the securitization participants (including MBIA), and the repricing proceeds accordingly credited to the corresponding securitizations that owned the loans.[18]

An alternate practice of Credit Suisse's that allowed it to profit while avoiding a repurchase of the Loan from the Trust, was, after Credit Suisse issued repurchase demands, to enter into a global settlement agreement and release with an originator, pursuant to

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[16] Haas Aff., Ex. 15, CS_M0005815707-CS_M0005815709 (Email from D. Hyman to CSFB RMBS Middle Office, dated Aug. 10, 2007, and attached Repricing Memo to Decision One, settling Aug. 10, 2007).

[17] Several additional repricing transactions are evidenced in the incomplete production obtained from Credit Suisse to date. *See, e.g.*, Haas Aff., Ex. 16, CS_M0005643110 (repricing transaction with Wall Street Mortgage Brokers for settlement Jan. 14, 2008 containing five HEMT 2007-2 loans), Ex. 17, CS_M0005893275-82 (repricing transaction with Ace Mortgage Company for settlement or settlement on Nov. 9, 2007 containing 1 HEMT 2007-2 Loan), and Ex. 18, CS_M0005893322 (repricing transaction with J&J Mortgage Corp. settling June 29, 2007 containing two transaction loans).

[18] Haas Aff., Ex. 19, CS_M0004264749-50 (Email from P. Sack dated Jan. 17, 2007, describing 350 loans where Credit Suisse "rec'd a check from the originator based on CTO [repricing] but we did not repurchase the loan from the deal or pass the $ to the trust . . . it would be best if we can demonstrate that we conducted a review to determine whether these loans breached securitization reps.").

which Credit Suisse waived its repurchase rights with respect to loans in the Trust in exchange for consideration from the originator.[19] Credit Suisse separately calculated the consideration it received for repurchased loans and the consideration it received for the global release it granted the originator, but apparently did not remit to the Trust any portion of the consideration it received, including for the release.[20] Of course, without the benefit of the disclosure sought with this motion, it is impossible to determine what happened to these funds.

The effect of these settlement agreements was that Credit Suisse obtained recoveries, in exchange for a release of its rights, a portion of which should rightfully have been allocated to the loans Credit Suisse acquired from the originator and conveyed to the Trust. And as a practical matter, once Credit Suisse entered into a global release agreement with an originator, Credit Suisse developed an incentive *not* to honor its contractual obligation to repurchase defective loans from the Trust: Because it could no longer put the defective loan back to the originator, any defective loan Credit Suisse might repurchase from the Trust would be—dollar for dollar—money out of Credit Suisse's pocket.

An example demonstrates this powerful disincentive, as applied to the HEMT 2007-2 Loans described above that Credit Suisse put back to Decision One. Credit Suisse entered into a settlement agreement with Decision One in December 2009, pursuant to which it released Decision One from further liability to repurchase defective loans.[21] But Credit Suisse had sold 1,541 Decision One loans into the HEMT 2007-2 Trust, with an average

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[19] *See, e.g.*, Haas Aff., Ex. 20, DOMC00231-DOMC00234 (Decision One Settlement Agreement).

[20] *See* Haas Aff., Ex. 21, CS_M0005643582 (Email from M. Dellafera dated Dec. 19, 2008) (breaking out Decision One settlement agreement into separate amounts for (i) settlement of early payment default claims, (ii) settlement of prepayment penalty claims, and (iii) a premium for a global release).

[21] *See* Haas Aff., Ex. 20, DOMCC00231-DOMC00234 (Decision One Settlement Agreement).

balance at closing of more than $55,000. Accordingly, assuming a breach rate of only 50% (far less than MBIA alleged in its Complaint, based upon its litigation-related investigation into the loans), faithfully repurchasing defective loans from the Trust could have cost Credit Suisse as much as $42 million (based on outstanding loan balance as of closing). Once Credit Suisse released Decision One, if Credit Suisse honored its repurchase obligations under the Transaction documents, it would be forced to repurchase loans at par from the Trust with no means to recoup from the originator. So powerful was the disincentive not to make repurchase payments to the Trust, that Credit Suisse had a "general rule," that it "d[idn't] repurchase any del[inquent] loans from deals unless [Credit Suisse was] simultaneously selling them back to the originator," so as to avoid "get[ting] stuck with the loan in the markdown account," i.e., taking the loss.[22] Of course, Credit Suisse did not disclose this practice to MBIA as it was persuading MBIA to participate in the Transaction.

