UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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NEW JERSEY CARPENTERS HEALTH FUND, *on Behalf of Itself and All Others Similarly Situated*,

Plaintiff,

-against-

NOVASTAR MORTGAGE, INC., NOVASTAR MORTGAGE FUNDING CORPORATION, SCOTT F. HARTMAN, GREGORY S. METZ, W. LANCE ANDERSON, MARK HERPICH, RBS SECURITIES, INC. f/k/a GREENWICH CAPITAL MARKETS, INC., d/b/a RBS GREENWICH CAPITAL, DEUTSCHE BANK SECURITIES, INC., WELLS FARGO ADVISORS, LLC f/k/a WACHOVIA SECURITIES LLC, MOODY'S INVESTORS SERVICES, INC. and THE MCGRAW-HILL COMPANIES, INC.,

Defendants.

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08 Civ. 5310(DAB)

ORDER AND MEMORANDUM

DEBORAH A. BATTS, United States District Judge.

Plaintiff New Jersey Carpenters Health Fund ("Plaintiff") brings this putative class action alleging that Defendant NovaStar Mortgage, Inc. ("NMI") disregarded its own lending practices in originating subprime home mortgages and then, through its subsidiary Defendant NovaStar Mortgage Funding Corporation ("NMFC")[1], arranged the sale of securities to investors that were backed by these allegedly improperly

[1] Defendants Scott F. Hartman, Gregory S. Metz, W. Lance Anderson and Mark Herpich (the "Individual Defendants"), together with NMI and NMFC are collectively known as "the NovaStar Defendants."

originated subprime mortgages.

Pursuant to a June 16, 2006 Registration Statement (the "Registration Statement") filed by NMFC, the securities consisted of the issuance, distribution, and sale of six separate offerings of mortgage pass-through certificates issued between June 22, 2006 and May 25, 2007 (the "Certificates"). Defendants RBS Securities, Inc., Deutsche Bank Securities, Inc., and Wells Fargo Securities, LLC (collectively the "Underwriter Defendants") were the underwriters for these Certificates. Plaintiff alleges that the offering documents for the Certificates contained material misstatements and/or omissions in violation of Sections 11, 12 and 15 of the Securities Act of 1933 ("the '33 Act").

Plaintiff has also named rating agencies Defendants Moody's Investors Service and The McGraw-Hill Companies, Inc.[2] (together "Rating Agency Defendants")[3] asserting that the Rating Agency Defendants are "underwriters and control persons within the meaning of Sections 11 and 15 of the '33 Act" and thus strictly liable for any and all purported material misstatements and omissions in the offering documents for the Certificates.

For the reasons below, the Motions of Defendants Moody's Investors Service, Inc., and The McGraw-Hill Companies, Inc. to

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[2] Standard & Poor (S&P) is a division of Defendant McGraw-Hill Companies, Inc.

[3] Collectively, all Defendants in the suit are known as "Defendants."

dismiss the Complaint against them are GRANTED, with prejudice, and these Defendants are DISMISSED from this action. All of Plaintiff's claims made under the NovaStar Funding Trust Series 2006-3, 2006-4, 2006-5, 2006-6, and 2007-1 offerings are DISMISSED, with prejudice. All of Plaintiff's claims regarding appraisals, loan-to-value ratios or mortgage-backed securities ("MBS") certificate ratings are DISMISSED, with prejudice.

Plaintiff's claims against NMFC, the Individual Defendants and the Underwriter Defendants based on Section 11 of the '33 Act are DISMISSED, without prejudice and with leave to amend. Plaintiff's claims against the Underwriter Defendants based on Section 12(a)(2) of the '33 Act are DISMISSED, without prejudice and with leave to amend. Plaintiff's claims against NMI, the Individual Defendants and the Underwriter Defendants under Section 15 of the '33 Act are DISMISSED, without prejudice and with leave to amend.

I. BACKGROUND

For purposes of this Motion, the Court assumes all of Plaintiffs's factual allegations in the Consolidated First Amended Securities Class Action Complaint ("CAC") are true.

This putative class action arises from the issuance of $7.75 billion of mortgage-backed Certificates by the Novastar Defendants from June 22, 2006 to May 25, 2007. (CAC ¶ 2.) The

Certificates were issued in six separate offerings pursuant to the Registration Statement. All of the Certificates were collateralized by residential mortgages, meaning that the investors' interest and principal payments were derived from payments made by borrowers on the underlying mortgages. (CAC ¶¶ 5-6, 22, 38-39.) The mortgage loans were originated by NMI allegedly pursuant to underwriting guidelines set forth in the Registration Statement and each Prospectus Supplement (the Offering Documents"). (CAC ¶¶ 57-59, 164-97.)

