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Practical Considerations For Litigating Against SPVs

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In the wake of the financial crisis, many lawsuits seeking to recover damages for alleged investment losses have been filed by special-purpose vehicles (SPVs). Some of these entities were created specifically for litigation, while others were pre-existing investment vehicles that ended up owning litigation claims.

In the simplest terms, an SPV is a legal entity created to fulfill a narrow and temporary objective, and they typically are used to protect other parties — including their founders, managers, creditors and owners — from unintended risk.[1] They are widely used in securitization and other structured finance endeavors, such as collateralized debt obligations (CDOs), which depend on the precise identification and allocation of investment risks. Most SPVs do not have any employees and act solely through individuals employed by or associated with other entities that provide services to the SPV. That organizational structure gives rise to complex litigation issues that courts are beginning to address.

This article, which is divided into two substantive parts, describes some of the issues that counsel litigating against SPVs should consider and offers some practical insights on those points. The first part addresses the typical parties and claims in recent SPV litigation and, in particular, examines the suitability of SPVs as class representatives. The second surveys issues that arise during discovery, such as how counsel obtains documents and testimony relevant to the case where the SPV itself has no employees or records.

Typical Parties and Claims

In litigation arising out of the financial crisis, the SPVs asserting claims can be divided into three broad categories: (1) investment funds controlled by institutional investors; (2) stand-alone trusts that issue securities, in the form of securitizations or CDOs; and (3) entities created for the purpose of asserting litigation claims, sometimes as part of a “bad bank” that was spun off to hold nonperforming, high-risk or illiquid assets. Each category of SPVs presents its own challenges.

Investment funds are often the nominal plaintiffs in securities fraud and breach of contract cases, although typically such funds have no employees and do not conduct

independent operations. The critical considerations for parties defending claims asserted by such funds are to identify the employees of the entity that directed the activities of the fund, and to ensure that documents are collected and produced from the (potentially more than one) corporate department or entity that interacted with the fund.

Trusts used to issue securities are administered by a set of administrative parties, such as indenture trustees, securities administrators, servicers and collateral managers. The activities of those administrators are tightly circumscribed by contract. When a trustee takes actions that go beyond its typical ministerial roles, attorneys are usually at least heavily involved, if not leading the effort. Thus, discovery related to the actions of corporate or indenture trustees is often limited by the application of the attorney-client privilege or attorney work-product protection. Frequently, more fruitful sources of discovery for these issuing entities are collateral or investment managers that, depending on the nature of the security, are responsible in the ordinary course of business for selecting and monitoring the collateral underlying the security.

"Bad bank"-type entities present perhaps the most complex issues in connection with litigation. From a defendant's perspective, it is essential that the plaintiff have possession of, or at least unrestricted access to, all relevant data, documents and witnesses associated with the original owner of the claims asserted. As discussed below, well-established case law enforces the fundamentally equitable proposition that a litigant cannot strip itself of discoverable information prior to asserting claims and thereby establish a one-sided discovery process.

Regardless of the type of plaintiff entity, claims concerning securities are frequently asserted as class actions. A plaintiff class may be certified only if it meets the initial requirements of Rule 23 of the Federal Rules of Civil Procedure: numerosity, commonality, adequacy and typicality, and superiority. Whether some types of SPVs can be considered an adequate class representative for purposes of Rule 23 remains an open question.[2] For example, if an SPV plaintiff is unable to comply with discovery requests, whether as a result of its lack of resources, lack of relevant information, or both, it may not be considered an adequate class representative.[3] It is also unclear whether all SPVs would have "typical" claims where the investor's investment process is at issue; that is especially so for the bad-bank variety, which acquire assets precisely because they are somehow underperforming. Other issues worthy of consideration by litigants include (1) whether SPVs that receive essentially valueless assets from the original holder meet the "injury in fact" requirement for standing, (2) the viability of asserting counterclaims against an SPV that may be undercapitalized, and (3) whether SPVs that receive assets of value are vulnerable to having such transfers characterized as fraudulent conveyances in the event that the original holder is, or becomes, insolvent.

Discovery Issues

Proportionality Principles. Litigation against SPVs that have no employees or records raises numerous discovery-related issues. As an initial matter, this feature might weigh in favor of broader discovery from nonparties that are associated with the SPV, such as managers and other service providers. In addressing a discovery dispute pursuant to Federal Rule of Civil Procedure 26(b)(1), a court would have to balance the probative value of the information sought against the burden that nonparties affiliated with the SPV would face in responding.[4] The court might find it significant if the SPV is a "passive entity" that simply bought and held securities and if the employees of a nonparty, like a collateral manager, made decisions on the SPV's behalf. If that is the case, a court might be inclined to rule that the unique nature of an SPV that lacks employees militates in favor of permitting an opposing party to take more comprehensive discovery from nonparties, including from collateral managers and any

company that the SPV engaged to provide due diligence and litigation consulting services.

Possession, Custody, and Control of Documents. Because an SPV might well lack any employees and other infrastructure associated with a typical business entity, such as email servers and file cabinets, counsel will likely have to look elsewhere for this material, usually to the SPV's service providers. But before resorting to a subpoena, there is another avenue that counsel should consider for obtaining such documents. The contracts that govern the relationship between an SPV and its service provider might contain a document-sharing provision that grants the SPV the right to seek documents from its counterparty. Depending on its language, such a provision might provide the basis for counsel to argue that the SPV has "control" over documents that are physically located at a separate entity.