MBIA is entitled to discovery on these improper practices now, as the disclosure is directly material to Credit Suisse's motive to repudiate the Repurchase Protocol, its knowledge of defective loans in the Trust, its fraudulent intent, and the damages incurred by the Trust and MBIA as a result of Credit Suisse's duplicitous practices.

B. Credit Suisse Violated the Court's Orders by Failing to Make Full Disclosure of Its Quality Control Data

The second dispute at issue in this motion concerns Credit Suisse's refusal to provide sufficient disclosure of its quality control data.

1. Credit Suisse's Representations Regarding Quality Control Review Were An Inducement for MBIA to Participate in the Transaction

[22] Haas Aff., Ex. 22, CS_M0005660020-21 (Email from P. Sack to T. Steczkowski, dated Mar. 20, 2008) and Ex. 23, CS_M0005775323-25 at 24 (Email from P. Sack to M. Daniel dated Jan. 5, 2007) (reflecting concerns about repurchasing loans that Credit Suisse could not put back).

MBIA alleges that CS Securities fraudulently induced it to participate in the Transaction by means of "false statements and omi[ssions of] material facts," about Credit Suisse's business practices and the quality of the loans conveyed to the Trust, including misrepresentations about Credit Suisse's quality control practices and findings.[23] Some of these fraudulent misrepresentations were memorialized in the pitchbook that Credit Suisse presented to MBIA in soliciting MBIA's participation in the Transaction. Slide 20 of the Credit Suisse Pitchbook summarized Credit Suisse's purported quality control procedures, as represented to MBIA.[24]

> Residential Mortgage Backed Securities Group
>
> **Post Close Quality Control**
>
> - Objective - Increase the quality of loans originated / acquired by testing loans diligenced / not diligenced.
> - Analysis - All loans selected for QC review receive a full credit and compliance underwrite. The underwrite includes re-verification of assets, income, credit worthiness, property value and compliance with state / federal regulatory laws.
> - Sampling - 3% of all loans originated / acquired by all business channels are selected for analysis.
> - Communication - Monthly meetings are held with each business channel to discuss findings and design preventative policies.

In fact, given the extensive defects and breach rates of the Loans, it is apparent that these quality control commitment were illusory.

2. MBIA Has Been Stymied in Its Efforts To Obtain Discovery Regarding Credit Suisse's Quality Control Practices

Given the significance of these representations, MBIA has sought discovery related to them. On January 10, 2010, MBIA issued its first set of document requests to Credit Suisse. Request 39 calls for documents and data "concerning . . . quality control, fraud detection, or claims or repurchase demands by or against [Credit Suisse], concerning any of

[23] Ex. 24, Complaint, First Cause of Action, ¶¶ 80-85.

[24] Ex. 1, Credit Suisse Pitchbook, Slide 20.

the HEMT Loans."[25] Credit Suisse agreed to produce the information requested by Requests 39 to the extent the information was "related to the Transaction, HEMT 2007-2."[26]

MBIA has consistently maintained that quality control data "related to the Transaction, HEMT 2007-2" comprises all quality control data and related analyses associated with the monthly samples drawn by Credit Suisse from pools of its inventory loans containing Loans, whether or not the sample (by chance) happened to contain a HEMT 2007-2 Loan. This is based on Credit Suisse's practice of conducting quality control by sampling its entire inventory of loans by channel of acquisition and loan type, and Credit Suisse's intent and understanding that the results of that sampling should be extrapolated to any unsampled or unreviewed Loans at issue in this litigation.[27]

Credit Suisse has resisted this argument. Credit Suisse initially failed even to disclose the existence of its quality control database (the PBS System) in violation of the Court's February 22, 2010 Order to disclose all relevant databases, and continued to deny its existence in response to a direct inquiry from MBIA.[28] After MBIA found references to the PBS System in manuals that the Court compelled Credit Suisse to produce (at MBIA's request, because Credit Suisse's databases were produced incompletely),[29] Credit Suisse

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[25] Haas Aff., Ex. 2, MBIA's First Set of Document Requests.

[26] Haas Aff., Ex. 3, Letter from D. Teshima to D. Slarskey dated Apr. 21, 2010.

