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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 45

GEOFFREY VARGA and MARK LONGBOTTOM, as Joint Official Liquidators of Bear Stearns High-Grade Structured Credit Strategies (Overseas) Ltd. and Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage (Overseas) Ltd.	
Plaintiffs,	Index No. 652410/2013
-against-	DECISION AND ORDER
McGRAW HILL FINANCIAL INC. (f/k/a THE McGRAW-HILL COMPANIES, INC. and d/b/a STANDARD & POOR'S RATING SERVICES), STANDARD & POOR'S FINANCIAL SERVICES LLC, MOODY'S CORPORATION., MOODY'S INVESTORS SERVICE, INC., MOODY'S INVESTORS SERVICE LIMITED, FITCH GROUP, INC., FITCH RATINGS, INC. (f/k/a FITCH, INC.) and FITCH RATINGS LIMITED,	Motion Sequence Nos. 001and 002
Defendants,	
BEAR STEARNS HIGH-GRADE STRUCTURED CREDIT STRATEGIES MASTER FUND, LTD., and BEAR STEARNS HIGH-GRADE STRUCTURED CREDIT STRATEGIES ENHANCED LEVERAGE MASTER FUND, LTD.,	
Nominal Defendants.	

ANIL C. SINGH, J.:

Geoffrey Varga and Mark Longbottom, joint official liquidators of Bear Stearns High-Grade Structured Credit Strategies (Overseas) Ltd. and Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage (Overseas) Ltd. (Overseas Funds), brings this action for fraud against McGraw Hill Financial Inc., Standard and Poor's Rating Services LLC, Moody's Corporation, Fitch Group Inc. and its subsidiaries (collectively, Rating Agencies). Plaintiff allege that the Rating Agencies violated New York State law by engaging in fraud in relation to assignments of ratings of creditworthiness to residential mortgage backed securities (RMBS) and collateralized debt obligations (CDOs) purchased by "master funds," in which the Overseas Funds were invested. The Rating Agencies have moved to dismiss the complaint pursuant to CPLR 3211 (a) (1), (5), and (7). Further, Fitch Ratings Limited moves to dismiss the complaint pursuant to CPLR 3211 (a) (8). Plaintiffs' oppose the motion.

Background

The complaint alleges Overseas Funds are both Cayman Islands exempted companies organized under the company's law of the Cayman Islands. Prior to the events complained of, the Overseas Funds operated, as "feeder funds" for the Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd. and Bear Stearns High-Grade Structured Credit Strategies Enhanced Master Fund Ltd. (collectively, "Master funds"). The Master and Feeder Funds were structured and managed by Bear Stearns Asset Management (BSAM), at all relevant times a subsidiary of Bear Stearns, the entity that issued securities that comprised 82% of the Master Funds' net assets.

At all relevant times, the Overseas Funds have been shareholders/investors in the Master Funds. The Overseas Funds did not trade directly, but instead invested all of their assets in the Master Funds, and accomplished all of their investment and trading activity through their investment in the Master Funds. The Master Funds were formed for the sole purpose of achieving administrative efficiencies and conducting trading activities on behalf of the Overseas Funds.

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The Rating Agencies rate securities and assign grades based upon their perception of the securities' creditworthiness. Institutional and private investors often use these ratings as a guide to their possible exposure as a result of economic stress.

The Overseas Funds were created in 2003 and 2006 and marketed to a small group of institutional or otherwise eligible investors. The Overseas Funds touted themselves as investing in "high grade" RMBS and CDO-structured debt securities collateralized by pools of individual residential mortgages and, in the case of CDOs, various other debt securities. The Overseas Funds' detailed their investment strategy in their Confidential Offering Memoranda (COMs) and discussed the "high-grade" nature of the securities in which they invested. In particular, the COMs represented that the Master Funds would invest in the safest tranches of structured financings as determined by the rating agencies, predominantly securities that had received ratings of AAA, AA, or AA-. In making this representation, the Overseas Funds allege they relied upon the Rating Agencies' impartiality and accuracy in rating the securities at issue.

As RMBS and CDOs offer little transparency to investors into the composition and characteristics of the underlying loan collateral, the importance of rating agencies, which do have access to this data, is increased along with the weight afforded said ratings by investors. Plaintiffs allege that the Rating Agencies were aware of the importance of their ratings and, in order to increase their market share, touted the up-to-date models upon which they relied, the objectivity and accuracy of their ratings, and their commitment to robust surveillance in assuring the continuing accuracy of the ratings.

The Rating Agencies customarily prepared and issued a "Pre-Sale Report," or similar document, that summarized their findings on a security prior to the issuance of the rating itself. The Pre-Sale Report was intended to provide comfort to potential investors that a rating by the

Rating Agency was forthcoming, and indicated the anticipated rating. The Rating Agencies issued Pre-Sale Reports on the securities at issue, detailing their belief that such securities would receive a rating of AAA, AA, or AA-, all ratings denoting a strong confidence in the creditworthiness of such securities. These Pre-Sale Reports were issued to the Master and Overseas Funds, as were the actual ratings issued at a later date. Of the forty-one securities held by the Master Funds, thirty were purchased prior to the issuance of an official rating.

The Overseas Funds never directly invested in any security rated by the Rating Agencies. Instead, their claim relates to the purchase of securities made by the Master Funds, on whose behalf, the Overseas Funds bring suit. The Master Funds acquired the first of the securities at issue on August 14, 2006 and the last on May 29, 2007.

In mid-July of 2007, the Rating Agencies notified investors that they were placing a "watch" on the securities at issue, indicating growing concern over the future performance of such securities. By this time, the Rating Agencies had witnessed rapid depreciation in the RMBS and the CDOs at issue which increased the risk that the tranches purchased by the Master Funds would be negatively impacted. The delinquencies in the underlying loans were so great that, in some instances, the Rating Agencies were seeing realized losses after only six months with such losses being all but unheard of in a 30-year loan. Internal correspondence of the Rating Agencies indicates their awareness of the severity of the situation and the weakness of the RMBS market.

The first downgrade of the securities at issue occurred on November 12, 2007, with the bulk of the remaining securities being downgraded in 2008. By the time the Rating Agencies issued the downgrades, the Master and Feeder Funds had sustained massive losses, and the RMBS and CDOs at issue had become virtually worthless. As a result, both the Master Funds and Overseas Funds were forced into insolvency, and are currently in receivership in the Cayman

Islands, where a court has granted the Overseas Funds permission to sue in the State of New York.

Plaintiffs allege that the Rating Agencies knowingly issued inaccurate ratings for the securities at issue in order to increase their profit and market share. In particular, Plaintiffs contend that the Rating Agencies were aware of the instability of the RMBS market both when it issued the original ratings, and, certainly, well before their first downgrades in November of 2007. Specifically, Plaintiffs contend that the Rating Agencies used outdated models on the securities at issue at the request of the issuer, Bear Stearns and Bear Stearns Asset Management, in order to profit under the "issuer pays model" of Rating Agency compensation whereby the Rating Agencies allegedly received inflated revenue for providing the ratings that the issuers sought in a process known as "ratings shopping". Plaintiffs allege that in their use of outdated rating models, the Rating Agencies failed in their duty of objectivity and, in the maintenance of these fraudulent ratings, in their duty of surveillance.

Plaintiffs seek compensatory damages of one billion dollars for loss of revenue both directly and derivatively on behalf of the Master Funds. This is the third action brought by Plaintiffs in connection with the collapse of the RMBS market. The first two were against Bear Stearns, and Deloitte, its accountants. The Plaintiffs alleged that Bear Stearns and Bear Stearns Asset Management manipulated the rating and misrepresented the quality of RMBS they issued. The securities at issue in the Deloitte proceeding were omitted from this suit.

Discussion

The Rating Agencies move to dismiss the claims on the basis that the plaintiffs have not adequately pleaded actionable misstatement, scienter, reliance, or loss causation. The Rating Agencies further assert that the claims are time-barred under New York law. The Rating

Agencies additionally argue that the plaintiffs lack the standing to sue both directly and derivatively, and are also barred by the *in pari delicto* doctrine. Fitch Ratings, Ltd. also moves to dismiss for lack of personal jurisdiction.

On a motion to dismiss for failure to state a cause of action, the court accepts all factual allegations pleaded in plaintiff's complaint as true, and gives plaintiff the benefit of every favorable inference. CPLR 3211 (a) (7); *Sheila C. v. Povich*, 11 A.D.3d 120 (1st Dep't 2004). The court must determine whether "from the [complaint's] four corners[,] 'factual allegations are discerned which taken together manifest any cause of action cognizable at law." *Gorelik v. Mount Sinai Hosp. Ctr.*, 19 A.D.3d 319 (1st Dep't 2005) (quoting *Guggenheimer v. Ginzburg*, 43 N.Y.2d 268, 275 (1977)). Vague and conclusory allegations are not sufficient to sustain a cause of action. *Fowler v. American Lawyer Media, Inc.*, 306 A.D.2d 113 (1st Dep't 2003).

