No. 11-2762

(Docket Number in District Court: 1:08-cv-10783-MGC)

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

NECA-IBEW HEALTH & WELFARE FUND, Individually and on Behalf of All Others Similarly Situated,
Plaintiff-Appellant,

[Caption continued on following page.]

Appeal from the United States District Court
for the Southern District of New York
The Honorable Miriam Goldman Cedarbaum

PLAINTIFF-APPELLANT'S REPLY BRIEF

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vs.

GOLDMAN SACHS & CO., GOLDMAN SACHS MORTGAGE COMPANY, DANIEL L. SPARKS, KEVIN GASVODA, MICHELLE GILL, GS MORTGAGE SECURITIES CORP.,
Defendants-Appellees,

GS MORTGAGE SECURITIES CORP., GSAA HOME EQUITY TRUST 2007-3, GSAA HOME EQUITY TRUST 2007-4, GSAMP TRUST 2007-HE2, GSAMP TRUST 2007-FM2, GSAA HOME EQUITY TRUST 2007-5, GSAA HOME EQUITY TRUST 2007-6, GSAA HOME EQUITY TRUST 2007-7, GSAA HOME EQUITY TRUST 2007-8, GSR MORTGAGE LOAN TRUST 2007-4F, GSAMP TRUST 2007-HSBC1, GSAMP TRUST 2007-HEI, STARM MORTGAGE LOAN TRUST 2007-4, GSAA HOME EQUITY TRUST 2007-10, GSR MORTGAGE LOAN TRUST 2007-5F, GSR MORTGAGE LOAN TRUST 2007-3F, GSR MORTGAGE LOAN TRUST 2007-OA2, SUNTRUST ROBINSON HUMPHREY, INC.,
Defendants,

THE POLICE AND FIRE RETIREMENT SYSTEM OF THE CITY OF DETROIT,
Intervenor.

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I. ARGUMENT

A. The District Court's Erroneous View of §11 Injury and Damages Is Indefensible

Defendants concede that the "narrow question before this Court" is whether the Fund adequately pleaded diminution in value in keeping with §11(e)'s plain text. Answering Brief at 28.

That question has been answered. The Fund alleges diminished value for its Certificates (JA-236:¶93), and that the "diminutions in value and price have caused damages to the [Fund] and the Class." JA-235:¶92; *see also* Opening Brief at 45-54. Accepting those allegations as true, *Matrixx Initiatives, Inc. v. Siracusano*, ___ U.S. ___, 131 S. Ct. 1309, 1314 (2011), no more is required. The Fund successfully alleges a cognizable injury, both under §11 as well as under constitutional "injury in fact" requirements. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992).

Despite this, defendants proffer arguments that re-hash the district court's (incorrect) holdings, using inapposite case law and nonsensical reasoning. Each is disposed of below.

1. Defendants' "Missed Payments" Argument Mischaracterizes the Fund's Injury

Like the district court, defendants insist that the Fund suffered no actual loss from missed payments under the Certificates. Answering Brief at 30-31. Like the district court, defendants misapprehend the injury alleged.

The Fund never claimed injuries from diminished payments. Rather, the complained-of injury is the Certificates' diminution in ***value*** – which diminution is expressly covered by §11(e)'s tripartite structure:

> [Recoverable damages represent] the ***difference*** between the ***amount paid for the security*** (not exceeding the price at which the security was offered to the public) ***and*** (1) ***the value thereof as of the time such suit was brought***, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment . . . .

15 U.S.C. §77k(e).[1] The first prong's focus on alleged "value" is plain; it says nothing about whether a security's diminished value is excused by ongoing payments. *N.J. Carpenters Health Fund v. DLJ Mortg. Capital, Inc.*, No. 08 Civ. 5653 (PAC), 2010 U.S. Dist. LEXIS 47512, at *12 (S.D.N.Y. Mar. 29, 2010) (in mortgage-backed-securities context, even though plaintiff continues to receive principal and interest payments, its "alleged injury is the loss of market value"). Defendants assert that

[1] Throughout this Brief, ***emphasis*** is added and citations are omitted unless noted otherwise.

continued payments moot any diminished-value loss, but they cannot read into the statute nonexistent exceptions. *Hallstrom v. Tillamook Cnty.*, 493 U.S. 20, 27 (1989) ("we are not at liberty to create an exception where Congress has declined to do so"); *De Leon-Ochoa v. AG of the United States*, 622 F.3d 341, 353-54 (3d Cir. 2010) ("[w]e simply will not read into an unambiguous statutory requirement an exception").

The folly of defendants' position is illustrated with a simple hypothetical: Assume that before filing suit the Fund ***had*** sold its Certificates at a loss – which sale satisfies even the district court's narrow view of injury.[2] Even if the Fund continued to receive payments up to that moment, the sale at a loss satisfies §11(e)'s second prong. Given that, why should continued payments obliterate a different prong of the statute?[3]

2. Defendants' Insistence upon a "Secondary Market" Ignores Record Facts and Precedent

In constructing their argument that there must be a secondary market for the Certificates before the Fund can allege diminished value, defendants utilize a foundation that ignores or misstates record facts.

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[2] The hypothetical eventually became a reality. CD129:2.

[3] Moreover, §11's companion statute, §12, ***expressly*** contemplates that despite having received income on the security, plaintiffs may still recover. Opening Brief at 50 n.19.