[27] Haas Aff., Ex. 25, CS_M0004252914, et seq., ("Credit Suisse RMBS Conduit Process Control Manual") at CS_M000425342. *See generally* CS_M000525341-48.

[28] Haas Aff., Ex. 26, Feb. 25, 2010 Order, Ex. 27, Letter from D. Teshima to D. Slarskey dated Mar. 23, 2010 (attaching list of "Defendants' Data Storage Systems" not including the PBS System), and Ex. 28, Email from D. Teshima to D. Slarskey dated Oct. 27, 2010 (stating that "quality control information is not maintained in the databases").

[29] Haas Aff., Ex. 29, Dec. 10, 2010 Order.

acknowledged the PBS System but refused to produce relevant information from it.[30] Credit Suisse first took the position that only results reflecting the *actual evaluation* of Loans were relevant, which was rejected by the Court in its June 24, 2010 Order; and, more recently, Credit Suisse has parsed that Order to assert that it is only required to produce "quality control data on [the] PBS [System] related to the Loans and the quality control pools ... *in which [a] HEMT 2007-2 loan was reviewed.*"[31] Credit Suisse's proposed disclosure would ignore sampling data on loans like the Transaction Loans—the results of which were used to evaluate the Transaction Loans—if a Transaction Loan was not included in the particular sample.

As noted, in its June 24, 2010 Order, the Court adopted MBIA's view of the relevant quality control data and documents, ordering disclosure of all data that may have been useful in evaluating Loans:

> [Credit Suisse] shall produce all data relating to sampling of loans for performance on a monthly basis in buckets that included any of the securitized loans and all documents *relating to the manner in which the performance of the sampled loans were evaluated*, for the period beginning with the first securitized loan purchased by Defendants through April 30, 2007.[32]

The Court reiterated that sound logic in the January 31, 2011 Order requiring production of the PBS System data specifically.[33]

3. Limited Discovery To Date Confirms the Relevance of the Sought-After Quality Control Data.

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[30] Haas Aff., Ex. 30, Email from D. Teshima to D. Slarskey dated Jan. 26, 2011 (denying the relevance of PBS System Data).

[31] Haas Aff., Ex. 31, letter from D. Teshima to D. Slarskey dated Mar. 16, 2011.

[32] Haas Aff., Ex. 32, June 24, 2010 Order (emphasis added).

[33] Haas Aff., Ex. 4 (Jan. 31, 2011 Order).

The validity of MBIA's argument and the Court's rulings has been corroborated by Credit Suisse's disclosure of its policies and the quality control procedures it should have performed. Through disclosure MBIA has obtained a copy of Credit Suisse's RMBS Conduit Process Manual (the "CS Manual"), which sets forth that Credit Suisse intended and understood its sampling methodology to "*provide an inference of the findings to the balance of the population*," including unsampled Loans.[34] Accordingly, Credit Suisse should be compelled to produce, on a loan-by-loan basis, any PBS System data, and any related analysis, for sampled loans *drawn from pools of loans containing Loans*, whether or not—as Credit Suisse now seeks to limit production—"a HEMT 2007-2 loan was reviewed" in the sample.[35]

To be more specific, the PBS System data will reflect Credit Suisse's understanding as to what constitutes a loan defect, because the quality control process entails the sampling of loans, the analysis of those loans for defects, and Credit Suisse's determination as to whether there is a basis for Credit Suisse to issue its own repurchase demand to an originator. According to Credit Suisse, "PBS is primarily used to keep track of loans which have gone delinquent or have some other violation . . . [*L*]*oans are analyzed and those identified as 'not good' [are] put back for reselling to sellers and brokers.*"[36] Credit Suisse's own records confirm that it generated quality control data on a sample basis so that it could evaluate potential defects in the remainder of its inventory. As a result, documents and data

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[34] Haas Aff., Ex. 25, Credit Suisse RMBS Conduit Process Control Manual at CS_M000425342.

[35] Haas Aff., Ex. 32, Letter from D. Teshima to D. Slarskey dated Mar. 16, 2011 at 2.

[36] Haas Aff., Ex. 33, CS_M0005721845, et seq. ("RPM/PBS System Overview") at 850 (emphasis supplied). *See also id.* at CS_M0005721866 ("PBS is a system used by internal Quality Control Group of Credit Suisse to manage the QC process. It provides a platform for users to get loans from RPM, take sample from loans, upload QC results, *make analysis, decide whether to putback loans or not, and generate advice letters.*").

regarding these samples contain critical information about Credit Suisse's loan portfolio, including those that were included in the Transaction.