Deposition Practice. One approach is for counsel to take a 30(b)(6) deposition of the SPV at the beginning of the discovery period to identify the key players who made decisions on the SPV's behalf. The SPV might claim that it cannot produce a corporate representative, again citing its lack of employees or access to documents. While courts have not yet squarely addressed this issue, the CDO's ability to direct its counsel and perform other tasks, such as verifying interrogatory responses, should undercut that argument.[5] Even if counsel decides not to use a 30(b)(6) deposition for this purpose, the transaction documents that govern the SPV will likely provide clues to who was calling the shots on behalf of the SPV. Recent case law involving claims filed by CDOs that purchased residential mortgage-backed securities (RMBS) certificates demonstrates that there are numerous entities and individuals with potential useful information, including the CDO's collateral manager, its directors and other service providers, such as litigation consultants.

Obligation to Produce Assignor Documents. SPVs frequently acquire securities by assignment, and such assignment may include the right to bring claims related to such securities. Where a plaintiff asserts claims that have been assigned to it by another entity, courts require the assignee to obtain and produce relevant documents from the assignor, to the same extent as if such documents were in the possession, custody and control of the assignee plaintiff.[6] Indeed, courts have found that allowing assignors to benefit from their lack of discoverable information would be patently unfair[7] and are generally unsympathetic to arguments relating to the burden on assignors.[8] Recently, in the context of a "bad bank" SPV, several courts in the Southern District of New York have cited Winnick in requiring the SPV to produce documents from its claim assignor, regardless of arguments concerning the burden of obtaining and producing documents held overseas from a foreign entity.[9]

SPVs remain a useful tool and are frequently used across the commercial landscape — from corporate acquisitions to structured finance. Litigation practitioners, whether asserting claims on behalf of SPVs or defending claims asserted by them, will benefit from a practical consideration of the strengths and weaknesses of these entities in formulating an overall litigation strategy.

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[1] See, e.g., Fed. Housing Fin. Agency v. Nomura Holding Am. Inc., 104 F. Supp. 3d 441, 579 (S.D.N.Y. 2015) (describing SPVs in that case as "shells, with no employees or assets aside from what they held for

purposes” of their parent company’s RMBS business).

[2] For example, recent decisions in the Southern District of New York concerning a putative class action represented by a “bad bank” SPV plaintiff have rejected the class, without prejudice, on ascertainability grounds. See Royal Park Invs. SA/NV v. Deutsche Bank Nat’l Tr. Co., 2017 WL 1331288 at *9 (S.D.N.Y. April 4, 2017). The court has yet to resolve the issue of whether the SPV’s limited ability to participate in discovery renders it an inadequate class representative. Id. at *12.

[3] See Koss v. Wackenhut Corp., 2009 WL 928087, at *7 (S.D.N.Y. Mar. 30, 2009) (“A class representative is a fiduciary to the entire class and bears a responsibility to comply with discovery requests.”); see also 5 James Wm. Moore et al., Moore’s Federal Practice ¶ 23.25(c)(i) (3d ed. 2016) (class representatives must “comply with reasonable disclosure obligations or discovery requests”).

[4] Fed. R. Civ. P. 26(b)(1).

[5] See Fed. R. Civ. P. 33(b)(3) & (5).

[6] See JPMorgan Chase Bank v. Winnick, 228 F.R.D. 505, 506 (S.D.N.Y. 2005) (requiring plaintiff to produce assignor documents, and noting that, “[i]t is both logically inconsistent and unfair to allow the right to sue to be transferred to assignees of a debt free of the obligations that go with litigating a claim”; otherwise “the assignor would be able to assign a claim more valuable than it could ever have, because its claim, if pursued by the assignor, would entail certain obligations that, when assigned, would magically disappear”).

[7] See Bank of New York v. Meridien BIAO Bank Tanzania Ltd., 171 F.R.D. 135, 149 (S.D.N.Y. 1997) (concluding it would be “patently unfair” to let an assignee evade discovery obligations that the original debt owner would have had to sustain, leaving the opposing party to obtain the discovery from the original debt owner).

[8] See, e.g., Winnick at 507 (stating that if “the assignees failed to obtain rights to insist on cooperation from their assignors in providing such discovery, and cannot persuade [the assignors] to cooperate now, that is their problem, not defendants.’”).

[9] See, e.g., Royal Park Invs. SA/NV v. Deutsche Bank Nat’l Tr. Co., 314 F.R.D. 341, 347 (S.D.N.Y. 2016) (directing “Royal Park to produce documents held by BNP Paribas to the same extent that it would be required to produce those documents from its own files”); Order, Royal Park Invs. SA/NV v. U.S. Bank Nat’l Assoc., No. 14-CV-2590-VM/JCF (S.D.N.Y. Mar. 30, 2016) (ECF No. 78) (ordering Royal Park to produce documents held by its assignors); Order, Royal Park Invs. SA/NV v. HSBC Bank USA, N.A., 14-CV-8175-LGS/SN (S.D.N.Y. Dec. 4, 2015) (ECF No. 89) (ordering Royal Park to produce relevant documents held by BNP); Apr. 24, 2017 Hr’g. Tr., Royal Park Invs. SA/NV v. HSBC Bank USA NA, 14-CV-8175-LGS/SN (S.D.N.Y.) (ECF No. 347 at 35-36) (ordering Royal Park to produce assignor documents based on the parties’ agreed-upon search terms).

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