The action alleges violations of Sections 11, 12 and 15 of the '33 Act, 15 U.S.C. §§ 77k, 77l(a)(2) and 77o, based on misstatements and omissions, including that stated underwriting guidelines were systematically disregarded. (CAC ¶¶ 164-78.)

The Parties in this action, include:

Plaintiff New Jersey Carpenters Health Fund

Plaintiff Carpenters Health Fund is a Taft-Hartley Pension Fund. Plaintiff purchased 100,000 units of NovaStar Home Equity Loan Asset-Backed Certificates, Series 2007-2, Class M1 Certificates pursuant to the June 16, 2007 Registration Statement.

Defendant NMI

Defendant NMI acted as the Sponsor/Seller for the Certificates issued pursuant to the Registration Statement, originated all of

the mortgage loan collateral underlying the value of the Certificates, and served as servicer of the mortgage loans post-securitization.

Defendant NMFC

Defendant NMFC, created for the sole purpose of forming, collecting and thereafter depositing the collateral into the issuing trusts, is a wholly-owned subsidiary of Defendant NMI. Defendant NMFC filed the Registration Statement and Prospectus with the SEC in connection with the offerings. Defendant NMFC served as the Depositor in connection with each of the offerings. The role of the Depositor was to purchase the mortgage loans from the Seller, NMI, and then assign the mortgage loans and all of its rights and interest under the mortgage loan purchase agreement to the trustee for the benefit of the Certificate-holders. NMFC, as Depositor, was also responsible for preparing and filing any reports required under the Securities Exchange Act of 1934.

Individual Defendants

The Individual Defendants, and their titles during the relevant time period, are: Scott F. Hartman (NFMC's President and Director of NFMC); Gregory S. Metz (NFMC's Secretary and Principal Financial Officer); W. Lance Anderson (Director of NFMC and

NovaStar's President and Chief Operating Officer); and Mark Herpich (Director of NFMC). All of the Individual Defendants signed the June 16, 2006 Registration Statement.

The Underwriter Defendants

Defendants RBS Securities, Inc. (named as GCM), Deutsche Bank Securities, Inc. (named as DBS), and Wells Fargo Securities, LLC (named as Wachovia) served as the Underwriters and Joint Book-Runners in the sale of the NovaStar Certificates and assisted in drafting and disseminating the Offering Documents for the Registration Statement. The Underwriter Defendants allegedly failed to perform the requisite level of due diligence in connection with all of the NovaStar offerings.

The 2007-2 Prospectus included guidelines for the 2007-2 M-1 series, inter alia:

- For the specific Certificates that Plaintiff purchased, the M1 series, borrowers are required to have: (1) no 30 day lates within last 12 months; (2) a minimum FICO score of 520; and (3) bankruptcy filing requirements that include no "Chapter 7: 2 years since discharge date (100%, 97%) LTV, or 12 months discharge, [and no] Chapter 13: >12 months discharge (>90%) discharged at closing <=90% LTV w/ 0 X 30 BK; (4) adverse accounts not considered unless they effect title rating; (5) a debt-to-income ratio of 50% (60% at lowered LTV); (6) a maximum loan-to-value ration of 100% (600 score) or 95% (580 score) or 90%; and (7) a maximum combined loan-to-value ratio of 100%.

More general underwriting standards applicable to all the

Certificates in the 2007-2 series include:

- Each loan applicant completes an application that includes information with respect to the applicant's income, liabilities and employment history.

- Prior to issuing an approval on the loan, the loan underwriter runs an independent credit report or pulls a reissue of the client's credit through an independent 3rd party vendor.

- Appraisals, which conform to the Uniform Standards of Professional Appraisal Practice, are required on all loans and in many cases a review appraisal or second appraisal may be required.

- Quality control reviews are conducted to ensure that all mortgage loans meet quality standards. The type and extent of the reviews depend on the production channel through which the mortgage loan was obtained and the characteristics of the mortgage loan. The sponsor reviews 8 to 10% of each month's production. The random audit selection criteria includes a proportional representation of loan type, loan product, loan purpose, FICO score, LTV, underwriting grade, state and broker.

- The underwriting guidelines include six levels of applicant documentation requirements, referred to as "Full Documentation," "Limited Documentation," "Stated Income," "No Documentation," "No Income/No Asset," "Streamline" and "Full Doc/12-Month Personal Bank Statement."

- Under the Full Documentation program applicants generally are required to submit verification of employment and most recent pay stub or up to prior two years W-2 forms and most recent pay stub.

- Under the Limited Documentation program, no such verification is required, however, bank statements for the most recent consecutive 6-month period are required to evidence cash flow.

- Under the Stated Income program, an applicant may be qualified based on monthly income as stated in the loan application.