ARGUMENT

It is axiomatic that New York law strongly favors open and far-reaching pretrial discovery. CPLR 3101(a) provides for "full disclosure of all matter material and necessary in the prosecution or defense of an action." The Court of Appeals interprets § 3101 to require "disclosure, upon request, of any facts bearing on the controversy which will assist preparation for trial by sharpening the issues and reducing delay and prolixity." *Allen v. Crowell-Collier Publ. Co.*, 21 N.Y.2d 403, 406, 235 N.E.2d 430, 452 (1968); *see also Osowski v. AMEC Constr. Mgmt., Inc.*, 69 A.D.3d 99, 106, 887 N.Y.S.2d 11, 15-16 (1st Dep't 2009) (applying *Allen*). Full disclosure is critical when, as here, MBIA has the higher burden on its fraud claim of proving Defendants' knowledge and intent by clear and convincing evidence, and when the nature of Defendants' actions intentionally has been obscured.

In addition, although it should go without saying, proper and efficient discovery requires compliance with this Court's Orders—which Credit Suisse has avoided. "[C]ompliance with a disclosure order requires both a timely response and one that evinces a good-faith effort to address the requests meaningfully." *Kihl v. Pfeffer*, 94 N.Y.2d 118, 123 (1999). Credit Suisse has already been ordered to produce all of the materials sought with this motion, by the Court's June 24, 2010 Order. The pattern of Credit Suisse's failure to disclose, evasion, and recalcitrance, which has required MBIA to repeatedly seek the Court's intervention to obtain compliance, reflects Credit Suisse's lack of good faith in failing to comply with the Court's prior orders. Indeed, it was only after MBIA threatened this motion, that Credit Suisse—last week—formally acknowledged its obligation to

produce quality control data from the PBS System, though of course it continued to evade full disclosure with its parsing of its obligations.

I. Credit Suisse Must Produce Books and Records Reflecting its Recoveries on Its Putback Demands for Loans

There can be no serious dispute as to the relevance of the cash flows associated with Credit Suisse's repurchase demands and recoveries on HEMT 2007-2 Loans that it failed to repurchase from the Trust, for the reasons set forth above. Indeed, the Court ordered that data to be produced in its January 31, 2011 Order, only vacating that portion of the Order when Credit Suisse raised the specter that there may not be a factual basis for MBIA's allegations. This was nothing more than a purposeful and improper delay tactic, given the availability to Credit Suisse of the information that MBIA has set forth herein, and the records that MBIA seeks to have produced. Nonetheless, the Court expressed understandable incredulity that Credit Suisse could have engaged in such brazen conduct as demanding originators repurchase defective loans—and collecting on those demands—without notifying the Trust that it was holding defective loans, remitting those funds to the Trust, or repurchasing the defective loans. Incredible though it may seem, MBIA has shown that this is exactly what Credit Suisse did.

At the January 27, 2011 conference, and on several telephone calls thereafter, the Court asked MBIA to provide a factual basis for an order compelling Credit Suisse to produce the books and records and accounting entries related to those recoveries. That standard has now been met in spades, by MBIA's piecing together the documents produced, even without the full disclosure sought. The limited disclosure pieced together by MBIA herein makes clear that Credit Suisse *recovered large sums of money* from those originators for defects on Loans, without repurchasing the loans or passing the proceeds through to the

Trust, all while denying MBIA's repurchase demands. MBIA has met the Court's request to show a factual basis for this disclosure even before obtaining the relevant disclosure. Credit Suisse should be called to fully account for all consideration it received in connection with its repurchase demands or settlements relating to Loans, producing documents sufficient to show the timing, amount, and allocation of such recoveries or consideration that affects the Loans.