Defendants insist that their Offering Documents "specifically disclaimed" a secondary market's existence. Answering Brief at 28. In truth, they reassured investors that they "***intend[ed]***" to make one – cautioning only that one might never develop. CD99/Ex. A at S-50. Defendants also assert that "given the absence of a secondary market," the Fund cannot plead facts establishing the Certificates' lowered value. Answering Brief at 29. In truth, that "absence" is illusory: The Complaint expressly alleges that "[t]here ***is*** a secondary market for the purchase and sale of the Certificates." JA-236:¶93. In December 2008, class members would have received between "35 and 45 cents on the dollar" for their Certificates. *Id*. Defendants may someday dispute those facts, but at present they are accepted as true. *Matrixx*, 131 S. Ct. at 1314; *Gorman v. Consol. Edison Corp.*, 488 F.3d 586, 591-92 (2d Cir. 2007).

Defendants also overlook that in October 2010, with its §§12 and 15 claims upheld, the Fund proffered "additional evidence" concerning the Certificates' secondary market. CD115:6-7. The Fund produced *Bloomberg* charts showing daily market prices for its Certificates. CD115:6; CD115/Ex. B. The Fund also noted that on the date of suit, the market price for the 2007-10 Certificates was 46% of face value, while the market price for the 2007-5 Certificates had dropped to 73%. CD115:7. Defendants' "no-secondary-market" assertions are belied by these facts.

Finally, this Court recognizes that efficient markets aren't required to calculate "value" under §11. *McMahan & Co. v. Wherehouse Entm't*, 65 F.3d 1044, 1049 (2d Cir. 1995) (§11 value may still be determined "even where market price is not completely reliable"); *id*. at 1048-49 (Congress's use of term "'value'" in §11(e) "as distinguished from the terms 'amount paid' and 'price' indicates that, under certain circumstances, the market price may not adequately reflect the security's value"). At oral argument, class counsel explained that experts had calculated the Certificates' values. JA-184/27:2-4 (experts "have concluded that there is a diminution in value of the bonds or the certificates").

In light of the foregoing, the Fund's diminished-value allegations suffice.

3. Defendants' Charges of "Speculative Estimates" of Loss Cannot Overcome Well-Pleaded Allegations

Using arguments inappropriate at the pleading stage, defendants dismiss the Complaint's diminished-value allegations as "speculative estimates." Answering Brief at 29. They insist that the Fund should have sold, or at least attempted to sell, its Certificates at a loss. *Id*. at 30. Defendants' insistence ignores well-pleaded facts, and relies upon inapposite case law.

As noted *supra*, the Complaint ***does*** allege diminished value for the Certificates at the suit's commencement. JA-235:¶92. That allegation alone suffices at the pleading stage, for it satisfies §11(e)'s plain text. Defendants want more, apparently, but the Complaint provides that, too: It alleges that at the time suit was brought, the Certificates were worth "between 35 and 45 cents on the dollar" paid for them. JA-236:¶93. Moreover, the Certificates were downgraded from investment-grade "AAA" status to "CCC" – "a rating many levels below the threshold for 'junk' status." JA-235:¶90. Surely a downgrade from "AAA" to "junk" supports diminished value. Such allegations suffice at the pleading stage, where the Fund need only allege the Offering Documents' misstatements. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).

Defendants nonetheless insist that the Fund should have attempted to sell at a loss. They repeat language explaining that "'one element of the section 11 tort is sale at a loss'" (Answering Brief at 30), but omit that the comment was directed at plaintiffs whose securities were worth $21.35 (Canadian) ***more*** on the date of suit than when first acquired. *See Stark Trading v. Falconbridge Ltd.*, 552 F.3d 568, 573 (7th Cir. 2009). Under §11(e), there could be no recovery. *Id*.

Defendants' other cases are equally infirm. They say this lawsuit should be dismissed like another one where "'plaintiff ha[d] no conceivable damages under Section 11.'" Answering Brief at 29 (quoting *In re Initial Pub. Offering Sec. Litig.*, 544 F. Supp. 2d 277, 299 (S.D.N.Y. 2008)). Defendants omit that the *IPO* plaintiffs had "sold their securities ***above the offering price***." *IPO*, 544 F. Supp. 2d at 300.

Defendants hail a Ninth Circuit opinion (Answering Brief at 29), but again, that plaintiff disposed of his shares for ***nearly double the acquisition price***. *See In re Broderbund/Learning Co. Sec. Litig.*, 294 F.3d 1201, 1204 (9th Cir. 2002) ("there was no loss whatsoever; rather, there was a tremendous gain").[4]

At bottom, §11(e)'s plain text requires neither a ***realized*** loss nor an established secondary market in order to state a claim. Plaintiffs need only plead some diminution in "value." 15 U.S.C. §77k(e).

B. Plaintiff Has Standing to Represent All Purchasers from the ***Same*** Registration Statement and Prospectuses that Were Expressly Incorporated into It

Defendants take aim at the Fund's standing to bring claims on behalf of purchasers of all Certificates, both on the offering and "tranche" levels. Answering Brief at 12-27. In so doing, they rely upon inapposite authority, overlook record facts, and engage in hypertechnical constructs.

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4 Defendants' cases that speak of there being no single, objective method of valuing asset-backed securities actually bolster the Fund's position, for they recognize that valuation ***is*** possible despite infrequent transactions or non-public prices. *See, e.g.*, *Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC*, 376 F. Supp. 2d 385, 396 (S.D.N.Y. 2005) (valuation "involve[s] the exercise of judgment").

1. Plaintiff Has Standing at the "Offering" Level

Citing a grab-bag of district court decisions and one circuit-level opinion, defendants insist that the Fund needed to have purchased Certificates from ***each*** of the 17 Trusts that offered securities pursuant to the same Registration Statement in order to represent fellow plaintiffs. They make it sound as if each Trust represented a discrete, independent offering with absolutely no connection to another. Not so.

