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Second Circuit Expands Standing for Mortgage-Backed Securities Purchasers

In the wake of the housing crisis, more than 20 class actions were commenced by purchasers of mortgage-backed securities (MBS) against issuers and underwriters pursuant to Section 11 of the Securities Act of 1933. Although a few cases have been resolved, many are still winding their way through the federal courts. A threshold question that the courts have grappled with is whether the named plaintiffs in these class actions may sue on both securities they purchased in a particular offering and securities that were issued under the same shelf registration. Allowing a plaintiff to assert class claims for securities it did not purchase raises difficult questions regarding constitutional standing, as well as statutory standing under the Securities Act. Thus, most federal courts have held that the named plaintiff has standing to assert claims only relating to the offerings in which it purchased securities. These rulings have reduced the scope of many of the pending MBS class actions dramatically. *See, e.g., Public Empl. Ret. Sys. of Miss. v. Merrill Lynch & Co.,* 714 F. Supp. 2d 475, 480-81 (2010) (dismissing claims relating to 65 of 84 offerings).

In *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, No. 11-2762-cv, decided on September 6, 2012, the U.S. Court of Appeals for the Second Circuit outlined a potentially significant expansion of class standing that runs contrary to these rulings. A common theme in MBS class actions is an allegation that the lenders that originated the underlying loans were "systematically disregarding" the loan underwriting standards described in the prospectus supplements, rendering them misleading. In *NECA*, the Second Circuit reinstated claims with respect to five offerings that contained loans originated by the lender that also had originated loans in the two offerings from which the plaintiff purchased its certificates.

The court held that "in a putative class action, a plaintiff has class standing if he plausibly alleges (1) that he 'personally has suffered some actual . . . injury as a result of the putatively illegal conduct of the defendant.'…and (2) that such conduct implicates 'the same set of concerns' as the conduct alleged to have caused injury to the other members of the putative class by the same defendants." Given the allegation that the loan originators were not following the underwriting guidelines described in the prospectus, the court reasoned that claims of other MBS purchasers would "implicate 'the same set of concerns' as plaintiff's claims" to the extent these purchasers bought in offerings that "were backed by loans originated by originators common to those backing the offerings from which the plaintiff bought." The court found it significant that NECA was suing not the originators, but the entities that issued, underwrote and sponsored the MBS; and that the offering documents at issue allegedly contained identical misrepresentations. Thus, NECA's concerns relating to the underwriting standards of the originators whose loans backed the MBS that NECA purchased were the "same concerns" as those of other purchasers who bought MBS backed by loans from those same originators. However, the court confirmed that NECA lacked standing to bring claims on behalf of purchasers who bought MBS in offerings backed by loans originated solely by lenders that were not involved in the MBS that NECA purchased.

If you have any questions regarding the matters discussed in this memorandum, please contact ***Christopher P. Malloy*** *at 212.735.3792, christopher.malloy@skadden.com or call your regular Skadden contact.*

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The *NECA* opinion injects uncertainty into current MBS litigation and potentially increases the exposure of MBS issuers and underwriters in pending and future litigation. In several MBS class actions pending in the district courts in the Second Circuit, the plaintiffs are arguing that claims previously dismissed on standing grounds should be reinstated as to offerings where there is some overlap in originators with an offering for which the plaintiff does have standing. In the Eastern District of New York, in *Plumbers' & Pipefitters' Local # 562 Supp. Plan & Trust v. J.P. Morgan Acceptance Corp.* the district court *sua sponte* reconsidered a prior ruling dismissing claims on standing grounds and, in light of the *NECA* opinion, expanded the number of MBS offerings at issue in the case from eight to 30. In cases outside the Second Circuit, plaintiffs have argued that the *NECA* decision should be adopted as law. The extent to which that will occur remains to be seen. Indeed, the *NECA* decision is in apparent tension with the First Circuit's decision in *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp*., 632 7 F.3d 762, 768 (1st Cir. 2011), which limited class standing to offerings in which the named plaintiff had purchased securities.