I. Fraudulent Misrepresentations

Plaintiffs allege fraud against all defendants. To state a claim for fraud, a plaintiff must allege a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely on it, justifiable reliance of the other party on the misrepresentation or material omission, and injury. *Ventur Grp., LLC v. Finnerty*, 68 A.D.3d 638 (1st Dep't 2009). In any claim for fraud, New York law requires that "the circumstances constituting the wrong shall be stated in detail." CPLR 3016(b). Under this heightened pleading standard, a claim of fraud must be supported by factual allegations that sufficiently detail the allegedly fraudulent conduct and give rise to a reasonable inference of the alleged fraud. *Pludeman v. Northern Leasing Systems, Inc.*, 10 N.Y.3d 486, 492 (2008). Vague and conclusory allegations or speculative inferences lacking factual support do not suffice. *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 N.Y.3d 553, 559 (2009). However, CPLR

3016 (b) "should not be so strictly interpreted as to prevent an otherwise valid cause of action in situations where it may be impossible to state in detail the circumstances constituting a fraud." *Id.*, quoting *Pludeman v. Northern Leasing Sys., Inc.*, 10 N.Y.3d 486, 491 (2008). "Thus, where concrete facts are peculiarly within the knowledge of the party charged with the fraud, it would work a potentially unnecessary injustice to dismiss a case at an early stage where any pleading deficiency might be cured later in the proceedings." *Pludeman*, 10 N.Y.3d at 491–492 (internal quotation marks and citations omitted). Thus, the statute is satisfied when the alleged "facts are sufficient to permit a reasonable inference of the alleged conduct." *Id.* at 492, 860 N.Y.S.2d 422, 890 N.E.2d 184.

1. Misrepresentation

An actionable fraud claim requires proof that defendant made a misrepresentation of fact which was false and known to be false. *Waterscape Resort LLC v. McGovern*, 107 A.D.3d 571, 572 (1st Dep't 2013). Plaintiffs allege the ratings issued by the Rating Agencies knowingly misrepresented the creditworthiness of the underlying securities, and that the Rating Agencies also misrepresented well their objectivity in the rating process. Plaintiffs allege that the Rating Agencies failed to conduct the "continued surveillance" of the ratings that their issuing reports promised. Testimony at congressional hearings, and interviews with senior employees of the various Rating Agencies, support the proposition that the Rating Agencies were aware of the deficiency of their ratings. The complaint contains statements made by employees of the various Rating Agencies which can be best summarized by a quotation from a former S&P CDO group managing director: "we knew the ratings were wrong at the time." Further, Plaintiffs allege that the rating agencies relied upon outdated models, unrealistic assumptions, and inaccurate data when analyzing the creditworthiness of the securities at issue.

Plaintiffs allege misrepresentation in the rating agencies' promises of "independence and objectivity" with regard to their ratings. Plaintiffs maintain that promises were not only given to them, but detailed in the various Rating Agencies' internal polices. Plaintiffs argue that this promise of objectivity was intentionally undermined in an effort to increase profit and market share under the "issuer pays model".

Plaintiffs contend that the Rating Agencies were aware of the volatile naturc of the RMBS securities at the time they rated them. Plaintiffs allege that the Rating Agencies, misrepresented the creditworthiness of the securities for the sake of profit. The Rating Agencies further misrepresented the creditworthiness of the securities when they failed to adjust the ratings in a timely fashion, thus failing in their stated duty of surveillance.

Defendants contend that Plaintiffs have not adequately plead misrepresentation in that the misrepresentations were, in fact, non-actionable opinions, and further that misrepresentation with regard to the ratings are not pled with the requisite degree of specificity as to who made such misstatements. The Rating Agencies rely on cases such as *Allstate Ins. Co. v. Credit Suisse Sec. (USA) LLC,* 42 Misc. 3d 1220(A), 986 N.Y.S.2d 864 (Sup. Ct. N.Y. Cnty. Jan. 24, 2014).

In *Allstate*, the plaintiff Allstate purchased RMBS from defendant Credit Suisse which sustained massive losses over time. During the course of Allstate's investmcnt, the ratings of the RMBS securities deteriorated to become utterly valueless. Allstate argued that the defendants manipulated the credit ratings in a manner similar to that alleged here under the "issuer pays model". The Rating Agencies rely upon the opinions point that "Claims based on credit ratings have been dismissed as inactionable absent an allegation that the rating agency did not believe that the ratings it assigned were supported by the factors considered". *Id.*

However, Defendants omit a key portion of that holding. Citing *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 775 (1st Cir. 2011), the court stated that ratings are inactionable "so long as the ratings were honestly made, had some basis, and *did not omit critical information*." *Allstate*, 986 N.Y.S.2d at 864 (emphasis added). Here, Plaintiffs allege that the rating agencies, as a whole, abandoned their standard rating procedures to increase profit and market share. In doing so, they allege that the Rating Agencies relied on outdated models and inaccurate data, which surely would qualify as "omitting critical information." Defendants claim the allegations lack the specificity to prove this rating; that is not the case. As the Court noted, "the weight of the authority indicates that . . . allegations of systematic underwriting failure are sufficient to state a claim and do not need to be accompanied by reference to specific loans in the securitization pools of the Certificates." *Allstate*, 42 Misc. 3d 1220(A), at 10 (citing *Stichting Pensioenfonds ABP v. Credit Suisse Grp. AG*, 38 Misc. 3d 1214(A), 2012 WL 6929336 (Sup. Ct. N.Y. Cnty. Nov. 30, 2012) (Friedman, J.).

Plaintiffs' allegations of the systematic abandonment of rating practices are sufficient at this stage to state a claim, and do not need to be accompanied by allegations against the specific employees who rated the securities. This holding is bolstered by the recently affirmed *M&T Bank Corp.*, which held that "that [a] plaintiff [who] made allegations regarding defendant's conduct with respect to RMBS and CDOs in general rather than making specific allegations concerning the [RMBS] at issue here" has succeeded in stating a complaint as the court "conclude[d] that any further specificity regarding defendant's knowledge of the falsity of its ratings is within the knowledge of defendant and cannot be adequately stated at this juncture of the litigation." *M&T Bank Corp. v. McGraw Hill Companies, Inc.*, 126 A.D.3d 1414, 1416–17 (4th Dep't 2015).

Plaintiffs' allegations of a systematic failure in this instance are similar to those the court found persuasive in *M&T Bank Corp.* and *Allstate*. Plaintiffs have alleged specific facts sufficient to support a holding that there are actionable misrepresentations with respect to the RMBS and CDOs at issue. They have alleged that the Rating Agencies knowingly inflated the ratings for these securities to increase profit and market share. The Rating Agencies allegedly relied upon outdated models and data to produce favorable ratings, and in doing so, has created a material misrepresentation. *See Capital Ventures Int'l v. J.P. Morgan Mortgage Acquisition Corp.*, No. CIV.A. 12-10085-RWZ, 2013 WL 535320, at *6 (D. Mass. Feb. 13, 2013) (finding actionable misstatements "defendants knew that the underlying data was faulty and so that there was no real basis for the credit ratings"). Plaintiffs have pled sufficient facts to give rise to an inference of misrepresentation by alleging that the Rating Agencies had real knowledge of the defects in their rating methods and the volatility of the securities at issue. Any further specificity would require access to information within the knowledge of the Rating Agencies.

The Rating Agencies next contend that their statements regarding independence and objectivity were non-actionable puffery. Such arguments are rendered unpersuasive in the wake of *State v. Moody's Corp.*, No. X04HHDCV106008836S, 2012 WL 2149408, at *7 (Conn. Super. Ct. May 10, 2012) and *United States v. McGraw-Hill Companies, Inc.*, No. CV13-0779 DOC (JCGx), 2013 WL 3762259, at *1 (C.D. Cal. July 16, 2013). Those cases involved actions against Moody's and McGraw-Hill alleging misrepresentation and manipulation of ratings. These cases contained allegations of misrepresentations relating to of "independence and objectivity." The court in *McGraw-Hill* held that such statements of independence and objectivity were not "mere aspirational musings of a corporation setting out vague goals for its future. Rather they are specific assertions of ongoing policies that stand in stark contrast to the

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behavior alleged by the government's complaint." *McGraw-Hill*, 2013 WL 3762259, at *16. *See also Moody's*, 2012 WL 2149408, at *7 ("The State has pled specific representations of independence by Moody's . . . such specific statements go beyond mere puffery").

The Rating Agencies attempt to counter these arguments with *Boca Raton Firefighters & Police Pension Fund v. Bahash*, 506 F. App'x 32, 38 (2d Cir. 2012). In that case the plaintiff based its claim of misrepresentation upon public statements made by officers of the defendant. The court dismissed the complaint, in part because the public statements were "generic and indefinite." The Rating Agencies would apply the same reasoning in this case, however, such an argument here misses the mark. Significantly, the statements at issue in *Boca Raton* were "generic" and "indefinite" in their scope in that they were routinely made in an "off the cuff manner" to make a general statement about the defendant. In contrast, the assurances made here were of a concrete and crucial nature and were specific representations made to the purchasers of the securities at issue. These statements are unlike those found inactionable in *Boca Raton*, and are instead similar to those found persuasive in *Moody's* and *McGraw-Hill*. *See also Reese v. McGraw-Hill Cos., Inc.*, 293 F.R.D. 617, 620 n.2 (finding statements regarding independence actionable for having alleged "specific, verifiable representations by" the defendants).