Indeed, defendants deliberately designed each Supplemental Prospectus so that it was "expressly incorporated" into the same Registration Statement – and that ***sole*** Registration Statement contained misstatements common to ***each*** of the Certificates:

- for Conduit Program loans, "the originating lender makes a determination about whether the borrower's monthly income (if required to be stated) will be sufficient to enable the borrower to meet its monthly obligations on the mortgage loan and other expenses related to the property" (JA-116:¶29; JA-212:¶29; *see also* JA-116:¶30; JA-212:¶29);
- each appraisal in the files had been done by an appraiser "whose compensation is not affected by the approval or disapproval of the mortgage loan" (JA-127:¶57; JA-221:¶52);

- "documents . . . submitted for loan underwriting were not falsified and contain no untrue statement" and "are free of fraud and any misrepresentation" (JA-132:¶76; JA-227:¶70);
- all Certificates would receive "investment grade" ratings (JA-136:¶82; JA-232:¶79); and
- omitted that Goldman Sachs was betting against the housing market via "credit default swaps" at the same time defendants were selling the Certificates as "investment grade" instruments (JA-137-JA-138:¶¶89-93; JA-234-JA-235:¶¶85-89).

Thus, given these misrepresentations and omissions in the ***sole*** Registration Statement common to ***every*** Trust – and thus to ***every*** Certificate issued – there is no reason to require the Fund to buy Certificates from each Trust in order to establish its standing.

As for the district-court decisions that defendants rely upon to argue otherwise, this Court owes them no more deference than it does to the decision below, which it reviews *de novo*. In fact, one of their main decisions, the "*Maine State I*" opinion, actually supports the Fund – for plaintiffs' claims there "***rel[ied] on*** separate disclosures or omissions made for each Offering in the individual prospectus supplements." *Me. State Ret. Sys. v. Countrywide Fin. Corp.*, 722 F. Supp. 2d 1157, 1164 (C.D. Cal. 2010). The Fund's claims here include a large universe of misstatements that appeared in the single Registration Statement, and were common to ***each*** Supplemental Prospectus.

The circuit-level decision defendants cite does not control here. *See Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762 (1st Cir. 2011). Although *Nomura* held that plaintiffs lacked standing to pursue claims on behalf of mortgage-backed securities purchasers from other offerings and other trusts, several rationales driving that decision are inapposite here.

The *Nomura* plaintiffs attempted to sue (among others) each of the eight trusts that had issued all of the certificates, despite having incurred no injury from six of them. *Id.* at 768. There was simply no injury traceable to those particular defendants – a threshold consideration in "standing" jurisprudence. *Id*. (citing *Lujan*, 504 U.S. at 560-61). Here, ***each*** of the defendants is alleged to have injured the Fund.

Moreover, the *Nomura* panel conceded that the issue was unsettled and "not so simple," with even the Supreme Court offering contradictory guidance, but felt that its hands were tied by a 33-year-old First Circuit case. *Id*. at 768-70. How far that authority "extends today may be debatable" and its discussion of the issue was not extensive (*id*. at 769) – but nonetheless the panel felt constrained to follow it. *Id*. at 770. This Court is not bound by another circuit's debatable precedent.

Finally, *Nomura* noted there ***could exist*** situations in which the named plaintiffs' claims so closely resembled other plaintiffs' claims that an "identity of issues" existed, such that the formers' establishment "necessarily establishes those of other class members." *Id*. at 770; *accord id.* at 771 (distinguishing *Nomura* from one containing "necessary identity of issues and alignment of [plaintiffs'] incentives"). That precise situation exists here: The Fund has alleged a specific injury – diminished value of its Certificates – that is common to ***every*** Certificate purchaser, with ***identical claims*** brought against ***each*** defendant based upon, *inter alia*, the ***identical false statements*** that appeared in the ***sole*** Registration Statement that was used to sell each Certificate. The "identity of issues and alignment of incentives" could not be clearer.

Defendants belittle their own Registration Statement, portraying it as an empty vessel. They point out that it contained "no information" regarding individual Certificates or mortgage "collateral" (Answering Brief at 18), or loan originators (*id.* at 20).

But the common Registration Statement ***did*** contain the myriad misstatements cited immediately *supra*, several of which reasonably fall within the very categories of purported "no information." *See, e.g.*, JA-212:¶29 (borrowers' qualifications and underwriting standards); JA-221:¶¶52-53 (appraisals will conform to USPAP standards). Given these common misrepresentations, the cases cited in the Opening Brief at pp. 55-56 ***are*** apposite.[5]

2. Plaintiff Has Standing at the "Tranche" Level

Relying on a second *Maine State* opinion, defendants say that the Fund is further limited to its specific "tranche" of Certificates within the Offerings. Answering Brief at 21-25 (citing *Me. State Ret. Sys. v. Countrywide Fin. Corp.*, No. 2:10-CV-0302 MRP, 2011 WL 4389689 (C.D. Cal. May 5, 2011) ("*Maine State II*")).[6]

Maine State II's focus on purportedly "unique" securities at the tranche level and differing "investor expectations" (2011 WL 4389689, at *4) misreads the statute.

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[5] Defendants' attempt to distinguish the Fund's myriad authorities on the ground that they involved "conventional" versus "shelf" offerings (Answering Brief at 20 n.5) is misguided. Section 11 provides liability for misstatements in ***registration statements***, period; it doesn't excuse "shelf" registration statements from telling the truth. Just as misguided is defendants' citation to SEC regulations concerning "post-effective" amendments to registration statements, hoping to portray each of the offerings as unrelated. *Id*. at 17-18. Defendants omit that each of the offerings nonetheless included a ***common*** Registration Statement containing ***common*** misstatements affecting ***all*** Certificate purchasers. Even defendants' "authorities" on the point would seem to agree, then, that standing exists for each of the ostensibly separate offerings, as they involved the ***same*** "document[] that governed [the Fund's] purchase of securities." *In re Wells Fargo Mortg. Backed Certificates Litig.*, 712 F. Supp. 2d 958, 964 (N.D. Cal. 2010).