- Under the "No Documentation" program, an applicant provides no information as it relates to their income.

- Under the "No Income/No Asset" program, the applicant's income and assets are not verified, however the applicant's employment is verified.

- The Streamline program is only for borrowers that currently have a mortgage with the sponsor. The documentation required for this loan is based on previous documentation type.

- The Full Doc/12 Months Personal Bank Statement Program allows self-employed or fixed income borrowers to substitute most recent consecutive 12-months bank statements for wage earner's W-2 forms and recent pay stubs.

- Given that the sponsor primarily lends to non-conforming borrowers, it places great emphasis on the ability of collateral to protect against losses in the event of default by borrowers.

- On a case-by-case basis, exceptions to the underwriting guidelines are made where the sponsor believes compensating factors exist. Compensating factors may consist of factors like length of time in residence, lowering of the borrower's monthly debt service payments, the loan-to-value ratio on the loan, as applicable, or other criteria that in the judgment of the loan underwriter warrant an exception.

(2007-2 Prospectus at S-86 - 90; CAC ¶¶ 166, 164, 168, 171, 173, 175, 177.)

The Offering Documents contained a litany of risk factors, yet they do not warn investors that the stated loan origination guidelines would be systematically disregarded. (CAC ¶¶ 76-92)

At the time of issuance, 83% of the Certificates were assigned the highest, AAA or Aaa, investment grade ratings from the Rating Agency Defendants. (CAC ¶¶ 74-75.) In July 2007, just two months after the 2007-2 offering, the Rating Agency Defendants announced that they needed to revise the methodologies used to rate these Certificates. (CAC ¶¶ 101-03.) One of the

reasons provided for these revisions was the previously undisclosed "level of loosened underwriting at the time of loan origination" employed in the origination of the loan collateral. (CAC ¶¶ 100-03.) Approximately 72% of the AAA or Aaa Certificates collapsed to junk bonds, increasing the likelihood of default. (CAC ¶ 75.) In addition, Certificate loans experienced exponential increases in delinquency and foreclosure rates immediately upon issuance. (CAC ¶¶ 69-70.) Within four months of each offering, delinquency rates increased by 1,020%, and continued to increase steadily to 50% of total mortgage collateral by the time the Complaint was filed. (CAC ¶¶ 69-71.)

The Rating Agency Defendants' actions became the subject of various governmental and other investigations. (CAC ¶¶ 100-21.) In July 2008, the SEC reported that there were material undisclosed conflicts of interest in the Rating Agency Defendants' process of rating MBS, including the Rating Agency Defendants' role in structuring the MBS. (CAC ¶¶ 15, 68, 125-28.) The Rating Agency Defendants, in seeking the highly profitable MBS ratings engagements from the same small group of investment banks firms, had incentive not to update their models to reflect more aggressive mortgage loan products because the higher the investment grade ratings, the greater the profits for the investment banks. (CAC ¶¶ 14-16, 65-66, 105-115, 124, 186, 195, 197.)

In June 2008, a New York State Attorney General investigation, which included NMI with respect to their underwriting and issuing of MBS, revealed that investment banks may have disregarded data presented to them by their outside due diligence firms which showed that the underlying loans did not comply with the mortgage loan underwriting guidelines stated in the offering documents. (CAC ¶¶ 13, 95, 97-99.)

The Complaint alleges violations of Sections 11, 12(a)(2) and 15 of the Securities Act arising from three categories of material omissions that had not been disclosed in the offering documents: (1) the guidelines set forth in the offering documents were systematically disregarded, (CAC ¶¶ 11, 76-99, 164-78); (2) the credit support or investor protections built into the structure of the Certificates were inadequate and based on outdated models employed by the Rating Agency Defendants who had the incentive to inflate credit support and Certificate ratings, (CAC ¶¶ 14-15, 105-21, 182-86, 195, 197); and (3) the Rating Agency Defendants' activities in connection with the Certificates were infected by undisclosed conflicts of interest, including the Rating Agency Defendants' provision of unpaid services in creating and structuring the Certificates as an inducement for NovaStar to hire them to rate the Certificates, (CAC ¶¶ 15-16, 126-27, 131-35); and NovaStar's requirement that the Rating Agency Defendants submit to the "ratings shopping" process as a

prerequisite for being engaged to rate the Certificates. (CAC ¶¶ 15-16, 125-40).

These material omissions constituted material misstatements in the specific portions of the offering documents that described: (1) the guidelines used to originate mortgages, because, in fact, those guidelines were systematically disregarded, (CAC ¶¶ 164-78); and (2) the various forms of stated credit support or investor protections because, having been derived from outdated models employed by the conflicted Rating Agency Defendants, they were wholly inadequate. (CAC ¶¶ 182-86.)