2. Scienter

In order to satisfy the element of scienter, a complaint must present facts supporting a "reasonable inference that the defendant participated in, or knew about, the fraud." *China Dev. Indus. Bank v Morgan Stanley*, 2011 NY Misc LEXIS 1808, at *16-18. A reasonable inference can be established either through the allegation that the defendants had the motive and opportunity to commit fraud, or through strong circumstantial evidence of conscious misbehavior and recklessness. *Woodward v. Raymond James Fin., Inc.*, 732 F. Supp. 2d 425, 435-36

(S.D.N.Y. 2010) (citing *ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009)). However, "because the element of scienter is most likely to be within the sole knowledge of the defendant and least amenable to direct proof, the requirement of CPLR 3016(b) should not be interpreted strictly when analyzing the scienter allegations in a complaint." *Aris Multi-Strategy Offshore Fund, Ltd. v. Devaney*, No. 602231/08, 2009 WL 5851192, at *9 (Sup. Ct. N.Y. Cnty. Dec. 14, 2009) (internal citation omitted).

Under the recklessness prong, the plaintiff must demonstrate that the defendant participated in conduct that is "highly unreasonable and represents an extreme departure from the standards of ordinary care...to the extent that the danger was either known to the defendant or so obvious the defendant must have been aware of it." *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978) (quoting *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977)). To show the Rating Agencies engaged in reckless behavior Plaintiff must establish that they may have either 1) [known] facts or had access to information suggesting that their public statements were not accurate; or (2) that the defendants failed to check information they had a duty to monitor." *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000) (citations omitted). *See also Woodward*, 732 F. Supp. 2d at 435-436.

Plaintiffs allege in that employees of the Rating Agencies were aware of the deficiencies of the RMBS market at the time the securities were issued. Furthermore, while the Rating Agencies were issuing high ratings for these securities, they later admitted to knowing "the ratings were wrong at the time", and that they "were not unaware of these loans being weak" but "did not do the due diligence function of trying to recognize whether there was fraud involved." Plaintiffs contend that the Rating Agencies were aware that evidence arose as early as 2006 that "things [in the RMBS were slipping]" but for "whatever reason turned a blind eye to this."

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Plaintiffs allege that these statements demonstrate that defendants "knew facts" suggesting their ratings were inaccurate and "failed to check information they had a duty to monitor" within the ruling in *Novak. See also Allstate*, 986 N.Y.S.2d 864 (holding that reports of loosening standards and knowledge of deficiencies in the RMBS market were sufficient for scienter).

Under the motive and opportunity prong, a complaint must allege both that the defendant has the "means and likely prospect of achieving concrete benefits by the means alleged," *Novak*, 216 F.3d at 307 (internal citation omitted), and that such benefits "could be realized by one or more of the false statements or wrongful disclosures alleged." *Kalnit v. Eichler*, 264 F.3d 121, 138 (2d Cir. 2001) (internal quotation marks omitted). "To establish the strong inference of scienter through the motive and opportunity prong, the complaint must allege that [the defendant] or its officers benefited in some concrete and personal way from the purported fraud. Motives that are common to most corporate officers, such as the desire for the corporation to appear profitable and the desire to keep stock prices high to increase officer compensation, do not constitute 'motive' for purposes of this inquiry." *Woodward*, 732 F. Supp. 2d at 435 (citations omitted). While the motive to profit alone is not sufficient to plead scienter, the motive to increase profit combined with knowledge of a deficiency in the underlying product is. *Abu Dhabi Commercial Bank v. Morgan Stanley & Co. Inc.*, 651 F. Supp. 2d 155, 179 (S.D.N.Y. 2009) (hereinafter *Abu Dhabi I*). In *Abu Dhabi I*, a case that also concerned allegedly fraudulent ratings, the court held that:

> [T]he Rating Agencies were paid only if they provided the desired ratings and only in the event that the transaction closed with those ratings....[this] may be sufficient to support a finding of motive. Because the Rating Agencies were responsible for determining and issuing their ratings and devised the models that produced the allegedly unreasonably high ratings, the Rating Agencies had the opportunity to assign misleading ratings. Plaintiffs have thus sufficiently pled scienter as to the Rating Agencies.

See also Stichting, 2012 WL 6929336, at *9 (finding that in the loan underwriting context, abandonment of standard practices is sufficient for scienter).

Such a factual pattern is analogous to the allegations made by Plaintiffs in this case who allege that as a result of the "issuer pays" model, defendants had a motive to not just increase their profits, but to do so with the *knowledge* that the underlying ratings were unsupported and predicated upon misinformation and outdated models.

The Rating Agencies contend that plaintiffs have not satisfied the element of scienter because they have not pleaded with particularity which of the Rating Agencies who actually participated in the rating of the securities at issue knew of the defects in the RMBS market. The Rating Agencies cite to *Jones v. Bank of Am. Nat'l Assoc'n*, 2013 N.Y. Slip Op. 51288(U)2013 WL 4017344 (Sup. Ct. N.Y. Cnty. July 29, 2013), to support their argument that the Plaintiffs must identify "the name or names of the person" who made the representations in order to sufficiently prove scienter. *Id.*, at *6. Further, the Rating Agencies, citing to *Tsereteli v. Residential Asset Securitization Trust 2006-A8*, 692 F. Supp. 2d 387, 395 (S.D.N.Y. 2010), *adhered to sub nom. Tsereteli v. Residential Asset Securitization Trust 1006-A8*, 697 F. Supp. 2d 546 (S.D.N.Y. 2010), contend that allegations "of abandonment of standards, while enough in the loan underwriting context, are not sufficiently particular in the credit rating context."

The Rating Agencies' arguments are not persuasive. As in *Abu Dhabi I*, the Plaintiffs have alleged not only that defendants abandoned their standards for rating securities, they have further alleged that the defendants were aware of the underlying deficiencies of the RMBS they were rating. Defendants' contention that the abandonment of standards is not sufficient to find scienter is accurate, however in *Tsereteli* there were no additional allegations that the defendant was aware of the problems with the securities being rated. As such, that case is distinguishable.

Our case is more akin to *Abu Dhabi I*, as allegedly the Rating Agencies had the opportunity to assign knowingly inaccurate ratings, and a motive in increasing profits on the back of knowingly suspect information.

Defendants' contention that Plaintiffs need to identify specific the persons responsible for the ratings is also unpersuasive. In both *Stichting* and *Allstate*, allegations of companywide abandonment of rating policies is sufficient for an inference of scienter at this pleading stage. Taking the evidence in the light most favorable to Plaintiffs, and considering that additional evidence of scienter may be in sole possession of the Rating Agencies at this stage Plaintiffs sufficiently plead scienter.

3. Reliance

In order to establish reasonable reliance, a plaintiff must plead that it relied upon the misrepresentations at issue, and that such reliance was "reasonable." *Water Street Leasehold LLC v. Deloitte & Touche LLP*, 19 A.D.3d 183, 184–86 (1st Dep't 2005). CPLR 3016(b) requires a plaintiff to allege each element of its fraud claim, including reliance, with "particularity." *LaSalle Nat'l Bank v. Ernst & Young LLP*, 285 A.D.2d 101, 109 (1st Dep't 2001). Because reliance is fact intensive, the issue of reasonable reliance "is rarely a suitable matter for a motion to dismiss." *Basis Yield Alpha Fund Master v. Morgan Stanley*, No. 652129/2012, 2013 N.Y. Slip Op. 33061(U), 2013 WL 942359 (Sup. Ct. N.Y. Cnty. Fen. 28, 2013). *See also DDJ Mgmt., LLC v. Rhone Grp. LLC*, 15 N.Y.3d 147, 156 (2010) ("If plaintiffs can prove the allegations in the complaint, whether they were justified in relying on the warranties they received is a question to be resolved by the trier of fact."); *Aozora Bank, Ltd. v. Morgan Stanley & Co.*, No. 652118/2013, 2014 N.Y. Slip Op. 32135(U), 2014 WL 3899215, at *9 (Sup. Ct. N.Y. Cnty. Aug. 5, 2014).

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The Rating Agencies contend that Plaintiffs do not sufficiently plead reliance as to the Master Funds. The Rating Agencies maintain that the Master Funds purchased the majority of the rated securities before any rating was issued and that the Master Funds conducted their own independent credit investigation when deciding to invest. Plaintiffs counter this argument by pointing to the industry custom for market participants to invest in CDOs and RMBS based on the Pre-Sale Reports issued by Defendants. Statements made in preliminary offering materials, including statements related to credit ratings, can be the subject of a fraud claim. *See NRAM PLC v. Societe Generale Corp. & Inv. Banking*, No. 652033/2013, 2014 N.Y. Slip Op. 32155(U), 2014 WL 3924619, at *7-8 (Sup. Ct. N.Y. Cnty. Aug. 5, 2014) (plaintiff properly pled reliance on misrepresentation regarding credit ratings contained in pitchbook and offering circular); *Loreley Fin. (Jersey) No. 28, Ltd. v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 117 A.D.3d 463, 467-68 (1st Dep't 2014). The complaint states that the Master Funds "relied upon the Rating Agencies' ratings in making their investment decisions to comport with their portfolio composition targets," pointing specifically to their use of the Pre-Sale Reports.

