UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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BLACKROCK BALANCED CAPITAL PORTFOLIO (FI), et al.,

Plaintiffs,

-against-

HSBC BANK USA,

Defendant.

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14-CV-09366 (LGS)(SN)

ORDER

SARAH NETBURN, United States Magistrate Judge:

The plaintiffs sued HSBC in its capacity as the trustee for certain residential mortgage backed securities trusts ("RMBS"). The plaintiffs allege that HSBC failed to intervene or take corrective action when the trusts' value plummeted during the residential mortgage crisis. According to the plaintiffs, HSBC knew about the pervasive origination and servicing abuses that led to widespread mortgage default and catastrophic loss of value in the RMBS trusts. At issue in this motion are the PSA trusts, which are governed by New York law. With respect to those trusts, the plaintiffs assert breaches of contract, fiduciary duty, duty to avoid conflicts of interest, and the Streit Act.

The plaintiffs bought many of their PSA certificates on the open market at distressed prices after their value had collapsed. HSBC argues that the plaintiffs will not be able to prove economic harm because they bought the certificates knowing they were worthless. The plaintiffs argue that HSBC's breaches are ongoing. They also purport to assert the rights of prior certificate holders. According to the plaintiffs, those rights were transferred along with the certificates by the automatic operation of General Obligations Law § 13-107.

HSBC now seeks to compel the plaintiffs to produce document discovery from any prior certificate holder whose rights they intend to assert. The plaintiffs argue that prior holders' documents are not within their custody or control, and, consequently, HSBC cannot compel their production. But even assuming that HSBC has a right to them, the plaintiffs claim that they cannot produce documents "from likely thousands of prior owners with whom Plaintiffs have no relationship whatsoever." ECF No. 159 at 1. RMBS certificates trade anonymously on the open market, are not tracked by any unique identification number, and are sold by financial intermediaries who do not own them. See ECF No. 164 at 1-2. They also argue that third-party documents would not be relevant to claims or defenses in this case.

According to HSBC, third-party documents could prove its affirmative defenses or show that the plaintiffs lack standing to assert prior owners' claims. HSBC acknowledges that identifying former owners might be difficult, but it insists that allowing the plaintiffs to assert third parties' litigation rights without assuming their discovery responsibilities would be both unprecedented and unfair. HSBC believes that the plaintiffs can identify former owners by serving subpoenas on the financial intermediary counterparties who sold the RMBS. According to HSBC, the plaintiff in a related case did just that in order to establish numerosity for a purported class action. See Royal Park Investments SA/NA v. HSBC Bank USA Nat'l Assoc., S.D.N.Y. 14-cv-08175 (LGS)(SN), ECF No. 137 at 1.

The Court rules that the plaintiffs should bear the burden of obtaining third-party document discovery from prior owners whose rights they intend to assert. Yet, because the plaintiffs have shown that this discovery will be burdensome, the Court will compel only limited discovery to determine how much third-party discovery will be proportional to the needs of the case.

DISCUSSION

Under the General Obligations Law, "a transfer of any bond shall vest in the transferee all claims or demands of the tranferrer, whether or not such claims or demands are known to exist, (a) for damages or rescission against the obligor on such bond, (b) for damages against the trustee or depositary under any indenture under which such bond was issued or outstanding . . . ." N.Y. Gen. Obligations Law § 13-107(1). Section 13-107 makes the transfer of rights the automatic result of a bond transfer, and transferees may "assert the claims that the transferor could have asserted, whether or not the transferees themselves suffered any injuries." Bluebird Partners, L.P. v. First Fidelity Bank, N.A., 97 N.Y.2d 456, 462 (2002). Section 13-107 allows a bondholder to sue a trustee even when the bondholder had prior knowledge of any alleged breaches. LNC Invs., Inc. v. First Fidelity Bank, N.A. N.J., 173 F.3d 454, 462 (2d Cir. 1999).

For the purposes of this motion, the parties do not dispute that the certificates at issue are "bonds" under the statute. Indeed, § 13-107 applies on its face to the PSA trusts because they include "shares and interests in an issue of bonds, notes, debentures, or other evidences of indebtedness of individuals, partnerships, associations or corporations, whether or not secured." N.Y. General Obligations Law § 13-107(2); see Okla. Police Pension & Ret. Sys. v. U.S. Bank, Nat'l Ass'n, 986 F. Supp. 2d 412, 415-16 (S.D.N.Y. 2013) (applying § 13-107 to RMBS trusts). Thus, § 13-107 would appear to allow the plaintiffs to assert the claims of prior PSA certificate holders.

HSBC argues that the transfer of any right to sue also entails the transfer of document discovery obligations. According to HSBC, the transfer of rights under § 13-107 is indistinguishable from a written assignment of rights. Assignees generally have a duty to obtain document discovery from assignors because "it is both logically inconsistent and unfair to allow

the right to sue to be transferred to assignees" without also assigning "the obligations that go with litigating a claim." JPMorgan Chase Bank v. Winnick, 228 F.R.D. 505, 506 (S.D.N.Y. 2005) (Lynch, J.). Otherwise, an assigned claim would be more valuable than an unassigned claim because discovery obligations "would magically disappear." Id. Because assignees sue "in the shoes" of the original rights holder, "there is nothing unfair about imposing on them the cost of purchasing cooperation or otherwise complying with discovery obligations." Id. at 507. See also In re NTL, Inc. Secs. Litig., 244 F.R.D. 179, 196-97 (S.D.N.Y. 2007); Bank of N.Y. v. Meridien BIAO Bank Tanzania Ltd., 171 F.R.D. 135, 149 (S.D.N.Y. 1997).