[6] That the district court decided the "tranche" issue is debatable. At the September 22, 2010 hearing the court indicated it had already decided the issue, but at the previous hearing its rulings focused on the other 15 "trusts," and not "tranches." JA-198/41:2-9.

By its plain terms, §11 cares not a whit about investor "expectations" or reliance; rather, the statute forbids misstatements (or omissions) appearing in ***any part*** of registration statements. 15 U.S.C. §77k. Moreover, that the Certificates in the Trusts here were subdivided into "tranches" with varying levels of payment priority does not excuse the fact that the ***sole*** Registration Statement's misstatements tainted ***each*** security offered – thus triggering liability under §11.

Other courts have considered the issue of "tranches" of securities and whether they matter when plaintiffs allege ***common*** misrepresentations appearing in the securities' offering materials – and come down squarely on the Fund's side. *See, e.g.*, *Pub. Emps. Ret. Sys. of Miss. v. Merrill Lynch & Co.*, No. 08 Civ. 10841 (JSR), 2011 U.S. Dist. LEXIS 93222, at *34 (S.D.N.Y. Aug. 22, 2011) ("Defendants cite no case for the proposition that standing must be determined on a tranche-by-tranche basis. . . . [T]he representations in each Offering ***apply equally to all tranches*** within that Offering."); *N.J. Carpenters Health Fund v. Residential Capital, LLC*, 272 F.R.D. 160, 166 (S.D.N.Y. 2011) ("The alleged disregard for those guidelines thus impacted all proposed class members in the same manner, irrespective of which tranche they purchased.").

In reality the "tranches" may affect, at most, the measure of recovery for their purchasers. *Residential Capital*, 272 F.R.D. at 166 ("The question whether the offering documents were materially misleading will be answered the same way regardless of the . . . loss levels of purchasers of different tranches."); *In re Dynex Capital Sec. Litig.*, No. 05 Civ. 1897 (HB), 2011 U.S. Dist. LEXIS 22484, at *7 (S.D.N.Y. Mar. 7, 2011) ("While investors' repayment rights may vary slightly based on the seniority of the tranches they purchased, this does not present a 'fundamental' conflict within the class."). But different recoveries for different plaintiffs is sorted out later, at a successful case's end; it shouldn't affect a named plaintiff's ability to bring suit on behalf of all investors victimized by the same misstatements.

3. The "Standing" Concerns Here Are Actually Class-Certification Issues

The Fund agrees with defendants that standing is antecedent to class certification issues. Answering Brief at 25. But that is as far as the agreement stretches, for defendants beg the question when they argue that the Fund cannot use a procedural rule to ***create*** standing. *Id.*; *id.* at 26 (cannot "delay[]" standing determination).

The Fund urges no such creation or delay. Rather, it simply asserts that because it already established both constitutional and statutory standing, the district court's concerns actually relate to the Fund's satisfaction of Rule 23. Opening Brief at 62-65.

C. Defendants' "Alternative" Grounds for Affirmance Are Unavailing

Perhaps sensing the shaky "injury" and "standing" grounds upon which they stand, defendants urge this Court to affirm the dismissal on other grounds. Answering Brief at 37-56. Their suggestion should be rejected for several reasons.

Appellate courts ordinarily decline to reach issues that were not actually analyzed and decided by the district court.[7] Reaching such grounds is particularly inappropriate where the decision involved a question of law at the litigation's preliminary stage.

Moreover, none of the alternative grounds suggested is valid:

1. The Statute of Limitations Presents No Bar to the Suit

Defendants insist that "inquiry notice" was triggered here by various disclosures, and that the Securities Act's one-year statute of limitations began running

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[7] *See, e.g.*, *Altvater Gessler-J.A. Baczewski Int'l (USA) Inc. v. Sobieski Destylarnia S.A.*, 572 F.3d 86, 91 (2d Cir. 2009) ("[w]e decline Sobieski's invitation to affirm the district court's dismissal on the alternative grounds"); *Bechhoefer v. United States DOJ*, 209 F.3d 57, 63 (2d Cir. 2000) (declining invitation to affirm on alterative bases: "[a]lthough the DEA raised both issues in its motion for summary judgment, the District Court did not rule on either issue"); *United States v. Johnson Controls, Inc.*, 457 F.3d 1009, 1022 (9th Cir. 2006) ("while 'we ***may*** affirm the district court's judgment on a different ground, we need not do so,' and 'we usually do not'") (emphasis in original).

as to all of the Fund's claims. Answering Brief at 37-43. They are mistaken, for several basic and compelling reasons.

As a threshold matter, defendants employ an incorrect formulation of "inquiry notice." They say the Securities Act's one-year period begins running the moment a plaintiff is placed on "inquiry notice" – which is the same formulation rejected by the Supreme Court in *Merck & Co. v. Reynolds*, ___ U.S. ___, 130 S. Ct. 1784 (2010). The *Merck* Court held that the "discovery" of facts sufficient to put a plaintiff on "inquiry notice" ***does not*** automatically start the running of the limitations period. *Id.* at 1798. Rather, the Supreme Court explained, "terms such as 'inquiry notice' and 'storm warnings' may be useful to the extent that they identify a time when the facts would have prompted a reasonably diligent plaintiff to begin investigating," but still "***the limitations period does not begin to run until*** the plaintiff thereafter discovers or a reasonably diligent plaintiff would have discovered '***the facts constituting the violation***.'" *Id*.