Defendants' main response to this argument rests on the claim that Plaintiffs' allegation is made "upon information and belief." Defendants claim that Plaintiffs' lack of specificity as to which security related to which Rating Agency report does not suffice to plead the reliance element of their fraud claim, again citing *Jones v. Bank of Am. Nat'l Assoc'n*, 40 Misc. 3d 1223(A), (Sup. Ct. Kings Cnty 2013). In *Jones*, the complaint omitted the most basic information about the alleged misrepresentations attributed to the defendants, including "when and where any of the purported misstatements were made." *Id.*, at *7. The court held that plaintiffs must identify "the name or name of the person or persons making the misrepresentations, when the representations were made and the circumstances constituting the wrong . . . ." *Id.*, at *6. Here, Plaintiffs point to the Rating Agencies' Pre-Sale Reports as a source of their reliance and then further detail in the complaint the Master Funds' reliance on Defendants' misrepresentations regarding their objectivity and independent, the accuracy of their ratings, and their commitment to conducting ongoing surveillance of their ratings.

The Rating Agencies further argue that the Master Funds purchased the majority of the securities before any rating was issued. Further, that the Master Fund conducted an independent credit investigation. Accordingly, reliance cannot be established on the "undisputed facts" This argument is without merit. As the Court of Appeals has reiterated in *ACA Fin. Guar. Corp. v. Goldman, Sachs & Co.*, 25 N.Y.3d 1043, 1044, (2015), "the question of what constitutes reasonable reliance is not generally a question to be resolved as a matter of law on a motion to dismiss." (Internal citations omitted). Taking the evidence in the light most favorable to Plaintiffs, Plaintiffs sufficiently plead reliance as to the Master Funds.

The same however cannot be said as to the Feeder Funds. The Feeder Funds did not themselves purchase any of the rated securities. Plaintiffs would have the court find that the Feeder Funds directly relied on Defendants' alleged misrepresentations because the assets from the Feeder Funds were invested through the Master Funds in accordance with an investment strategy that relied on the truthfulness of the Defendants' ratings. This argument ignores the Feeder Funds' investment structure. The Feeder Funds were, by their nature, "predestined" to invest their assets in the Master Funds. The investment regardless of any statement by the Rating Agencies. Therefore, any direct reliance by the Feeder Funds is foreclosed.

In attempt to salvage their reliance pleading as to the Feeder Funds, Plaintiffs argue that the third-party reliance doctrine applies. The doctrine may apply where a false statement, made to a third party, does not injure the third party but instead harms the plaintiff. *See, e.g.*, *Desser v.*

Schatz, 182 A.D.2d 478, 479-80 (1st Dep't 1992) ("Reliance by [a third party], to the clear detriment of plaintiff, is manifest, and it is of no moment . . . that the false representation was not made directly to plaintiff."). Here, the recipient of the alleged false statement–the Master Funds–was itself harmed; this injury was then passed on to the Feeder Funds, as a result of their financial interest in the recipient. Given the nature of the investment structure and based on the facts set forth in the complaint, it is clear that the third-party reliance doctrine does not apply in this case. Plaintiffs are unable to show reasonable reliance as to the Feeder Funds.

4. Loss Causation

Common law fraud plaintiffs must allege "that the misrepresentation directly caused the loss about which they complain." *Laub v. Faessel*, 297 A.D.2d 28, 30 (1st Dep't 2002); *Loreley Financing (Jersey) No. 4 Ltd. v. UBS Ltd.*, 978 N.Y.S.2d 615, 619-21 (Sup. Ct. N.Y. Cnty. Dec. 24, 2013). To establish loss causation, a plaintiff must show that "it was foreseeable that [the plaintiff] would suffer losses as a result of relying on [the defendant's] alleged misrepresentations." *NRAM*, 2014 WL 3924619, at *13 (citing *MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 A.D.3d 287, 295 (1st Dep't 2011)).

Defendants claim that Plaintiffs do not adequately plead loss causation because Plaintiffs did not demonstrate that Defendants' misstatements were the direct cause of the Funds' losses. Defendants construe the complaint as Plaintiffs contending that the Rating Agencies' downgrading of multiple securities was the direct cause of their losses. Plaintiffs actually allege that it was Defendants' misrepresentations which caused the Funds' losses. The downgrade of securities was merely when defendants conceded that their ratings and other representations were inaccurate. Plaintiffs' claims are sufficient to allege loss causation.

Defendants maintain that Plaintiffs are judicially estopped from alleging that Defendants' representations caused the Funds' losses because Plaintiffs have taken a directly contradictory position in previous litigation. Judicial estoppel "precludes a party from framing his pleadings in a manner inconsistent with a position taken in a prior judicial proceeding." *Secured Equities Investments v. McFarland*, 300 A.D.2d 1137, 1138 (4th Dep't 2002). The doctrine is not applicable to preclude a party's claim where "the party did not secure a judgment in his or her favor in the prior proceeding or, at the very least, the party did not succeed in having the allegedly inconsistent position adopted in some manner by the court or tribunal in the prior proceeding." *Nomura Asset Capital Corp. v. Cadwalader, Wickersham & Taft LLP*, 2009 N.Y. Slip Op. 51090(U), 2009 WL 1543682, at *6 (Sup. Ct. N.Y. Cnty. Apr. 28, 2009) (citations omitted).

In contending that Plaintiffs are making a claim that is inconsistent with a position adopted by a prior proceeding, Defendants rely on *Varga v. Bear Stearns Co. Inc.*, No. 08 Civ. 3397 (AKH) (S.D.N.Y. March 26, 2009), where Plaintiffs brought a lawsuit against the Master Funds' investment managers. In *Bear Stearns*, Plaintiffs took the position that the Funds collapsed due to "the ways in which the Bear Stearns Defendants assembled and leveraged" those securities in the Master Funds' portfolios. *Id.* Based on Plaintiffs' position in *Bear Stearns*, Defendants contend that it was Bear Stearns' investment strategy that caused the Funds' collapse and that it would be contradictory in the instant action to find both the strategy and the Rating Agencies' credit ratings as the cause of the Master Funds' losses.

Plaintiffs need not establish that Defendants' misrepresentations and omissions were the sole cause of their losses. Rather, they need only allege facts that would allow a factfinder to determine that Defendants' misrepresentation is a "substantial factor" in causing Plaintiffs' harm.

Banque Indoseuz v. Barclays Bank, PLC, 181 A.D.2d 447, 447 (1st Dep't 1992). The complaint makes clear that Defendants' representations were a substantial factor underlying the Funds' decision to invest, and the information that Defendants' statements concealed was the precise cause of the Funds' loss.

The court also rejects Defendants' argument that Plaintiffs' prior allegations in *Bear Stearns* bar them under the doctrine of judicial estoppel merely because the court so-ordered the stipulation of dismissal. The *Bear Stearns* action concluded in settlement, and the stipulation merely stated that the parties agreed to dismiss their claims. The doctrine of judicial estoppel does not bar Plaintiffs' claim that Defendants caused their losses.

II. Statute of Limitations

Defendants move to dismiss pursuant to CPLR 3211 (a) (5), contending that Plaintiffs' claims are barred by the statute of limitations. The statute of limitations for fraud is the greater of (i) six years from the date the cause of action accrued or (ii) two years from discovery of the fraud. *See Sargiss v. Magarelli*, 12 N.Y.3d 527, 532 (2009).

Under New York law pursuant to CPLR §213 (8), the six-year statutory period begins to run on "the date of the fraudulent act." *Ghandour v. Shearson Lehman Bros.*, 213 A.D.2d 304, 305 (1st Dep't 1995). *See also* Commentary to Actual Fraud, 75 N.Y. Jur. 2d *Limitations and Laches* § 175 (2012) ("six years from the commission of the wrong"). Clear authority expressly holds that the claim accrues on the date the plaintiff "completed the act that the alleged fraudulent statements had induced." *Prichard v. 164 Ludlow Corp.*, 49 A.D.3d 408, 408-09 (1st Dep't 2008). *See also Commerzbank AG London Branch v. UBS AG*, Index No. 654464/2013, 2015 N.Y. Slip. Op. 21051(U), at *4 (Sup. Ct. N.Y. Cnty. June 17, 2015) (holding that the fraud claim "accrues on the date of purchase of the securities"); *SSR II, LLC v. John Hancock Life Ins.*

Co. (USA), Index No. 652793/2011, 2012 WL 4513354, at *10 (Sup. Ct. N.Y. Cnty. Sept. 28, 2012) (holding that fraud claim accrued at the time of the plaintiff's investment).

Plaintiffs acquired the last of the securities at issue on May 29, 2007 and commenced this action on July 9, 2013, well outside the six-year statutory period enumerated in CPLR §213 (8). Plaintiffs, in an attempt to salvage their action, cite *N.Y.C. Transit Auth. v. Morris J. Eisen, P.C.*, 276 A.D.2d at 85-86, which held that "a cause of action for fraud cannot accrue until every element of the claim, including injury, can truthfully be alleged." Plaintiff argues that on October 22, 2008 the public became aware of the Rating Agencies' intentional wrongdoing following Congressional investigations. Thus Plaintiff reasons the *Eisen* holding extends the start date for the running of the six year statute of limitations until October 22, 2008 the date on which they could plead scienter.

