

Home Equity Mtge. Trust Series 2006-5 by U.S. Bank N.A. v DLJ Mtge. Capital, Inc.
2017 NY Slip Op 32053(U)
September 28, 2017
Supreme Court, New York County
Docket Number: 653787/2012
Judge: Saliann Scarpulla
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

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HOME EQUITY MORTGAGE TRUST SERIES
2006-5 BY U.S. BANK NATIONAL ASSOCIATION,
SOLELY IN ITS CAPACITY AS TRUSTEE,

Plaintiff,

-against-

Index No. 653787/2012

DECISION AND ORDER

DLJ MORTGAGE CAPITAL, INC., SELECT
PORTFOLIO SERVICING, INC.,

Defendants.

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HON. SALIANN SCARPULLA, J.:

In this action, *inter alia*, to recover damages for breach of contract, defendants DLJ Mortgage Capital, Inc. (“DLJ”) and Select Portfolio Servicing, Inc. (“SPS”) move to preclude plaintiff Home Equity Mortgage Trust Series 2006-5, by U.S. Bank National Association, solely in its capacity as Trustee (“Trustee”) from relying on employment and income information obtained from borrowers’ employers, and to award DLJ and SPS costs associated with bringing this motion.

In 2006, DLJ originated or acquired more than 12,000 residential mortgage loans. The Home Equity Mortgage Trust Series 2006-5 (“Trust”) was created to hold the mortgage loans and SPS was named mortgage servicer for the Trust. The Trust issued mortgage backed securities collateralized by the mortgage loans. More than \$780 million in securities were issued. The money collected through timely payments of principal and interest on the mortgage loans by the borrowers constituted the source of revenue for holders of the securities.

Subsequently, the mortgage loans began defaulting at high rates. The Trustee obtained copies of the loan files from third parties and conducted a review that allegedly showed that many mortgage loans were defective.

DLJ had made certain representations regarding the mortgage loans and promised to repurchase the mortgage loans if those representations proved false, pursuant to the remedy provision of the applicable Pooling and Servicing Agreements. The Trustee demanded that DLJ repurchase those defective loans, but DLJ refused. The claims in this action are for alleged breaches of representations and warranties governing the mortgage loans.

In February 2015, the Trustee served **several hundred** subpoenas on the employers and accountants of non-party mortgagees in multiple states. DLJ and SPS demanded that the Trustee withdraw the subpoenas because they were burdensome, intrusive and harassing. The Trustee then moved by order to show cause for permission to pursue discovery under the subpoenas issued. DLJ and SPS opposed and requested that the responses be stricken and destroyed.

At the oral argument on March 25, 2015, I held:

There's no doubt in my mind that you knew this was going to be controversial. And rather than request a conference to discuss it, if you wanted to have a smaller amount of subpoenas sent that would really target the information that you want, you could've easily asked for a conference...so for the foregoing reasons, because I find that in accordance with the First Department's decision with respect to the burdensomeness, the private confidential information that is being sought, the fact that I still haven't heard that this information would not be either verified or not verified by the loan documents themselves, the loan files themselves, and I am not satisfied that these subpoenas were sufficiently narrowly targeted to avoid any of those issues, I'm going to strike the subpoenas. If you would like to come back with a smaller targeted list that has directly to information that is not contained,

that has no possibility of being in the loan file and is necessary to prove your case, the feel free to do it...If you want to come back, I'm not opposed to discovery.

Given that the Trustee had already started receiving responses to the subpoenas, the Trustee was instructed to not use the information already obtained and to immediately notify the remaining subpoena recipients that they should not respond.

Subsequently, in April 2016, the Trustee disclosed the Expert Report of Richard W. Payne, III Regarding the Underwriting of Mortgage Loans Underlying the HEMT Trusts (the "Payne Report") which contained many allegations of breaches of loan-level representations and warranties. In the Payne Report, Payne relied on information obtained through "re-verification" of borrowers' employment information. The Trustee mainly relied on two sources of information for re-verification of borrowers' employment information. First, it relied on income verification reports ("Work Number Reports") obtained by the Trustee through the Work Number database, a public database maintained by Equifax.¹ Second, if the Trustee was unable to obtain verification of a borrower's employment and income through the Work Number database, the Trustee collected employment and income information through verifications of employment ("VOE") created by the Trustee's forensic analyst and faxed to employers, and then followed-up by up to three phone calls.

¹ Although Work Number reports can be obtained from the database without contacting borrower employers, some of the Trustee's inquiries into the database had employers contacted to re-verify or update borrower employment or income information.

In seeking this employment information, the Trustee did not disclose that it was for litigation purposes, and instead, the VOEs represented to the employers that the information was sought for “quality assurance” or “quality control” review and the Work Number Reports represented that the information was sought for “a review or collection of the employee’s account” or in connection with a consumer’s “application for credit.”

Defendants now move to preclude the Trustee from relying on the employment and income information obtained from borrowers’ employers. They argue that the Trustee violated the Court’s March 25, 2015 order that the Trustee was prohibited from relying on employment and income information it obtained by soliciting borrowers’ employers. In addition, the Trustee ignored the directive that if it wanted to seek employment information, it would have to request permission from the Court before doing so. At that time, the Trustee did not inform the court during the oral argument that it was already seeking to obtain borrower income and employment information through means other than the subpoenas. In addition, the Trustee never returned to court asking for permission to obtain any additional borrower employer information.