II. Credit Suisse Must Make a Full Disclosure of the Quality Control Documentation, Including PBS Data

Neither can Credit Suisse seriously contest that its quality control data and related analyses (including the repurchase demands that reflect Credit Suisse's conclusions about loan defects and their resolution) are relevant to the factual determination as to whether it performed the quality control analysis that it represented to MBIA it would perform and to show whether Credit Suisse faithfully applied the same standards in responding to MBIA's repurchase demands as it applied when *Credit Suisse* demanded repurchase of loans. Indeed, Credit Suisse did not contest the relevance of such data in responding to MBIA's document requests, and on that basis alone could be held to have waived any objection to production. *See Anonymous v. High School for Envtl. Studies,* 32 A.D.3d 353, 358, 820 N.Y.S.2d 573, 578 (1st Dep't 2006) ("Defendants['] fail[ure] to object to the March 24, 2004 document demand within the 20 days set forth in CPLR 3122(a) . . . generally limits [the Court's] review to the question of privilege under CPLR 3101(b)").[37]

[37] As an alternative to formal responses and objections, the parties engaged in discovery correspondence to surface any disputes over scope prior to the June 2010 status conference. Credit Suisse did not dispute that quality control data related to the HEMT 2007-2 Transaction was relevant.

Instead, after simply failing to disclose the relevant database and documents (and being called to account for them by MBIA after MBIA developed the evidence through third-party and court-ordered disclosure), Credit Suisse has sought to parse the standard set forth in the Court's June 24, 2010 Order in a way that minimizes its disclosure obligations. Most recently, Credit Suisse has taken the position that it is only obligated to produce "quality control data on PBS related to the Loans and the quality control pools (or 'buckets,' as referred to in Item 4 of the Court's June 24, 2010 Order) *in which an HEMT 2007-2 loan was reviewed.*"[38] This is not a good faith attempt to comply with the plain terms of the June 24, 2010 Order.

This is a simple issue. The PBS System, as described above, is a compilation of data on a loan-by-loan basis, the function of which is to manage Credit Suisse's quality control processes including the analysis of whether loans identified through quality control sampling are "not good," and accordingly "put back for reselling to sellers and brokers."[39] In light of Credit Suisse's policy that quality control sampling was intended to "provide an inference of the findings to the balance of the population,"[40] Credit Suisse should be ordered to (i) identify all loans that were designated for quality control purposes from any inventory of loans containing a HEMT 2007-2 Loan (whether or not the sample drawn from that inventory contained a HEMT 2007-2 Loan), and (ii) produce *all PBS Data associated with those loans*, along with any other documents reflecting, in the words of the Court's June 24,

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[38] *See* Haas Aff., Ex. 32, Letter from D. Teshima to D. Slarskey dated Mar. 16, 2011. Credit Suisse claims that it is voluntarily producing "all data on PBS related to any one of the HEMT 2007-2 loans." MBIA respectfully submits that this production is far from voluntary; it has required several court orders, and MBIA's diligent discovery of this database as a result of its extensive efforts to obtain relevant data from Credit Suisse and third parties.

[39] Haas Aff., Ex. 34, RPM/PBS System Overview at 850.

[40] Haas Aff., Ex. 26, Credit Suisse RMBS Conduit Process Control Manual at CS_M0005479779.

2010 Order, the "manner in which the performance of the sampled loans were evaluated." Credit Suisse will undoubtedly say that the PBS System contains *additional* irrelevant data, and that it should be allowed to hand-pick the data to produce. But in light of Credit Suisse's pattern of evasion and refusal to disclose even the fundamental existence of the database, the Court should require a full production of the PBS System data, for the sampled loans associated with the HEMT 2007-2 Loans, unredacted for what Credit Suisse unilaterally determines to be relevant. Anything short of that simply invites further efforts by Credit Suisse to avoid full disclosure of its quality control practices, which were the subject of pre-contractual representations and which will shed light upon Credit Suisse's performance of its repurchase obligations to MBIA.

CONCLUSION

For the foregoing reasons, Credit Suisse should be ordered:

1. To produce documents sufficient to show the treatment in Credit Suisse's books and records of any consideration recovered in connection with any repurchase demand for a HEMT 2007-2 Loan, including but not limited to any repurchase monies, repricings, or amounts associated with related global settlements.

2. To identify all loans designated for quality control review from any population that contained one or more of the Loans (the "Quality Control Loans") and produce all data from the PBS System for the Quality Control Loans, along with all documents reflecting any putback analysis or repurchase demands for the Quality Control Loans, and the basis for those demands, for the period of time from the date that Credit Suisse acquired the first HEMT 2007-2 Loan, through the date of its last quality control sample drawn from a population of loans containing one or more of the HEMT 2007-2 Loans.

Dated: New York, New York
March 25, 2011

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