This theory imbues the six-year statutory period with a degree of elasticity not reflected in any New York case law of which the court is aware. Plaintiffs have misapplied *Eisen* in an attempt to move the accrual of the statute of limitation beyond the date of the purchase of the securities. In *Eisen,* an attorney deceit case under §487 of the Judiciary Law, plaintiffs became aware of the defendants' criminal conviction in connection with their legal practice then initiated their claim. The Court found the accrual commenced from the date of injury which was the settlement and affirmance of judgment. Likewise, in the instant matter plaintiffs' claim accrued at the time of their injury which was at the purchase of the last securities on May 29, 2007. *See Prichard v. 164 Ludlow Corp.*, 49 A.D.3d 408 at 408 (holding that claim accrues at purchase of investment).

In the event plaintiffs are attempting to invoke the discovery rule of CPLR §203(g) which tolls the statute of limitations to "two years from discovery of the fraud" *see Sargiss v.*

Magarelli, 12 N.Y.3d 527, 532 (2009), then plaintiffs' claims are also untimely. Plaintiffs admittedly discovered the Rating Agencies' intentional wrongdoing on October 22, 2008 thus their claim expired on October 22, 2010 prior to the commencement of this action in 2013. *TMG-II v. Price Waterhouse & Co.*, 175 A.D.2d 21, 22, 572 N.Y.S.2d 6, 7 (1st Dep't 1991).

Plaintiffs next contend that the "continuing wrong" doctrine applies here to move the start date for the running of the six-year statute of limitations. The continuing wrong doctrine has been applied "in certain cases such as nuisance or continuing trespass where the harm sustained by the complaining party is not exclusively traced to the day when the original objectionable act was committed." *Capruso v. Village of Kings Point*, 23 N.Y.3d 631, 639 (2014). Under the doctrine, the statute of limitations "runs from the commission of the last wrongful act." *Harvey v. Metro. Life Ins. Co.*, 34 A.D.3d 364 (1st Dep't 2006) (quoting *Leonhard v. United States*, 633 F.2d 599, 613 (2d Cir. 1980)).

Plaintiffs would have the court hold that the six-year statutory period could not begin to run until at least November 12, 2007, when the first of any securities at issue was downgraded. Plaintiffs maintain that Defendants had a continuing obligation to monitor, review and appropriately update their ratings beyond the purchase date. Plaintiffs allege that Defendants failed to perform such obligation when the Rating Agencies continued to issue and maintain allegedly inflated ratings and failed to issue indicated downgrades. Plaintiffs further allege that Defendants engaged in a series of continuing misrepresentations and omissions through 2007-2008. Plaintiffs rely on *State v. 7040 Colonial Rd. Assocs. Co.*, 671 N.Y.S.2d 938 (Sup. Ct. N.Y. Cnty. Mar. 9, 1998) and *Abu Dhabi Commercial Bank v. Morgan Stanley & Co.*, No. 08-CV-7508, 2013 WL 1155420 (S.D.N.Y. Mar. 20, 2013).

In *State v. 7040 Colonial Rd. Assocs.*, the New York Attorney General brought an action under the Martin Act against the sponsor of real estate securities for allegedly making a series of fraudulent misrepresentations in connection with the sale of such securities. Plaintiffs rely on the court's holding that "each time the sponsor allegedly engaged in one of the 'acts or practices' . . . a new cause of action accrued, even if the new act or practice simply repeated the misrepresentations or omissions made previously by the sponsor." *Id.* at 944. Plaintiffs overlook the court's underlying concern of a "general rule of accrual" restricting the Attorney General's exercise of his statutory mandate. *Id.* This concern does not comport with a private common-law fraud dispute.

In *Abu Dhabi*, No. 08-CV-7508, 2013 WL 1155420, the plaintiffs invested in the Cheyne investment vehicle for which the defendant rating agencies issued allegedly false ratings. Plaintiffs rely on Judge Scheindlin's holding that "[t]he cut-off date for establishing fraud on the part of the Rating Agencies is not the date of the launch of the Cheyne SIV in 2005 but rather the time period during which the Rating Agencies maintained responsibility for reviewing and updating the ratings, and during which plaintiffs purchased the Cheyne Notes . . ." *Id.* at *7. *Abu Dhabi* focused entirely on evidentiary issues, rather than on a statute of limitations dispute, much less the application of the continuing wrong doctrine. Furthermore, *Abu Dhabi* was filed well within six years from the date of the alleged wrongful act. *Abu Dhabi* does not advance Plaintiffs' position.

Plaintiffs argue that an omission or inaction can constitute a continuing wrong and that Defendants' failure to update their ratings in light of a collapsing real estate market constituted such a case. This position is unpersuasive. The cases relied on by Plaintiffs to support this theory do not implicate New York's six-year statute of limitations and can be otherwise differentiated from the instant action. For instance, Plaintiffs rely on *In re Beacon Assocs. Litig.*, 282 F.R.D. 315 (S.D.N.Y. 2012), in which the plaintiff investors invested in a feeder fund to a securities firm that defrauded thousands of investors through Madoff's Ponzi scheme. Plaintiffs point to the court's ruling that the plaintiffs' claims were timely and that throughout the relevant period, the defendant investment advisors were under a continuing duty to disclose their true concerns about Madoff. *Id.* at 324. The investor-advisor relationship in *Beacon* differs from the investor-rating agencies relationship in the instant case, particularly as the relationships implicate the notion of duty.

Defendants did not owe, and are not alleged to have owed, any duty to Plaintiffs. Under New York law, a duty arises only by "actual privity of contract between the parties or a relationship so close as to approach that of privity." *Ossining Union Free Sch. Dist. v. Anderson LaRocca Anderson*, 73 N.Y.2d 417, 423-24 (1989). The relationship between rating agencies and investors, absent direct contact between them, cannot satisfy this standard. *Anschutz Corp. v. Merrill Lynch & Co.*, 690 F.3d 98, 114-15 (2d Cir. 2012). Plaintiffs also do not attempt to invoke a duty, the necessary predicate for "omission" liability. The continuing wrong doctrine is inapposite in this case.

Even if the Rating Agencies had a duty to speak, Plaintiffs' claims relating to ongoing surveillance activities are both insufficient to state a claim under New York law and belied by their own arguments regarding loss causation. Allegations that Defendants' inaction somehow caused the Master Funds to hold, rather than sell, the securities are "too undeterminable and speculative to constitute a cognizable basis for damages," *Starr Found. v. Am. Int'l Grp., Inc.*, 76 A.D.3d 25, 29 (1st Dep't 2010), and such "holder" claims are not actionable, *Bank Hapoalim B.M. v. WestLB AB*, 2014 N.Y. Slip Op. 7092, 2014 WL 5334047 (1st Dep't Oct. 21, 2014).

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Plaintiffs do not allege that the Rating Agencies' surveillance caused the Master Funds to take, or refrain from taking, any particular action. To the contrary, they assert that the Rating Agencies "caused" their losses by issuing high ratings that were "a substantial factor in the [Master] Funds' decision to purchase the securities at issue." This does not address surveillance, and all of these purchases were made more than six years before the commencement of this lawsuit.

A straightforward application of the six-year statute of limitations is appropriate in the instant action. The Master Funds acquired the last of the securities at issue on May 29, 2007, and Plaintiffs commenced this action on July 9, 2013. Plaintiffs do not deny that the securities were purchased by the Master Funds more than six years prior to the commencement of this action. It is clear from the face of Plaintiffs' complaint that their claim is time-barred under the six-year statute of limitations.

On the other hand, the two-year period under CPLR § 213(8) runs from the time that Plaintiffs "discovered the fraud, or could with reasonable diligence have discovered it." Under New York law, such discovery implies that Plaintiffs were "possessed of knowledge of facts from which [the fraud] could [have been] reasonably inferred." *Sargiss*, 12 N.Y.3d at 532. That is, "where the circumstances are such as to suggest to a person of ordinary intelligence the probability that he has been defrauded, a duty of inquiry arises, and if he omits that inquiry when it would have developed the truth, . . . knowledge of the fraud will be imputed to him." *Higgins v. Crouse*, 147 N.Y. 411, 416 (1895). *See also CSAM Capital, Inc. v. Lauder*, 67 A.D.3d 149, 155 (1st Dep't 2009) ("the standard [for knowledge of fraud] is an objective one based on a person of ordinary intelligence"). As Defendants contend, questions about a plaintiff's knowledge or "awareness" relate to the two-year prong of the statute of limitations, and not to the six-year statutory period. CPLR § 203(g).

Plaintiffs have conflated the two-year discovery cases with the six-year statutory cases. Plaintiffs cited *HSH Nordbank*, *Phoenix Light* and *Allstate* for the proposition that the six-year period begins to run when a plaintiff can truthfully allege each element of the claim exists and when a plaintiff is on notice that each such element exists. However, these cases involve the two-year discovery rule and are more relevant in determining when the two-year period starts to run. *HSH Nordbank AG v. Goldman Sachs Group, Inc.*, 2013 WL 8476977, at *3 (Sup. Ct. N.Y. Cnty. Nov. 26, 2013) (German statute of limitations runs when "the claimant obtains knowledge of the circumstances giving rise to the claim"); *Phoenix Light SF Ltd. v. ACE Sec. Corp.*, 2013 WL 1788007, at *5 (Sup. Ct. N.Y. Cnty. Apr. 24, 2013) (Irish, Cayman Island, German, and Delaware statutes of limitations "do not begin with run until the plaintiff is on notice of the fraud"); *Allstate Ins. Co. v. Ace Sec. Corp.*, 2013 N.Y. Slip Op. 31844(U), 2013 WL 1103159, at *5 (Sup. Ct. N.Y. Cnty. Mar. 14, 2013) (Illinois statute of limitations does not run until "the date upon which the party bringing the action has notice of facts which in the exercise of reasonable diligence would lead to actual knowledge of the alleged violation").