II. DISCUSSION

A. Legal Standard

For a complaint to survive dismissal under Rule 12(b)(6), the plaintiff must plead "enough facts to state a claim to relief that is plausible on its face." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007). "A claim has facial plausibility," the Supreme Court has explained,

> "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged. The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully. Where a complaint pleads facts that are 'merely consistent with' a defendant's liability, it 'stops short of the line between possibility and plausibility of 'entitlement to relief.'"

Ashcroft v. Iqbal, 129 S.Ct. 1937, 1949-50 (2009) (quoting

Twombly, 550 U.S. at 556-57). "[A] plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." Twombly, 550 U.S. at 555 (internal quotation marks omitted). "In keeping with these principles," the Supreme Court has stated,

> "a court considering a motion to dismiss can choose to begin by identifying pleadings that, because they are no more than conclusions, are not entitled to the assumption of truth. While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations. When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief."

Iqbal, 2009 WL 1361536, at *13.

In ruling on a 12(b)(6) motion, a court may consider the complaint as well as "any written instrument attached to the complaint as an exhibit or any statements or documents incorporated in it by reference." Zdenek Marek v. Old Navy (Apparel) Inc., 348 F.Supp.2d 275, 279 (S.D.N.Y. 2004) (citing Yak v. Bank Brussels Lambert, 252 F.3d 127, 130 (2d Cir. 2001) (internal quotations omitted)).

Since Plaintiff's allegations and claims sound in strict liability, not fraud, the Complaint is subject to the standards of Rule 8(a), not to the heightened pleading requirements of Rule 9(b). Rule 8(a) provides that a pleading must "contain a short and plain statement of the claim showing that the pleader is

entitled to relief." Rule 8(a)(2). Rule 8 does not require "detailed factual allegations," but it demands more than an unadorned, the-defendant-unlawfully-harmed-me accusation." Iqbal, 129 S.Ct. At 1949. A pleading that offers "labels and conclusions" or "a formulaic recitation of the elements of a cause of action will not do." Id. Nor does a complaint suffice if it tenders "naked assertion[s]" devoid of "further factual enhancement." Id. While legal conclusions can form the framework of a complaint, they must be supported by factual allegations. Id.

B. Standing

1. Multiple Offerings Under One Registration Statement

For Plaintiff to have standing to sue on behalf of a class under the '33 Act, "at least one named plaintiff...must have purchased shares traceable to the challenged offering. In re Global Crossing, Ltd. Sec. Litig., 313 F.Supp. 2d 189, 207 (S.D.N.Y. 2003)(dismissing a claim where plaintiffs did not purchase shares issued pursuant to the offering in question). This is also true in cases involving MBS offerings. See, e.g., New Jersey Carpenters Health Fund v. Residential Capital, LLC, 2010 WL 1257528, at *3-4 (S.D.N.Y. Mar. 31, 2010)(dismissing with prejudice all claims relating to MBS securities offerings in which plaintiffs did not allege purchases for lack of standing);

New Jersey Carpenters Vacation Fund v. Royal Bank of Scotland Group, PLC, 720 F.Supp.2d 254 (S.D.N.Y. Mar. 26, 2010)(same). Courts should dismiss these claims even at the pre-class certification stage. Lehman Brothers Securities and ERISA Litigation, 2010 WL 545992, at *3 (S.D.N.Y. Feb. 17, 2010)(pre-class-certification dismissal of securities claims for lack of standing proper where claims arose from securities offerings in which named plaintiffs did not participate); see also In re Salomon Smith Barney Mutual Fund Fees Litigation, 441 F. Supp. 2d 579 (S.D.N.Y. 2006).

Plaintiff purportedly brings its claims on behalf of itself and a class of persons who purchased Certificates sold in any of six different offerings that were conducted under the June 16, 2006 Registration Statement. However, Plaintiff only alleges that it purchased in one of those six offerings: 100,000 Class M-1 Certificates from the May 25, 2007 Series 2007-2 offering. Plaintiff does not allege it purchased in the NovaStar Funding Trust Series 2006-3, 2006-4, 2006-5, 2006-6, and 2007-1 offerings. Each offering under the Registration Statement had its own issuing trust and each offering was made under a separate Prospectus Supplement. (CAC § 20, 33.)[4] Accordingly, Plaintiff

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[4] Plaintiff's relies on Hevesi v. Citigroup Inc. in support of its argument that it should have standing. 366 F.3d 70, 82 (2d Cir. 2004). However, in Hevesi, at least one named plaintiff had standing on each cause of action. Here, the sole Plaintiff in the action participated in only one offering - the

lacks standing to sue for the NovaStar Funding Trust Series 2006-3, 2006-4, 2006-5, 2006-6, and 2007-1 offerings under the June 16, 2006 Registration Statement.