Relying upon pre-*Merck* Second Circuit cases, defendants insist that *Merck*'s holding is inapposite because the Supreme Court focused on "inquiry notice" as it applied to the 1934 Securities Exchange Act ("Exchange Act"), as opposed to the Securities Act involved here. Answering Brief at 37-38 & n.12. They say that this Court has yet to decide whether *Merck* applies to Securities Act cases. *Id*. at 38 n.12.

There is no need to wait; *Merck* did not distinguish between the Securities Act and the Exchange Act in reconciling the circuits' views of the running of the statute of limitations vis-à-vis "inquiry notice." To the contrary, the Supreme Court specifically cited a Second Circuit opinion involving ***both*** Securities Act and Exchange Act claims when it rejected the general "inquiry notice" formulation urged by defendant Merck. *See Merck*, 130 S. Ct. at 1797 (collecting cases, including this Court's decision in *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 350 (2d Cir. 1993)).

Dodds itself makes no distinction between the two statutes. *Dodds*, 12 F.3d at 350 ("[T]he statutory periods for claims ***under either of these provisions begin to run*** when the claim accrued or upon discovery of the facts constituting the alleged fraud. Discovery . . . includes constructive and inquiry notice as well as actual notice."). Thus, *Dodds* and its progeny utilize the inquiry-notice formulation rejected by *Merck*.

Beyond misreading *Merck*, defendants are unable to show as a matter of law that the statute of limitations ran. Even their authorities counsel that "'[i]nquiry notice exists only when ***uncontroverted*** evidence irrefutably demonstrates when plaintiff discovered or should have discovered the fraudulent conduct.'" *Newman v. Warnaco Grp., Inc.*, 335 F.3d 187, 194-95 (2d Cir. 2003); *Staehr v. Hartford Fin. Servs. Grp.*, 547 F.3d 406, 427 (2d Cir. 2008) (defendants must present uncontroverted evidence of so-called "storm warnings," which must be ***directly related*** to the legal claims asserted by plaintiff).

Defendants cannot do that here. None of the articles or reports they rely upon mentions the Certificates, Trusts, loans at issue, or any of the defendants. Answering Brief at 40-41. Under this Court's precedents, those omissions mean the cited materials are insufficient to trigger even "inquiry notice." *See, e.g.*, *Staehr*, 547 F.3d at 427.

In *Staehr*, defendants argued that inquiry notice was triggered by four lawsuits, numerous new articles and industry newsletters, portions of defendants' regulatory filings with the SEC, and samples of annual insurance filings. *Id.* at 416. This Court rejected the argument. With regard to seventeen industry-related news articles – even with one explicitly mentioning defendants – this Court found that "[b]ecause nearly all of the stories in the record are devoid of ***company-specific information***, the argument that they constitute 'storm warnings' is far from compelling." *Id.* at 428. Further noting that "the specificity of storm warnings bears directly on the determination of whether, under the totality of the circumstances, a plaintiff should be charged with a duty to inquire," this Court held "[t]he news reports in the record were insufficient to give a reasonable investor notice of a probability that they might have been defrauded." *Id.* at 428-29. The same result obtains here.

Defendants are equally mistaken as to the *Nomura* lawsuit's effect. Although both cases involve mortgage-backed securities, *Nomura*'s allegations have nothing to do with the Certificates and misstatements at issue here. *Nomura* concerned different trusts, different securities, different mortgages, many different originators, and – with one exception – completely different defendants.[8] They cannot be said, ***as a matter of law***, to have put reasonable investors on notice that the existence of the claims alleged here was probable. *See Staehr*, 547 F.3d at 434.

Finally, in this Circuit even inquiry notice arises "only when ***uncontroverted*** evidence ***irrefutably demonstrates***" that plaintiffs discovered or should have discovered the alleged conduct. *Newman*, 335 F.3d at 194-95. The evidence here is controverted, for the disclosures were tempered by reassurances and words of comfort. *Cf. In re Ambac Fin. Grp., Inc.*, 693 F. Supp. 2d 241, 276 (S.D.N.Y. 2010) (no limitations period triggered if disclosures accompanied by """reliable words of comfort from management" such that an investor of ordinary intelligence would reasonably have relied on the statements to allay his or her concern'"); *accord In re*

8 Goldman Sachs only underwrote one of the eight trusts at issue in *Nomura*, which is not at issue here. CD99/Ex. F:¶21.

Alcatel Sec. Litig., 382 F. Supp. 2d 513, 527 (S.D.N.Y. 2005) (same) (citing *LC Capital Partners, L.P. v. Frontier Ins. Grp., Inc.*, 318 F.3d 148, 155 (2d Cir. 2003)).

Each of the Prospectus Supplements – including the two filed ***after*** the December 11, 2007 date heralded by defendants – contained affirmative misrepresentations tempering the disclosures purportedly triggering notice. Prospectus Supplements discussed Countrywide's and GreenPoint's underwriting practices, for example, reassuring investors as late as April 2008 that whatever they might have heard elsewhere, those loan originators properly applied the underwriting guidelines asserted in the Offering Documents. CD62:43-44. Any supposed industry-wide disclosures were controverted by the fact that the Certificates received "investment grade" credit ratings that remained largely unaltered until early-to-mid 2008. JA-205-JA-206:¶6; JA-235:¶90. And defendants cannot explain how the Fund should have been on notice of the false and misleading statements in the 2007-5 Supplement dated April 16, 2008, ***four months before*** the document was even re-filed with the SEC, and ***five months before*** the Fund purchased its Certificates on May 21, 2008.

Given the foregoing, a statute-of-limitations ruling is premature. *See, e.g.*, *Levitt v. Bear Stearns & Co.*, 340 F.3d 94, 104 (2d Cir. 2003) (statute-of-limitations factual disputes should not be resolved in defendant's favor on a motion to dismiss); *accord Staehr*, 547 F.3d at 427.