Plaintiffs' allegations are drawn from sources that were made public as early as 2008. These materials directly address Defendants' alleged conduct and are alleged by Plaintiffs in the complaint to provide support for the claims. By Plaintiffs' own admission, it was on October 22, 2008–the earliest disclosure of Congressional investigations–that Plaintiffs could have fully and truthfully alleged the Ratings Agencies acted with scienter. Pls. Opp'n 11. Such public materials are more than sufficient to start the running of the two-year limitations clock. Furthermore, Plaintiffs filed similar fraud claims against the Funds' investment manager, BSAM, in 2008 and against the auditors of the Master Funds in 2009, both times using the same facts as those in the instant case. *See Varga v. Bear Stearns Co. Inc.*, No. 08 Civ. 3397 (AKH) (S.D.N.Y. March 26, 2009); *Varga v. Deloitte & Touche LLP*, Index No. 601265/09 (Sup. Ct. N.Y. Cnty. Apr. 24, 2009), *removed*, No. 09 Civ. 4936 (S.D.N.Y. May 26, 2009). Even under the two-year discovery standard, Plaintiffs' claim is time-barred.

III. Standing

Defendants move to dismiss pursuant to Chapter 15 of the Bankruptcy Code for lack of standing. *See* 11 U.S.C. §§ 1509(b)(1), (c). Chapter 15 requires a foreign representative to seek recognition from a bankruptcy court pursuant to 11 U.S.C. § 1517 before the representative may "apply directly to a court in the United States." 11 U.S.C. § 1509(b).

Defendants contend that Plaintiffs' lack of Chapter 15 recognition per se bars them from suing in any court of the United States. This argument is unpersuasive. Chapter 15 recognition is not a prerequisite to a foreign representative's access to U.S. courts, such that "[n]onrecognition of the Foreign Proceedings . . . does not leave the [foreign representative] without the ability to obtain relief from U.S. courts." *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122, 132 (Bankr. S.D.N.Y. 2007), *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008) (citing 11 U.S.C. §§ 303(b)(4) and 1509(f)). Section 1509(f) of the Bankruptcy Code provides that "the failure of a foreign representative to obtain recognition under [Chapter 15] does not affect any right the foreign representative may have to sue in a court in the United States to collect or recover a claim which is the property of the debtor." *Id.* (citing 11 U.S.C. § 1509(f)). Here, it is uncontested that Plaintiffs did not apply for and were not granted recognition under Chapter 15 of the U.S. Bankruptcy Code. However, Plaintiffs also did not bring this case with the express purpose of assisting or facilitating their insolvency proceedings in the Cayman Islands. *See, e.g.*, *Saad Investments Co. v. JPMorgan Chase Bank*, Index No. 651833/2012, at 2 (Sup. Ct. N.Y. Cnty. Apr. 22, 2013), Dkt. No. 64 (refusing to extend comity to the foreign bankruptcy proceeding because the liquidator sought to prevent the defendants' counterclaim); *Reserve Int'l Liquidity Fund, Ltd.* v. *Caxton Int'l Ltd.*, 2010 WL 1779282, at *1 (S.D.N.Y. Apr. 29, 2010) (rejecting for lack of standing the liquidators' interpleader action seeking to bring about a final distribution of an off-shore market fund's assets).

Lack of recognition pursuant to Chapter 15 of the Bankruptcy Code does not negatively impact Plaintiffs' standing to bring this case.

Plaintiffs seek to bring both a direct claim as representatives of the Feeder Funds, and a derivative claim on behalf of the Master Funds. Defendants contend that Plaintiffs lack standing to pursue a fraud claim directly in the United States because the claim is derivative in nature. The question of whether a claim is direct or derivative is governed by the law of the place of incorporation. *See SSR II, LLC v. John Hancock Life Ins. Co. (U.S.A.)*, 2012 WL 4513354, at *3 (holding that the direct-versus-derivative issue is governed by the law of place of incorporation); *Finkelstein v. Warner Music Grp. Inc.*, 32 A.D.3d 344, 345 (1st Dep't 2006) (same). The Feeder Funds are incorporated in the Cayman Islands. Under Cayman law, shareholders may not recover "reflective losses," which are losses that the company itself could recover if it chose to initiate legal action. The Cayman courts have held that "[w]here a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss by the company . . . there is no discretion involved." *Johnson v. Gore Wood & Co.*, [2002] 2 A.C. 1, House of Lords. A shareholder cannot sue in a personal capacity for a loss unless that loss is distinct from that of the company, and this rule applies regardless of whether the company itself intends to sue. Defendants rely on an expert's opinion that the Feeder Funds have alleged only a reflective loss under Cayman law. The affidavit states that Plaintiffs' alleged damage stems solely from their status as shareholders in the Master Funds. They are reflective losses. Plaintiffs do not dispute the accuracy of the expert's affidavit. Under Cayman law, Plaintiffs lack standing to bring a direct action in U.S. courts.

In attempt to salvage their claim, Plaintiffs maintain that New York courts have previously allowed investors to pursue a fraud claim directly against a third party when that party's misrepresentation induced the investors to purchase or remain invested in an investment fund. Plaintiffs rely on the holding in *Alexander Dawson Found. v. Zucker*, No. 650053/2011, 2012 N.Y. Slip Op. 33492(U), 2012 WL 10028548, at *2 (Sup. Ct. N.Y. Cnty. Feb. 15, 2012), that plaintiffs had direct standing to bring a fraud claim against a hedge fund's auditors whose fraud induced plaintiffs to invest in the hedge fund. *See id.* (citing *Abrams v. Donati*, 66 N.Y.2d 951, 953 (1985) (holding that a claim may be brought directly when "the wrongdoer has breached a duty owed to the shareholder independent of any duty owing to the corporation wronged")). In the instant case, the Feeder Funds and the Rating Agencies are not alleged to have had any relationship, which would give rise to a duty, nor is it alleged that the Rating Agencies specifically "targeted" the Feeder Funds. *Cf. SSR II*, 2012 WL 4513354, at *4 (allowing a direct claim to proceed where the defendant allegedly "targeted" indirect purchasers).

Plaintiffs also contend that they have standing to pursue their claim directly due to the nature of the Overseas Funds' investment structure. Plaintiffs rely on *Shalam v. KPMF LLP*, 43 A.D.3d 752 (1st Dep't 2007) to bolster this point. In *Shalam*, the Appellate Division affirmed the trial court's holding that the plaintiff-investor had standing to sue to recover monies paid to accountants by the venture firm in which the plaintiff was invested. *Id.* at 753. Plaintiffs overlook the fact that in *Shalam*, the plaintiff could pursue direct claims as it had alleged a "separate wrong" that injured only the plaintiff. *Id.* Here, that is not the case. Plaintiffs have failed to allege any "separate wrong" to the Feeder Funds that was not also suffered by the Master Funds.

Defendants further counter Plaintiffs' investment structure argument by drawing attention to the fact that investment in the Master Funds was required by the Feeder Funds' governing documents. Plaintiffs cannot claim that the Feeder Funds were induced to invest in the Master Funds when they were already required to do so.

Plaintiffs lack standing to bring a direct action against the Rating Agencies.

Defendants also contend that Plaintiffs lack standing under Cayman law to bring a claim derivatively on behalf of the Master Funds. Under New York law, the question of whether a shareholder has standing to pursue derivative claims is examined under the law of the state of incorporation, which in this case is the Cayman Islands. *See, e.g.*, *Shenwick v. HM Ruby Fund*, 106 A.D.3d 638, 639 (1st Dep't 2013); *Hart v. General Motors Corp.*, 129 A.D.2d 179, 183 (1st Dep't 1987); *CMIA Partners Equity Ltd. v. O'Neill*, 920 N.Y.S.2d 240 (Table), 2010 WL 4904479, at *4 (Sup. Ct. N.Y. Cnty. Nov. 22, 2010). New York procedural law requires plaintiffs to establish standing before a derivative action may proceed. *See, e.g.*, N.Y. Bus. Corp. Law § 626. Cayman law, which is modeled on English law, generally "prohibits shareholder derivative actions," subject to certain narrow exceptions not applicable here. *Shenwick*, 106 A.D.3d at 639.

Plaintiffs allege that they have standing to pursue a derivative claim because the Grand Court of the Cayman Islands granted Plaintiffs permission to bring this action, including both direct and derivative claims, in orders dated October 30, 2013. Defendants counter this by pointing to their expert's affidavit, which states that under Cayman bankruptcy law, liquidators must seek approval from a judge prior to initiating any legal action. The requirement for approval by the court overseeing liquidation does not displace ordinary Cayman law regarding the limited availability of derivative actions. On their face, the orders merely grant permission under Cayman liquidation law to attempt to file this action; they do not explicitly indicate that the requirements for bringing a derivative action under Cayman law are satisfied.