2. Market Value of the Certificates

Section 11(e) provides that one of the valid measures of a plaintiff's damages is "the difference between the amount paid for the security...and...the value thereof as of the time such suit was brought." 15 U.S.C. § 77k(e). Under Section 12(a), a plaintiff is required to provide an allegation of some cognizable loss. New Jersey Carpenters Health Fund v. DLJ Mortg. Capital, Inc., 2010 WL 1473288, at *5 (S.D.N.Y. 2010).

Here, Plaintiff's alleged injury is a 93% loss of market value in the Certificates since it initial value in the 2007-2 offering. (CAC ¶¶ 10, 20.)[5] Defendants argue that market value loss is insufficient where Plaintiff asserts a mortgage-backed securities claim because "instead of relying on the opportunity to sell the securities in the future, purchasers here can only reasonably rely on the cash flows that the investors receive on the bonds [and] Plaintiff has not alleged that it has failed to

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2007-2 offering.

[5] NovaStar Defendants take issue with Plaintiff's calculation in the market value loss of 93% in the Certificates, however, no defendant could reasonably dispute that as market value is calculated, some loss in the Certificates has occurred.

receive a single payment on its Certificates." (Underwriters Br. at 9-10.) Further, Defendants argue that the Offering Documents explicitly stated that it was unlikely that a secondary market for the Certificates would develop or, if it did develop, that it may not continue to exist. (Underwriters Br. at 9-10.)

Defendants' position is without support under Section 11(e). Public Employees' Retirement System of Mississippi v. Goldman Sachs Group, Inc., 2011 WL 135821, *9 (S.D.N.Y. Jan. 12, 2011)(rejecting the defendants argument that under Section 11 the value of certificates should not be based on their price in a sale in an illiquid market, but rather, the entitlement to receive pass-through payments); New Jersey Carpenters Health Fund, 2010 WL 1473288, at *5 (under Section 11, "Plaintiff's market value allegations are sufficient."); see also In re Countrywide Financial Corp. Sec. Litig., 588 F.Supp.2d 1132, 1169-70 (C.D.Cal. 2008)(same). First, Defendants' argument is not supported by the text of Section 11(e) itself. Nowhere does Section 11(e) single-out fixed-income debt securities claims and prevent these types of securities from being assessed on the basis of market value.

Second, Defendants cannot on one hand disclaim or warn that a secondary market for the Certificates might not develop, then on the other hand (allegedly) prevent that market from developing due to, at least in part, the allegations that underlie

Plaintiff's claims. Plaintiff alleges that when it bought the Certificates, there was a secondary market for investors, but the market collapsed due to the downgrading of the Certificates. (CAC ¶¶ 54, 74.)

Third, purchasers of these types of securities often have the expectation that they will be able to utilize a secondary market for these securities. New Jersey Carpenters Health Fund, 2010 WL 1473288, at * 5. This reality makes market value a critical valuation marker for Plaintiff. Id. The lack of a secondary market alleged here makes resale of the Certificates impossible without Plaintiff suffering from significant losses under a market theory. (CAC ¶¶ 10, 20.)

Finally, mortgage-backed Certificates are a type of regulated security relating to pooled asset-backed securities. 17 C.F.R. § 229.1111. To prevent Plaintiff from the opportunity to advance a market value damages claim would place severe limits on the application of the '33 Act to securities such as bonds. New Jersey Carpenters Health Fund, 2010 WL 1473288, * 5. A default in interest payments can take many years after a collapse in bond value. Id. Without soothsayer-like foresight at this stage of the litigation, it is impossible for this Court to determine whether or not interest payments will continue to occur in the future for Plaintiff's securities. This reality also makes market value a valid measure of damages.

D. Claims Against the Rating Agency Defendants

1. Section 11 Underwriter Claim

Plaintiffs seek to impose underwriter liability against the Rating Agency Defendants based on Section 11(a)(5) of the '33 Act.[6] That statute defines "Underwriter" as:

> "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph, the term 'issuer' shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by an issuer, or any person under direct or indirect common control with the issuer."

15 U.S.C. § 77b(a)(11).

Plaintiff does not assert that the Rating Agency Defendants purchased Certificates from an issuer for resale to the public or any other. (Pl. Rating Agency Opp. Br. at 6-10.) Instead, Plaintiff rests its claim on the assertion that the term "underwriter" includes not only those who have purchased securities from an issuer for resale, but also those who

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[6] The Rating Agency Defendants do not fall within § 11(a)(4) as the they were not named, nor did they consent to being named, as entities that certified or prepared a portion of the registration statement. 15 U.S.C. §77k(a)(4); see also In re Refco, Inc. Sec. Litig., 2008 WL 3843343, at *3 n.5 (S.D.N.Y. Aug. 14, 2008).