2. The Materiality of Defendants' Misstatements Is Beyond Question

Defendants also urge affirmance on "materiality" grounds, focusing on the number and individual characteristics of the underlying loans. Answering Brief at 55-56. And yet, like statute-of-limitations issues, materiality is rarely suitable for decision at the pleading stage. *See, e.g.*, *Asher v. Baxter Int'l Inc.*, 377 F.3d 727, 735 (7th Cir. 2004) (Easterbrook, J.) ("inappropriate to entertain" defendants' immateriality argument "at the pleading stage"). Its determination involves an "'inherently fact-specific finding.'" *Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706, 716 (2d Cir. 2011).

Beyond those bedrock axioms, defendants have another problem: They seek to misdirect this Court's attention to the character of the specific loans underlying the Certificates, when what matters to investors is the veracity of defendants' statements concerning the loan underwriting performed and the overall investment quality and riskiness of the Certificates they purchased. *See* JA-204-JA-206:¶¶3-6; JA-235:¶90. With that shift in focus, the issue of "materiality" becomes easy to decide in the Fund's favor.

Surely, reasonable investors would consider it important that, contrary to the Offering Documents' representations, at least 30%-40% of the loans contained within the Trusts were given to borrowers who could not afford to repay them, and that the originators were not following their purported lending "guidelines." JA-214-JA-220:¶¶35-51. Reasonable investors would want to know that up to 90% of the underlying loan documents had been falsified (JA-228:¶73), or that the majority of appraisals had been falsely inflated (JA-226-JA-227:¶69). Reasonable investors would want to know that the Certificates' credit ratings, ostensibly "investment grade," were in fact grossly unreliable because they were based upon outdated assumptions, relaxed ratings criteria, and inaccurate loan information. JA-232-JA-233:¶¶79-84.

At bottom, whether the foregoing would ***not*** have mattered to reasonable investors cannot be decided now. A complaint "'may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance.'" *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162 (2d Cir. 2000).

3. The Complaint Successfully Alleges a *Prima Facie* Case of Securities Act Liability

The Fund has already explained the simplicity with which a *prima facie* case of liability under the Securities Act may be pleaded. Opening Brief at 42-45. In response, defendants launch a scattershot volley of reasons why their misstatements were ***not*** actionable. Upon consideration, none of them is persuasive.

Duty to Disclose Underwriting Standards. Citing Item 1111 of SEC Regulation AB, defendants say that Item alone sets the parameters of disclosure duties having to do with underwriting standards. Answering Brief at 45. It purportedly both "creates" and "limits" their duties by requiring disclosure of only those deviations from underwriting criteria ***known*** to them. *Id*. It is thus an exception, they say, to the usual rule that §11 claims need not plead scienter. *Id*. This argument fails for several reasons.

First, although it didn't have to, the Complaint ***does*** allege defendants' "aware[ness]" of the underwriting deviations. JA-227-JA-228:¶72. That allegation must be accepted as true at this stage. *Matrixx*, 131 S. Ct. at 1314. The allegation that defendants were "aware" thus halts defendants' argument in its tracks, for their entire Item 1111 argument is based upon a false premise.

Defendants concede the allegation, but insist that because it involves notions of "knowledge," it must be pleaded with Rule 9(b) particularity. Answering Brief at 47.

They are wrong again. This Court's recent *Fait* decision reaffirms that claims under §§11 and 12 "do not require allegations of scienter." *Fait v. Regions Fin. Corp.*, No. 10-2311-cv, 2011 U.S. App. LEXIS 17517, at *10 (2d Cir. Aug. 23, 2011). Despite requiring allegations of defendants' misstated "beliefs" and "opinions," this Court cautioned that it was not equating them with "fraudulent intent." *Id.* at *18-*19 & n.5. That caution applies here.

Second, SEC regulations are designed to supplement – ***not replace*** – the broader disclosure requirements of §§11 and 12(a)(2). Defendants' own authority recognizes as much. *See In re N2K Inc. Sec. Litig.*, 82 F. Supp. 2d 204, 207 (S.D.N.Y. 1999) ("a material omission from a registration statement is actionable if the omitted facts (1) were required by SEC regulations to be stated therein, ***or*** (2) ***were necessary to make the disclosures in the registration statement not misleading***"), *aff'd*, 202 F.3d 81 (2d Cir. 2000); *In re Morgan Stanley Tech. Fund Sec. Litig.*, 643 F. Supp. 2d 366, 375 (S.D.N.Y. 2008) (same), *aff'd*, 592 F.3d 347 (2d Cir. 2010). Because the Fund is not suing for a violation of Item 1111, whether defendants complied with that Item is separate from whether they misstated material facts in violation of the Securities Act's broader requirements. *See, e.g.*, *N.J. Carpenters Vacation Fund v. Royal Bank of Scot. Grp., PLC*, 720 F. Supp. 2d 254, 269 (S.D.N.Y. 2010) (rejecting similar arguments because the plaintiffs "allege not only that RBS Defendants failed to disclose information about the underwriting guidelines, but that the statements about the guidelines were themselves incorrect"); *accord In re Lehman Bros. Sec. & ERISA Litig.*, 684 F. Supp. 2d 485, 493 (S.D.N.Y. 2010).[9]

Finally, even if defendants are correct that Item 1111's disclosure duties trump the Securities Act overall, they misread the Item and the nature of the Complaint's allegations. They say that Item 1111 only requires disclosure of ***known*** deviations from the underwriting criteria used – using those deviations as a proxy for falsehoods. But read fairly, the Item actually says that (i) the actual underwriting criteria utilized are to be (accurately) described, ***and then***, (ii) if one knows that the originator made allowable changes to those criteria, those subsequent changes must also be disclosed. 17 C.F.R. §229.1111(a)(3). That's a quite-different scenario from the wholesale breakdown in underwriting standards the Complaint alleges.