Plaintiffs further maintain that they have standing to bring this lawsuit derivatively because, under Cayman law, shareholders are permitted to assert claims derivatively, on behalf of their corporation, when the corporation is "disabled" from bringing the suit. Plaintiffs allege that Cayman law recognizes a shareholder's ability to pursue claims derivatively in instances where the corporation will not and cannot bring the claim on its behalf because it has no means to do so. Defendants refute this argument by pointing to the scope of the "disability" exception, such that the exception is available only when the defendant's alleged conduct has rendered it "impossible" for the corporation to bring suit. Here, a liquidator for the Master Funds, in a sworn statement, stated that the Master Funds declined to bring this action as a matter of strategy, rather than impossibility.

Plaintiffs lack standing to pursue this action derivatively.

Defendants contend that the *in pari delicto* doctrine bars Plaintiffs' claim. This argument is unpersuasive. The doctrine "mandates that the courts will not intercede to resolve a dispute between two wrongdoers." *Kirschner v. KPMG LLP*, 15 N.Y.3d 446, 464 (2010). Under New York law, a bankruptcy trustee may not recover for wrongs to which the bankrupt entity was a party. *Buechner v. Avery*, 38 A.D.3d 443, 444 (1st Dep't 2007). *See also Bullmore v. Ernst & Young Cayman Islands*, 861 N.Y.S.2d 578, 582 n.3 (Sup. Ct. N.Y. Cnty. 2008) (applying *in pari delicto* analysis to Cayman liquidators). New York courts have also consistently recognized that unless the plaintiff's wrongdoing and the viability of an *in pari delicto* defense is evident on the face of the complaint, dismissal on this basis is unwarranted. *See Morgado Family Partners, LP v. Lipper*, 19 A.D.3d 262, 263 (1st Dep't 2005) (declining to apply the doctrine on the face of the pleadings, stating that "it is not clear at this preanswer, prediscovery stage of the litigation whether [the *in pari delicto*] doctrine would apply to this trustee's claims"). In *Kirschner*, the *in pari delicto* doctrine was applied on the motion to dismiss because the complaint "acknowledged that the Refco insiders masterminded Refco's fraud." *Id.* at 459. Here, the complaint alleges that defendants "masterminded" the fraud and that the Funds' management did not participate in this wrongdoing.

The *in pari delicto* doctrine does not bar Plaintiffs' claim.

IV. Personal Jurisdiction

Fitch Ratings Ltd. (FRL) moves, pursuant to CPLR §3211 (a) (8) to dismiss the fraud claim against it for want of personal jurisdiction under federal due process requirements and the requirements of CPLR §302.

FRL is a London based U.K. private limited company and subsidiary of Fitch Ratings Inc. (FRI) a New York based corporation. FRL contends that it maintains no offices in New York, has no phone number in New York, no office in New York, and no permanent staff in New York. In fact, FRL is not licensed to do business in the State, and did not issue ratings for any of the securities at issue.

Although a subsidiary of FRI, FRL maintains that it has always been a legally distinct company. FRL does not rely on its parent corporation for financial support. FRL receives neither interest free loans from FRI nor credit on terms not otherwise available to the general public. FRL maintains its own books, records, and financial accounts, and prepares audited financial statements separate from those prepared by Fitch Ratings Inc. All transactions between the two companies are conducted at arm's length and payment is made for services rendered. Further, FRL makes royalty payments to FRI for use of the Fitch name.

FRL maintains its own headquarters and offices, none of which are in the United States. FRL and FRI each have a Board of Directors that meets separately, and maintain separate minutes. FRL and its parent company do have overlapping officers, follow a global corporate policy, and frequently appear under boilerplate language as Fitch entities.

Standard of Review

On a motion to dismiss for lack of personal jurisdiction, the plaintiff bears the burden of establishing that the court has jurisdiction over the defendant. *See Marist Coll. V. Brady*, 84 A.D.3d 1322, 1323. Plaintiff need only establish that facts "may exist" to make a "sufficient start" to warrant further discovery on personal jurisdiction. *Id.* at 1322 (citing *Peterson v. Spartan Indus., Inc.* 33 N.Y.2d 463, 466, (1974). Plaintiffs may establish the existence of such facts "through affidavits and relevant documents, to prove the existence of jurisdiction." *Fischbarg v. Doucet*, 9 N.Y.3d 375, (2007). A finding of personal jurisdiction must comport with both federal due process requirements and New York's personal jurisdiction statutes. *LaMarca v. Pak-Mor Mfg. Co.*, 95 N.Y.2d 210, 214, (2000). A corporation is subject to "general jurisdiction" in a forum when its "affiliations with the State...are so continuous and systematic as to render [it] essentially at home" in the forum. *Daimler AG v. Bauman.* 134 S. Ct 746, 761 (2014) (quoting *Goodyear*, 131 S. Ct. 2846, 2851 (2011)). Alternatively, a corporation is subject to "specific jurisdiction" when the cause of action arises from a transaction within the forum, or when a transaction outside of the forum results in harm within the forum.

General Jurisdiction

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Due process requires a defendant to have sufficient "minimum contacts with the forum state" in order for a finding of personal jurisdiction to be appropriately rendered. *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). The Court narrowed the "minimum contacts" test for general jurisdiction in *Daimler*, building upon *Goodyear Dunlop Tires Operations S.A. v. Brown*, by requiring a corporate defendant to have "affiliations with the State that are so continuous and systematic as to render [it] essentially *at home*" in the forum. 134 S. Ct 746, 761 (2014) (quoting *Goodyear*, 131 S. Ct. 2846, 2851 (2011)) (alteration in original) (emphasis added). The quintessential forums for a corporation, according to the Court, are the place of incorporation and the principal place of business. *Daimler AG v. Bauman*, 134 S. Ct. 746, 760, (2014). However, in "exceptional circumstances" personal jurisdiction may be found in other forums. *Daimler*, 134 S. Ct. at 761. Personal Jurisdiction is not appropriate in instances where a defendant's contacts with the forum consist merely of a phone number, mailing address, or limited operations in a state. *AG v. Wirthlin Worldwide Consulting, LLC*, No. 653427/2012, 2014 WL 2727018, at *1 (Sup. Ct. N.Y. Cnty. June 13, 2014).

In *Daimler*, the Court refused to find jurisdiction in California over a German corporation through its United States subsidiary, despite the fact that over 10% of the defendant's U.S. sales occurred in California. *Daimler*, 134 S. Ct. at 752. The court held that though the defendant had systematic and continuous ties with California, these ties were not sufficient to render the defendant "at home" in that state. The Court expressed doubt that jurisdiction could be found in a forum other than a corporation's place of incorporation or principal place of business, unless their ties to the forum were so "substantial" as to make jurisdiction appropriate. *Id.* at 746. However, the size of Daimler's operations in California, and the Court's decision not to find jurisdiction in that forum, make "exceptional circumstances" a very high bar.

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In *AG v. Writhlin*, this Court applied *Daimler* when it dismissed a complaint against a defendant headquartered in Utah and incorporated in Delaware for lack of personal jurisdiction in New York. While the defendant maintained a mailing address and phone number in New York, the Court found that these contacts were insufficient to support a finding of personal jurisdiction.

While the defendant in *Writhlin* maintained both a mailing address and phone number in New York, FRL maintains neither. Further, there is no indication that FRL maintains operations in New York of a size anywhere near those the defendant in *Daimler* maintained in California. As a finding of personal jurisdiction was held to be inappropriate in both of those cases, such a finding in here would surely be inappropriate, and offend FRL's right to due process. While Plaintiffs allege otherwise, FRL's affidavits demonstrate that FRL has no office in New York, no mailing address, and no permanent phone number. Further, even if such defendant were to maintain an office or have employees in New York, such contacts would not amount to the "exceptional case" contemplated by the Court in *Daimler*. As the defendant has even fewer contacts with New York than the defendants in *Writhlin* and *Daimler* had with their proposed forums a finding of personal jurisdiction in this instance would offend defendant's right to due process. Further jurisdictional discovery is not appropriate, as a "sufficient start" to proving personal jurisdiction has not been made.

CPLR, "Doing Business" Jurisdiction

Under CPLR 301 "[a] foreign corporation is amenable to suit in New York courts if it has engaged in such a continuous and systematic course of 'doing business' here that a finding of its 'presence' in this jurisdiction is warranted," or is otherwise domiciled, physically present, or has consented to doing business in the state. *Smart Trike, MNF, PTE, Ltd. v. Piermont Products*

LLC, 2014 N.Y. Slip Op. 31306(U), 2014 WL 2042298, at *3 (Sup. Ct. N.Y. Cnty. May 16, 2014) (quoting *Landoil Res. Corp. v. Alexander & Alexander Servs., Inc.*, 77 N.Y.2d 28, 33 (1990)). A corporation is determined to be "doing business" in New York when it conducts transactions in the state "with a fair measure of permanence and continuity." *Airtran N.Y., LLC v. Midwest Air Grp., Inc.*, 46 A.D.3d 208, 216 (1st Dep't 2007).

The continuing applicability of the doing business doctrine has been called into question in both federal and state courts in New York. *See Deustche Zentral-Genossenschaftsbank AG v. UBS*, No. 652575/2012, 2014 WL 1495632, at *5 (Sup. Ct. N.Y. Cnty. Apr. 17, 2014) ("The court notes…that *Daimler* significantly narrows the parameters for the exercise of general personal jurisdiction, and calls into question the validity of the doing business doctrine."). *See also Smart Trike*, 2014 WL 2042298, at *3.