"perform[] some act (or acts) that facilitates the issuer's distribution." (Pl. Rating Agency Opp. Br. at 6 (quoting Ingenito v. Bermec Corp., 441 F. Supp. 525, 536 (S.D.N.Y. 1977).)

More specifically, Plaintiff alleges that the Rating Agency Defendants: (1) ran the loan-level files through their ratings models in order to advise the NovaStar Defendants regarding the potential value of the loans; (2) advised the NovaStar Defendants on how to structure individual Certificates so as to obtain certain ratings; (3) participated in a ratings bidding process in order to secure work from the NovaStar Defendants and the Underwriter Defendants; and (4) participated in the drafting and dissemination of the Offering Documents. (CAC ¶¶ 8, 36, 56, 64-68, 125-30, 186, 211.)

It is clear that, as alleged, the Rating Agency Defendants played an important role in getting these securities to investors. However, as described by Judge Lynch in In re Refco, Inc., Secs. Litig., 2008 WL 3843343 (S.D.N.Y. Aug. 14, 2008) ("Refco II"), the type of activity complained of by Plaintiff cannot subject the Rating Agency Defendants to liability under Section 11:

> While the definition of 'underwriter' is indeed broad...[t]he definition primarily references those who 'purchase[ ] from an issuer with a view to ... the distribution of any security.' 15 U.S.C. § 77b(a)(11). The language on which plaintiffs rely then adds to this definition anyone who 'participates ... direct[ly] or

> indirect[ly] ... in any such undertaking.' Id. The 'participation' in question is participation in the 'undertaking' referred to immediately before: that of purchasing securities from an issuer with a view to their resale-that is, the underwriting of a securities offering as commonly understood. Whatever conduct may be covered by this language, it cannot easily be read to include the 144A Defendants' merely commenting on a draft of a registration statement for a bond offering in which they took no part in the distribution of the bonds. Id. at *4.

Plaintiff's allegations here are sufficiently similar to those in Refco II. The Rating Agency Defendants' alleged participation may have been in loan valuing, Certificate structuring to secure particular ratings, and drafting and disseminating the Offering Documents. However, the CAC is devoid of the activity necessary to show that the Rating Agency Defendants "participated in the relevant 'undertaking' - that of purchasing the securities here at issue, the Certificates - 'from the issuer with a view to their resale.'" Id.; see also In re Lehman Bros. Securities and Erisa Litigation, 681 F.Supp.2d 495, 499 (S.D.N.Y. 2010)(dismissing claims against rating agencies under §§ 11, 12(a)(2) and (15))(citation omitted); New Jersey Carpenters Vacation Fund v. Royal Bank of Scotland Group, PLC, 720 F.Supp. 2d 254, 262-64 (S.D.N.Y. 2010)(while "Rating Agency Defendants' activities were not necessarily innocent, they were not related to the core functions of an underwriter, i.e. the marketing, distribution, and sale of offerings to investors.).

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According, Plaintiff's Section 11 claims against the Rating Agency Defendants is dismissed.

2. Section 15 Rating Agency Control Person Claim

Plaintiffs also seek to impose liability against the Rating Agency Defendants based on Section 15 of the '33 Act. Section 15 of the '33 Act provides:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77o.

For Plaintiff to state a cognizable claim under Section 15, Plaintiff must make allegations that the Rating Agency Defendants controlled others who violated Section 11 or 12 of the '33 Act. Plaintiff alleges that the Rating Agency Defendants: (1) together with NMI and the Individual Defendants, created the issuing trusts; (2) participated in all aspects of the formation and

structuring of the Certificates, including securitizing the underlying mortgages in the Issuing Trusts; (3) negotiated with the "structuring team;"[7]; and (4) acted as underwriters. (CAC ¶¶ 8, 35-36, 56, 64, 105-15, 129-30, 211, 237; Pl. Rating Agency Opp. Br. at 22-23.)

Plaintiff makes the bald assertion that its allegations demonstrate that the Rating Agency Defendants "controlled all material aspects of the acquisition, structure and sale of the Certificates, as well as the activities of NMI, NMFC, and the Issuing Trusts within the meaning of Section 15." (Pl. Rating Agency Opp. Br. at 23.) However, Plaintiff's allegations do not demonstrate control, but only the power to influence or persuade those who issued or sold the securities. In re Lehman Bros. Securities and Erisa Litigation, 681 F.Supp.2d at 500("[w]hat is required is the practical ability to direct the actions of people who issue or sell securities."); In re Flag Telecom Holdings, Ltd. Sec. Litig., 352 F.Supp.2d 429, 458 (S.D.N.Y. 2005); accord SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472-73 (2d Cir. 1996) (same); see also In re Global Crossing, Ltd. Sec. Litig., 2005 WL 1875445, at *3 (S.D.N.Y. Aug. 5, 2005).