Disclosure of Risks. Defendants insist that, as a matter of law, the disclosure of various "risks" in the Offering Documents absolves them of all responsibility.

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[9] Defendants belittle cases rejecting their Item 1111 argument by asserting that the decisions "posit a distinction between omission and misstatement claims" that does not appear in the Regulation. Answering Brief at 46. Yet the cases correctly recognize that the Securities Act's reach is broader than Regulation AB's discrete disclosure requirements. *Lehman Bros.*, 684 F. Supp. 2d at 494 (under §11, defendants are "strictly liable for any misstatements in the Offering Documents").

Answering Brief at 47-52. They say that investors were fully informed about underwriting guidelines and possible exceptions, and that independent mortgage brokers and appraisers would be involved. *Id*.

But generalized, bland warnings are insufficient. Rather, the cautions "must relate directly to that by which plaintiffs claim to have been misled." *Hunt v. Alliance N. Am. Gov't Income Trust, Inc.*, 159 F.3d 723, 729 (2d Cir. 1998); *accord P. Stolz Family P'ship L.P. v. Daum*, 355 F.3d 92, 97 (2d Cir. 2004) ("the cautionary language must . . . warn[] of the specific contingency that lies at the heart of the alleged misrepresentation"). The cautions here did not.

For example, while defendants may have noted that some exceptions might be made, they ***did not caution*** that loan originators would, *inter alia*, coach borrowers to falsely state their incomes, or approve borrowers based on "teaser rates" knowing the borrowers would be unable to afford payments once the rates adjusted. JA-215-JA-216:¶38(a)-(f). While defendants may have disclosed Countrywide's "'Expanded Underwriting Guidelines'" (Answering Brief at 49), they ***did not caution*** that Countrywide's own personnel conceded that it was infested with employees who ignored its underwriting standards (JA-217-JA-218:¶43), or that Countrywide engaged in practices leading to an $8.4 billion settlement with some 33 states (JA-218-JA-219:¶47). Defendants ***did not caution*** that approximately 35%-40% of the loans in the 2007-5 Trust and 30%-35% of the loans in the 2007-10 Trust were made with no determination of the borrower's ability to repay. JA-220:¶51.

Similarly, telling investors that third-party appraisers would be involved in the loan process does not sufficiently caution that those appraisers were shirking professional guidelines while producing inflated appraisals. The Registration Statement claimed that property appraisals were done by qualified appraisers whose compensation was not affected by the loan's approval or disapproval – and yet the Complaint alleges the exact opposite. JA-222-JA-226:¶¶56-68. Indeed, the Complaint alleges that at least 47% of the 2007-5 Trust loans had property-value appraisals inflated by 9% or more, with another 31% inflated by less than that. JA-226-JA-227:¶69. Similar percentages afflicted the 2007-10 Trust. *Id.*[10]

Original Borrowers' Loan Documents Free from Misrepresentations. Defendants insist that ***they*** never represented that the underlying loan documents were free from material misrepresentations; they say all such representations were made by

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[10] Defendants place great weight on the "subjective" nature of property appraisals. But the Complaint alleges more than mere differences of opinion; it alleges that the appraisals were ***not*** based on comparable property values, violated USPAP standards, and that the appraisers gave in to widespread demands to issue pre-determined, compensation-linked appraisals. JA-222-JA-226:¶¶56-68. Under these circumstances, it can hardly be said the appraisals were honestly believed.

loan originators to loan purchasers (like GS Mortgage). Answering Brief at 53. Defendants are both wrong and attempting to manufacture a distinction without a difference.

While the Complaint does note that loan originators had warranted that no underlying documents were falsified (JA-227:¶70), it also alleges that defendant GSMC ***itself*** made the same reassurances to investors (JA-227:¶71). That allegation must be accepted as true. *Matrixx*, 131 S. Ct. at 1314. Moreover, whether the original misrepresentations emanated from loan originators does not matter; defendants placed them squarely in the Registration Statement, and under the Securities Act liability arises if "***any part*** of the registration statement, when such part became effective, ***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).[11]

Disclosure of Loan-to-Value ("LTV") Calculations. The Complaint alleges that LTV ratios in the Offering Documents were false and misleading. JA-231:¶78.

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[11] Defendants also say that investors were warned that loan originators could "deviate" from their guidelines (Answering Brief at 53), but allowing occasional deviations is not the equivalent of giving *carte blanche* to wholesale falsehoods. The Complaint alleges that ***90%*** of the loan files for the underlying mortgages were falsified and/or contained untrue statements. JA-228:¶73.

They were calculated using false and inflated property appraisals, resulting in artificially low ratios. *Id*.

Defendants' main response is that because some other courts have dismissed "[s]uch allegations," this Court should too. Answering Brief at 54. They say the allegations are derivative of the Fund's allegedly "flawed" appraisal allegations. *Id*. But those appraisal allegations are far from flawed (*see supra*), and defendants' urging that this Court simply "adopt" holdings from other district court cases – each with its own unique set of facts – is a flimsy foundation upon which to argue. The Complaint alleges that the LTV ratios were false and misleading, presenting a pleaded fact that must be accepted as true. *Matrixx*, 131 S. Ct. at 1314.

False Ratings. Defendants' insistence that the Offering Documents truthfully repeated the ratings given the Certificates (Answering Brief at 54-55) fundamentally misconceives the Complaint's allegations. The Fund doesn't dispute that the Certificates were labeled AAA-rated when issued – it alleges the ratings ***themselves*** were false. JA-232:¶80. What was touted as "investment grade" AAA was actually junk. JA-233:¶84. That plain statement of falsity satisfies *prima facie* Securities Act liability. *Herman*, 459 U.S. at 382.