Defendants also argue that in any event, the information solicited is irrelevant. According to defendants, many of the loans were originated under reduced documentation loan programs that did not even require an initial verification of the borrower’s income information. Further, it was improper to seek the verification of information that was not verified during the origination of a reduced documentation loan.

Defendants additionally maintain that the loan files, which the Trustee already possesses, would contain any information that had been used to verify borrowers’ income

and employment at the time of origination. Finally, they argue that the solicitation of the borrower income and employment information violated the Fair Credit Reporting Act and the Gramm-Leach-Bliley Act.

In opposition, the Trustee explains that while re-underwriting a sample of loans in this litigation, it exercised its contractual right to conduct reverifications as authorized by borrowers in their loan contracts. The borrower authorization, contained within the loan application signed by every borrower, provided:

Acknowledgement: Each of the undersigned hereby acknowledge that any owner of the Loan, its servicers, successor, 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 purpose through any source, including a source named in this application or a consumer reporting agency.

Authorization to Release Information

I/We have applied for a mortgage loan from [lender]. As part of the application process [the lender] may verify information contain in my/our loan application and in other documents required in connection with the loan, either before the loan is closed or as part of its quality control program.

I/We authorize you to provide to [lender], and to any investor to whom [lender] may sell my mortgage, any and all information and documentation that they request. Such information includes, but is not limited to, employment history and income; bank, money market, and similar account balances; credit history; and copies of income tax returns.

According to the Trustee, it was contractually authorized to conduct the reverifications and sought to reverify only the borrower's employment and income information as part of determining whether the loans complied with DLJ's warranties and representations. It chose to do so through Work Number Reports and VOEs. They were completed by the end of February 2015. The Trustee explains that it disclosed that it had

been conducting these additional reverifications in its order to show cause.² The Trustee claims that my March 25, 2015 decision did not bar the Trustee from relying on information obtained from these re-verifications, rather, I merely barred the Trustee from invoking the court's discovery powers through subpoenas to borrowers' employers, and from relying on responses to subpoenas that had already been served. The Trustee claims that it did not rely on any information it received in response to the subpoenas.

Discussion

On March 25, 2015, I struck the hundreds of subpoenas that the Trustee served on non-party borrowers' employers. Contrary to the Trustee's contention now, I did not merely do so simply to bar the Trustee from using the subpoena discovery mechanism. I struck the subpoenas because they were so overbroad and burdensome, they were incredibly intrusive into the non-party borrowers' privacy rights as to their employment and finances, and were 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. I gave the Trustee the option of coming back

² In one paragraph of their February 2015 order to show cause, the Trustee stated "plaintiffs have been engaging in discovery ... in support of an intensive expert examination of the loans in Plaintiffs' sample to determin[e] if they comply with DLJ's Representations and Warranties. This expert re-underwriting process includes comparing the loan file to underwriting guidelines and all Representations. To this end, the Trusts have sought to verify certain employment and income information in each loan application by examining each loan file, obtaining publicly available information through bankruptcy records and similar filings, and submitting requests for verification of the employment, income and deposit information in those loan files."

with a more targeted list of discovery, to seek information that had no possibility of already being in the mortgage loan file.

At no time during that oral argument did the Trustee reveal that it had already been seeking the borrowers' employment information through other means, *i.e.*, the Work Number database and the VOE. While it was vaguely mentioned in a paragraph in its order to show cause, the Trustee never specifically informed the court that it was seeking essentially the identical information, that I had just found to be burdensome and overly intrusive, through other means. Directly contacting the borrowers' employers through the VOEs contravenes my March 25, 2015 holding that it was inappropriate to invade the borrowers' privacy rights and employment by directly contacting their employers for the purposes of litigation discovery.

Further, the Trustee has not shown that it would be unable to prove its allegations – that the representations and warranties were breached – by means other than disrupting non-party borrower privacy and employment rights. The Trustee's claim, that it sent the faxes and subpoenas to employers simply as a permissible loan reverification tool, is meritless. This litigation was commenced in 2012. The Trustee's hundreds of subpoenas and fax requests, sent many years after litigation was commenced, were plainly used to support the Trustee's litigation position, as amply demonstrated by the Payne Report.

As such, the Trustee is precluded from relying on employment and income information obtained from the VOEs. As the Work Number database is a public database

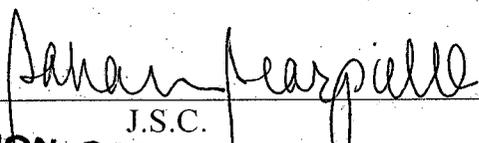
tool, reports generated by the Trustee through information received from that database will not be precluded.

In accordance with the foregoing, it is hereby

ORDERED that defendants DLJ Mortgage Capital, Inc. and Select Portfolio Servicing, Inc.'s motion to preclude plaintiff Home Equity Mortgage Trust Series 2006-5, by U.S. Bank National Association, solely in its capacity as Trustee from relying on employment and income information obtained from borrowers' employers, and to award DLJ and SPS costs associated with bringing this motion is granted only to the extent that plaintiff is precluded from relying on employment and income information obtained through Verifications of Employment faxed to employers.

This constitutes the decision and order of the court.

Dated: September 28, 2017
New York, New York


J.S.C.
HON. SALIANN SCARPULLA