The power to influence or persuade does not equal control for purposes of Section 15 of the 1933 Act. Id. What is required

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[7] Plaintiff alleges that the structuring team was responsible for setting up the issuing trusts. (Pl. Rating Agency Br. at 22-23.)

is "the practical ability to direct the actions of people who issue or sell securities." Id. (citing In re Flag Telecom Holdings, Ltd. Sec. Litig., 352 F.Supp.2d at 458; see also SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472-73 (2d Cir. 1996) (defining "control" as the "power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.") The CAC here alleges that the Rating Agency Defendants had considerable ability to advise, influence and work with the NovaStar and Underwriting Defendants with respect to virtually all stages of the securitization process. However, these allegations do not rise to the level of demonstrating that the Rating Agency Defendants had Section 15 control.

According, Plaintiff's Section 15 claim against the Rating Agency Defendants is dismissed.

E. Viability of Section 11 and 12(a) Claims[8]

To state a claim under Section 11, a plaintiff must allege that: (1) it purchased a registered security; (2) the defendant participated in the offering in a manner giving rise to liability

[8] The only offering Plaintiff has standing to sue on is the 2007-2 offering, see supra. Therefore, Defendants arguments that the Statute of Limitations apply are unavailing, as Plaintiff sued within a year of purchasing its securities.

under Section 11; and (3) the registration statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). A claim under this section may be asserted against every person who signed the registration statement, the directors of the issuer and the underwriter of the securities. Id. Section 12(a)(2) arises when a person offers or sells a security by means of a prospectus or oral communication that includes a material misrepresentation or omission. 15 U.S.C. § 77l(a)(2).

A court finds a violation of Section 11 when "material facts have been omitted or presented in such a way as to obscure or distort their significance." In re Flag Telecom Holdings, Ltd. Sec. Litig., 618 F. Supp. 2d 311, 320-21 (S.D.N.Y. May 1, 2009); see also Caiola v. Citibank, N.A., 295 F.3d 312, 329 (2d Cir. 2002)("materiality is found where there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.") "The test for determining whether the prospectus contained a material misstatement or omission is whether the defendants' representations in the prospectus, taken together and in context, would have misled a reasonable investor." In re Flag Telecom Holdings, Ltd. Sec. Litig., 618 F. Supp. 2d at 320-21.

Plaintiff alleges that the NovaStar Defendants systematically failed to comply with its underwriting guidelines, including that: "NovaStar made no attempt to confirm the standards used by mortgage brokers;" "NovaStar originators were instructed to push, onto unfit and unqualified borrowers, ARMs which readjusted after two or three years to significantly higher rates;" "NovaStar was not nearly as thorough in obtaining and verifying documentation as [the stated underwriting guidelines] imply;" "NovaStar failed to confirm that [home loan] appraisers [with conflicts of interest] were following the guidelines described;" "NMI was very liberal in granting exceptions to its underwriting standards;" "tremendous pressure [was] placed on underwriters to close as many loans as possible;" and NMI "issued bonuses for underwriters based solely on the number of loans they reviewed." As a result of these failures, Plaintiff alleges that the underlying mortgage loans were not as valuable as Plaintiff was led to believe. (CAC ¶¶ 77, 79-80, 83-86, 90, 92, 100-104, 164-178, 191.)

The Court agrees that Plaintiff's allegations are conclusory in nature. Plaintiff provides no specific factual allegations to support its statements. Rather, in support of its factual allegations, Plaintiff cites to news articles and broad investigations concerning the subprime mortgage crisis, that included many of the Defendants here. (CAC ¶¶ 79, 83, 84, 85, 86,

100-104.).

In addition, Plaintiff fails to make allegations specific to the NovaStar Defendants' origination practices that relate to the only offering that is relevant here: the 2007-2 offering. While at this stage Plaintiff's has putative standing to sue on behalf of a class who bought the 2007-2 Certificates, Plaintiff is still required to make allegations that are specific to the M-1 Certificates it bought. The M-1 Certificates have their own underwriting guidelines and securities structure within the 2007-2 offering and Plaintiff makes no allegations tying its '33 Act claims to that specific M-1 purchase.