Defendants say that "[n]umerous courts" have rejected "identical" ratings claims (Answering Brief at 54), but unlike defendants' cases, the Complaint alleges that these rating agencies utilized inaccurate information that ***defendants "provided to them***." JA-233:¶83. *Cf. J&R Mktg. v. GMC*, 549 F.3d 384, 393 (6th Cir. 2008) ("[t]he investors do not allege that GMAC lied to or misled the credit rating agencies").[12]

Credit Default Swaps. The fact that defendants disclosed that Goldman Sachs "might" take positions in the Certificates (Answering Brief at 55) does not excuse the omission that Goldman Sachs had entered into exotic credit-default swaps expecting residential mortgage borrowers to default. JA-234:¶¶86-88. For one thing, disclosing that one ***might*** have an economic interest in the underlying mortgage loans does not disclose that Goldman Sachs was ***then*** actively betting against the very type of loans underlying the Certificates. *Rombach v. Chang*, 355 F.3d 164, 173 (2d Cir. 2004) ("Cautionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired."). For another, Certificate purchasers would have wanted to know that while defendants were offering "investment grade" Certificates for sale, Goldman Sachs was placing massive bets ***against*** them. JA-234-JA-

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[12] Moreover, the allegations here collectively show that opinions expressed by the ratings could not have been truly held by the rating agencies because the inherently flawed models, false underlying data, and conflicts of interest made such a belief impossible. JA-232-JA-233:¶¶79-84.

235:¶¶85-89. Defendants insist they had no obligation to say more, but that contradicts a securities law truism: Having chosen to speak of the possibility of taking an interest in the underlying securities' performances, defendants assumed the duty to disclose that the possibility was a reality. *See, e.g.*, *Caiola v. Citibank, N.A.*, 295 F.3d 312, 331 (2d Cir. 2002) ("upon choosing to speak, one must speak truthfully about material issues").

D. There Was No Undue Delay in Seeking Amendment

Leave to amend isn't an issue here. Given §11(e)'s plain text and this Court's precedents like *McMahan*, 65 F.3d at 1047, the district court erred in requiring an out-of-pocket loss for injury. No amendment to the Complaint is needed to satisfy the correct standard.

With that said, however, the Fund cannot let defendants' leave-to-amend arguments go unanswered. They defend the district court's refusal to allow amendment on "undue delay" grounds because the Fund: (i) purportedly waited "until months after its sales of the securities to notify the court"; and (ii) deliberately waited until the court denied both its reconsideration motion and its Rule 54(b) motion before seeking amendment. Answering Brief at 57-58.[13] The record shows that both contentions are wrong.

First, class counsel did not delay its attempt to amend after discovering the Fund's sales of Certificates. The motion to amend was made by class counsel on ***February 8, 2011*** (CD128) after learning ***in late January*** about the sales. *See* JA-382/12:24-25. Defendants omit that fact.

Second, defendants are mistaken that the Fund deliberately waited until the court denied its motions for reconsideration and entry of Rule 54(b) judgment before suggesting amendment. The record shows that the former motion was denied in mid-November 2010 (SPA-14-SPA-15), and the latter on January 14, 2011 (SPA-16). Notably, both denials pre-dated the time frame when class counsel first became aware that the Fund could amend with allegations concerning sales at a loss; it was ***that*** late-January discovery that prompted the amendment motion. Moreover, defendants omit that in the late-October 2010 reconsideration papers, the Fund suggested several amendments that would assuage the district court's concerns regarding a secondary market. CD115:6 ("[p]laintiff is willing to amend the [Complaint] to reflect this

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[13] Defendants do not argue bad faith, prejudice, or futility. *See Foman v. Davis*, 371 U.S. 178, 182 (1962).

additional information"); CD115:7 n.9 ("plaintiff is also prepared to amend" the Complaint to reflect additional information). Contrary to defendants' suggestion that the Fund was a dilatory litigant, the record shows that the Fund diligently sought to satisfy the district court.

In light of the foregoing, there was no "undue delay." However the Court decides the main issue on appeal, it should allow the suggested amendments so that the Fund may satisfy some of the district court's other concerns. *See Foman*, 371 U.S. at 182 (refusal to grant amendment without any justifying reason is an abuse of discretion "and inconsistent with the spirit of the Federal Rules").[14]

[14] Also, should the Court decide to affirm the dismissal on any of the suggested "alternative" grounds, the Fund respectfully requests that it be allowed to amend to address those grounds.

II. CONCLUSION

For the reasons given *supra* and in the Opening Brief, the district court's dismissal should be reversed.

DATED: October 12, 2011

Respectfully submitted,

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RULE 32(a)(7)(C) CERTIFICATE

The undersigned counsel certified that Plaintiff-Appellant's Reply Brief uses a proportionally spaced Times New Roman typeface, 14-point, and that the text of the brief comprises 6,995 words according to the word count provided by Microsoft Word 2003 word processing software.

s/ Joseph D. Daley
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DECLARATION OF SERVICE

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Diego, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 655 W. Broadway, Suite 1900, San Diego, California 92101.

2. I hereby certify that on October 12, 2011, I electronically filed the foregoing document: PLAINTIFF-APPELLANT'S REPLY BRIEF with the Clerk of the Court for the United States Court of Appeals for the Second Circuit by using the appellate CM/ECF system.

3. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

I declare under penalty of perjury that the foregoing is true and correct. Executed on October 12, 2011, at San Diego, California.

s/ Jana P. Kusy
JANA P. KUSY