Applying Winnick, courts in this district have compelled RMBS certificate holders to produce third-party document discovery from prior owners. In Royal Park Investments SA/NV v. HSBC Bank USA, N.A., the court ruled that Royal Park, the assignee of RMBS formerly held by BNP Paribas, should be compelled to produce documents in BNP Paribas's possession. The court concluded that "if anyone can and should secure production of relevant documents held by BNP Paribas, it is Royal Park." S.D.N.Y. 14-cv-8175 (LGS)(SN), ECF No. 89 at 5 (Scheindlin, J.). The court reached the same conclusion in Royal Park Investments SA/NV v. Deutsche Bank Nat'l Trust Co., holding that Royal Park "'should properly bear the risks and burdens of discovery'" of documents from its assignor, BNP Paribas. 14-cv-04394 (AJN)(BCM), 2016 WL 1317979, at *6 (S.D.N.Y. Feb. 5, 2016) (quoting Winnick, 228 F.R.D. at 507) (Moses, J.).

The plaintiffs argue that they are not assignees in the usual sense because they received a transfer of rights by the automatic operation of § 13-107, rather than by a written agreement with an assignor. According to the plaintiffs, this difference has both a legal and a practical significance. As a legal matter, the plaintiffs do not have a relationship of privity with prior owners that would put those owners' documents within the plaintiffs' "possession, custody, or

control" as required by Federal Rule of Civil Procedure 34(a)(1). As a practical matter, the plaintiffs argue that they cannot identify all prior owners or obtain documents from numerous, anonymous third parties.

To illustrate these points, the plaintiffs distinguish this case from the Royal Park cases. Royal Park, the plaintiffs argue, is a special purpose vehicle created to handle BNP Paribas's toxic RMBS assets, and it received written assignments of all rights and obligations arising from those assets. It therefore has an ongoing relationship with BNP Paribas—in fact, the bank is a shareholder and a member of Royal Park's board of directors—and the court could rightly assume that Royal Park had a sufficiently close relationship to BNP Paribas to demand document production. The plaintiffs, by contrast, have no ongoing relationship with the former owners and no legal privity through a written contract. The plaintiffs bought their certificates through brokered sales on the open market and have no special access to their counterparties. The documents are not in the plaintiffs' control, and potentially insurmountable obstacles make it utterly impractical for the plaintiffs to obtain them.

The plaintiffs' argument fails to persuade. Winnick made clear that an assignor's documents need not be in an assignee's custody or control to be discoverable. Here, as in Winnick, the question is which party should bear the cost of third-party discovery. Here, as in Winnick, the party that seeks to assert the rights of the third party should bear the burden of production. It is of no legal significance that the plaintiffs did not receive written assignments from their counterparties. The simple fact is that the plaintiffs seek to enforce rights that accrued in the past to third parties. As a matter of fundamental fairness, the plaintiffs must assume the litigation responsibilities that accompany those rights.

The plaintiffs argue that third-party discovery will not disclose any relevant documents, but this argument also fails to persuade. Third-party discovery might help HSBC to develop affirmative defenses by showing that prior owners had already relinquished any claim through a prior settlement or other event. It might also undermine plaintiffs' standing. The plaintiffs, too, may need to rely on third-party discovery to prove their damages. The Court will not prejudge these questions at this early stage of the litigation and without a more complete record. Some third-party discovery must first take place.

Federal Rule of Civil Procedure 26 requires discovery to be proportional to the needs of the case, and the plaintiffs have made a compelling argument that third-party document discovery will be exceedingly costly if not impossible. The Court therefore will order a staged discovery process so that the parties can better assess whether third-party document discovery will be crucial to the case or a mere sideshow.

Accordingly, the Court orders the following. The plaintiffs shall serve subpoenas and a copy of this Order on the brokers for their RMBS transactions to learn the identities of the prior owners. (The plaintiffs know the brokers' identities—their names were included in a letter to the Court. See ECF No. 164 at 2 n.3.) They shall then serve document subpoenas and a copy of this Order on the prior owners to obtain transaction-level documents showing the dates, purchase price, and counterparties for the prior purchase of each certificate. With that information, they shall determine the identities of the entities who made the next-most recent sale and obtain the same transaction documents from those entities. After those documents have been gathered—or the plaintiffs can show that their best efforts have been futile—the parties shall meet and confer

to discuss the scope of remaining third-party discovery. The parties shall file a joint letter by August 1, 2016, updating the Court on their progress.

CONCLUSION

The plaintiffs cannot assert the litigation rights of prior RMBS owners without assuming the corresponding discovery obligations. They should bear the burden of third-party discovery. HSBC's motion to compel is GRANTED in part.

SO ORDERED.

SARAH NETBURN
United States Magistrate Judge

DATED: New York, New York
June 2, 2016