Finally, Plaintiff makes no allegations regarding why the events known to the market about the NovaStar Defendants and the subprime market in the months preceding the 2007-2 offering do not abrogate '33 Act liability on the specific facts here. This includes the NovaStar Defendants' difficulties, MBS and subprime market deterioration, increasing bond spreads, etc. While the Court is aware that Plaintiff is not required to meet the heightened pleading requirement under Rule 9(b), more is required than what Plaintiff has done here: 102 pages of "the subprime market melted down and Defendants were market participants, so they must be liable for my losses in my risky investment."

Accordingly, Plaintiff's claims under Section 11 and 12(a)

are dismissed, without prejudice.[9]

F. Section 15 Claims Against NMI and the Individual Defendants

To plead a claim under Section 15, "a plaintiff must allege (1) a primary violation by a controlled person and (2) direct or indirect control by the defendant of the primary violator." E.g., Adelphia Comm., 2007 U.S. Dist. LEXIS 66911, at *30; In re Global Crossing, Ltd. Sec. Litig., 322 F. Supp. 2d 319, 349 (S.D.N.Y. 2004). "Culpable participation" by the controlling person is not an element of a Section 15 claim. E.g., Adelphia Commc'ns, 2007 U.S. Dist. LEXIS 66911, at *31; Global Crossing, 322 F. Supp. 2d at 349. In In re Refco, Inc. Sec. Litig., 503 F. Supp. 2d 611 (S.D.N.Y. 2007) the district court stated, "a signature on an SEC filing containing the misrepresentations that are the subject of a claim is suggestive of control...allegations that [the individual] was directly involved in its day-to-day operations,

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[9] Allegations that reflect subjective opinions, as opposed to statements of fact, are not actionable unless the CAC alleges that the speaker did not truly have the opinion at the time it was made public. Tsereteli, 2010 WL 816623, at *4 (citing Shields v. Citytrust Bancorp., 25 F.3d 1124, 1131 (2d Cir. 1994)). Plaintiff fails to allege that any Defendant made knowingly false statements at the time they published their appraisals conducted on the mortgaged properties underlying the MSB Certificates, loan-to-value ratios in the offering documents, and MBS Certificate ratings. The Court dismisses Plaintiff's allegations regarding appraisals, loan-to-value ratios and MBS Certificate ratings.

including financial reporting and accounting...suffices as an allegation of control." Id. at 638.20

The NovaStar Defendants assert that Plaintiff's Section 15 claims must fail as: (1) there is no primary violation under Sections 11 and 12(a)(2); and (2) against the Individual Defendants, Plaintiff's claims are conclusory in nature and insufficient as a matter of law. (NovaStar Br. at 24-25.) The Court agrees.

First, the Court has dismissed the Section 11 and 12(a) claims against the NovaStar Defendants and the Underwriter Defendants, without prejudice. Until the Court finds that Plaintiff's Section 11 and 12(a) claims can be sustained, no claim under Section 15 can proceed.

Second, as Plaintiff's only have standing to sue under the 2007-2 offering, the allegations in the CAC against the Individual Defendants are conclusory in nature as to whether the Individual Defendants were even employed by NMFC when the 2007-2 offering took place, and what each Individual Defendants' role was in that offering.

Accordingly the NovaStar Defendants' Motion to Dismiss on the Section 15 claims is granted, without prejudice.

III. CONCLUSION

For the reasons above, the Motions of Defendants Moody's Investors Service, Inc., and The McGraw-Hill Companies, Inc. to dismiss the Complaint against them are GRANTED, with prejudice, and these Defendants are DISMISSED from this action. All of Plaintiff's claims made under the NovaStar Funding Trust Series 2006-3, 2006-4, 2006-5, 2006-6, and 2007-1 offerings are DISMISSED, with prejudice. All of Plaintiff's claims regarding appraisals, loan-to-value ratios or MBS certificate ratings are DISMISSED, with prejudice.

Plaintiff's claims against NMFC, the Individual Defendants and the Underwriter Defendants based on Section 11 of the '33 Act are DISMISSED, without prejudice and with leave to amend. Plaintiff's claims against the Underwriter Defendants based on Section 12(a)(2) of the '33 Act are DISMISSED, without prejudice and with leave to amend. Plaintiff's claims against NMI, the Individual Defendants and the Underwriter Defendants under Section 15 of the '33 Act are DISMISSED, without prejudice and with leave to amend.

Within 45 days of the date of this Order, Plaintiff shall file a Consolidated Second Amended Complaint which should be stripped of any allegations or factual averments related to any now dismissed claims or parties. Within 30 days of the filing of Plaintiff's Consolidated Second Amended Complaint, the remaining Defendants may move against or answer. Under no circumstances

will additional Parties be permitted to join or intervene in this action going forward.

SO ORDERED.

DATED: New York, New York
March 31, 2011

Deborah A. Batts

DEBORAH A. BATTS
United States District Judge