However, assuming this test remains valid, FRL does not conduct sufficient business in the state to be subjected to "doing business jurisdiction". FRL has not conducted business in the state with the "permanence and continuity" required by the CPLR as articulated in *Airtran*. In fact, FRL is not even licensed to do business in the state of New York. As such, even assuming the "Doing Business" test to be constitutionally valid, personal jurisdiction under this doctrine is inappropriate in this case.

"Mere Department" Theory

In the wake of *Daimler*, there remains a question of whether the "Department Test" remains valid. As the Supreme Court has expressed doubt as to whether general jurisdiction might be found in a forum other than the corporation's principle place of business or place of incorporation absent "exceptional circumstances", it is unlikely jurisdiction would be found in a state through its ties parent's ties to a subsidiary. We will now assume that the mere department

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theory is still good law. The "Mere Department" theory is applicable when a parent corporation's "control over the subsidiary's [operations]...[are] so complete that the subsidiary is, in fact, merely a department of the parent. *Delagi v. Volkswagenwerk A.G. of Wolfsburg, Germany*, 29 N.Y.2d 426, 431 (1972) (citing *Pub. Adm'r of New York Cnty. v. Royal Bank of Canada*, 19 N.Y.2d 127, 131 (1967)). New York courts consider four factors when assessing whether a "mere department" relationship exists: (1) an identical ownership interest, (2) financial dependency of the subsidiary on the parent, (3) parent's influence on the composition of the board and operations of the subsidiary, and (4) The parent's control over the marketing and operational responsibilities of the subsidiary. *Volkswagenwerk Aktiengesellschaft v. Beech Aircraft Corp.*, 751 F.2d 117, 120-22 (2d Cir. 1984). *See also Delagi*, 29 N.Y.2d at 432; *Taca Int'l Airlines v. Rolls-Royce of England, Ltd.*, 15 N.Y.2d 97 (1964).

Identical ownership is considered an "essential" factor in determining whether a subsidiary is a mere department of the parent. *Delagi*, 29 N.Y.2d at 432. FRL is unarguably a subsidiary of FRI.

Financial dependency can be shown when a subsidiary "is unable to function" without the parent. *Galleli v. Crown Imports, LLC*, 701 F. Supp. 2d 263, 273-274 (E.D.N.Y. 2010) (finding financial dependence where a subsidiary was insolvent without a parent); *see also Goldsmith v. Sotheby's Inc.*, No. 603504/04, 2007 WL 258287, at *7 (Sup. Ct. N.Y. Cnty. Jan. 2, 2007). Courts have found financial dependency in those instances in which a parent issued no interest loans to the defendant, or otherwise guaranteed their outstanding debt. *Rabinowitz v. Kaiser-Frazer Corp.*, 198 Misc. 707, 710-11 (Sup. Ct. Kings Cnty. 1950); *Titu-Serban Ionescu v. E.F. Hutton & Co.*, 434 F. Supp. 80, 82 (S.D.N.Y. 1977). Conversely, where a subsidiary has maintained "its own books, records, and financial accounts separate and apart from any affiliated company", it has been found to be a separate entity, and not a mere department of a parent. *Goldsmith*, 2007 WL 258287, at *8.

In the present case, FRL has demonstrated it is financially independent from FRI. FRL earns profits from its own sales, and is not wholly dependent on its parent for revenue, unlike the defendant in *Gallelli*. Further, FRL, like the defendant in *Goldsmith* which maintains its own records, keeps its own financial statements and books. Finally, whereas the subsidiaries in *Rabinowitz* and *Titu-Serban* relied upon their parent corporations for no interest loans or guarantees on debt, FRL has never obtained a loan from FRI at a rate unavailable to the general public, or relied upon FRI to guarantee their obligations. While FRL did report its financials on a consolidated basis, this is not evidentiary as this consolidation is required by New York law when a parent owns more the 50 percent of the subsidiaries' stock. *Volkswagenwerk*, 751 F.2d 117. Given FRL's financial independence from the parent, this factor weighs in favor of FRL.

The parent's influence over the subsidiary can be gleaned from the companies' failure to observe corporate formalities in the composition of the respective boards and in their transactions amongst each other. *Goldsmith*, 2007 WL 258287, at *8. The maintenance of separate boards, even with overlapping officers, weighs against a finding of mere department status. *Id.* (holding that the maintenance of separate boards holding separate votes pertaining to the companies as individual separate entities weighed against a finding of department status); *see also In re Ski Train Fire in Kaprun Austria on Nov. 11, 2000*, 230 F. Supp. 2d 403, 411 (S.D.N.Y. 2002). Further, conduct of transactions at "arm's length" between the two companies also weighs against a finding of mere department status. *In re Ski Train*, 230 F. Supp. 2d at 411.

In the present case, FRL and FRI maintain separate boards that meet separately to discuss the individual interests of the respective companies like the subsidiaries in *Goldsmith and In re*

Ski Train. While these boards have overlapping directors, this is typical of the parent-subsidiary relationship, and nothing about these common board positions indicates that dealings between the two companies were conducted at anything other than "arm's length". *See In re Ski Train*, 230 F. Supp. 2d at 411 (holding that overlapping boards is typical of a parent-subsidiary relationship, and does not weigh in favor of a department finding). As such, this factor weighs in favor of FRL.

The final factor is the parent's control over the subsidiary's marketing and operational policies. *Volkswagenwerk Aktiengesellschaft*, 751 F.2d at 122. The parent's control can be evinced by the way the parent portrays the subsidiary in it corporate publications. *See e.g.*, *Boryk v. deHavilland Aircraft Co.*, 341 F.2d 666, 668 (2d Cir. 1965) (parent's letterhead listed subsidiary as a branch); *Pub. Adm'r v. Royal Bank,* 19 N.Y.2d at 131–32 (parent's letterhead, general advertising, and reports to stockholders identified subsidiary as branch; subsidiary's documents were standard forms prepared by parent). Parents' control over the operations can also be determined by the operational duties the parent undertook on the subsidiaries behalf. *Taca Int'l Airlines,* 15 N.Y.2d at 101 (parent trained subsidiary's personnel, determined policy, prepared marketing material, set prices, and issued warranties). However, "a parent company's establishment of "broad policy decisions" is "inherent" to its role, *Saraceno v. S.C. Johnson and Son, Inc.*, 83 F.R.D. 65, 71 (S.D.N.Y.1979), and does not signify that [the parent] exercises "day to day control" over the operations [of a subsidiary]. *See H. Heller & Co. v. Novacor Chemicals Ltd.*, 726 F. Supp. 49, 55 (S.D.N.Y. 1988), *aff'd sub nom. Heller & Co. v. Novacor*, 875 F.2d 856 (2d Cir. 1989); *NovelAire Technologies, L.L.C. v. Munters AB*, No. 13 CIV. 472 CM, 2013 WL 6182938, at *8 (S.D.N.Y. 2013).

While in *Boryk* and *Pub. Adm'r*, the subsidiaries were listed as mere branches of their parent corporations, FRL identifies itself as a separate entity on its letterhead, and has maintained that it is nothing but a distinct company. Plaintiffs argue that FRL's maintenance of a broad corporate policy weighs in favor of a finding of department status, but per the federal court's guidance in *Saraceno* and *Novelaire*, such a finding is not warranted. This factor also weighs in favor of FRL.

Weighing the factors, the Court finds that New York cannot exercise personal jurisdiction over FRL under the mere department theory, as FRI exercises insufficient control over the. FRL is a financially independent entity that has maintained appropriate business ties with FRI. While there is an overlap in ownership and the composition of their respective boards, these are not significant indicia of control over FRL for a finding of mere department status.

State Long-Arm Statute and Specific Jurisdiction

CPLR 302, New York's long-arm statute provides for an exercise of personal jurisdiction when the cause of action arises out of a transaction that occurred in the State, or when a tortious act committed outside of the state results in injury in that state. CPLR § 302 (a) (1), (3).

There is no jurisdiction under CPLR 302 as FRL has not rated any of the securities at issue. Plaintiff points to a passage on two FRI press releases which announce that "Fitch" has rated certain of the securities at issue. Fitch is defined in the small-print at the bottom of the page as meaning "Fitch, Inc, Fitch Ratings, Ltd. and their subsidiaries..." Plaintiff claims this passage means that the Fitch who rated the securities is in fact FRL. Defendant's affidavits contradict this, and we are inclined to follow the California federal court's ruling in the related *Anschutz Corp. v. Merrill Lynch & Co.*, 785 F. Supp. 2d 799 (N.D. Cal. 2011), in which the court held that the type of "boilerplate language" plaintiff relies on should be defeated by the contradicting affidavit. Accordingly, personal jurisdiction under this theory is improper.

V. Conclusion

Accordingly, it is hereby

ORDERED that defendants' motion to dismiss is granted and plaintiffs' claim of fraudulent misrepresentation is dismissed with prejudice; and it is further

ORDERED that the motion to dismiss plaintiffs' cause of action against Fitch Ratings, Ltd. for lack of personal jurisdiction is granted.

Date: July 31, 2015
New York, New York

Anil C. Singh