

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

NEW YORK STATE TEACHERS')
RETIREMENT SYSTEMS,)
Individually and on Behalf of All)
Others Similarly Situated,)

Plaintiff,)

vs.)

FREMONT GENERAL)
CORPORATION, et al.,)

Defendant(s).)
_____)

Case No. 2:07-cv-5756-FMC-FFMx

ORDER GRANTING MOTION TO
DISMISS THE SECOND AMENDED
CONSOLIDATED CLASS ACTION
SECURITIES COMPLAINT

This matter is before the Court on Defendants' Motion to Dismiss the Second Amended Consolidated Class Action Securities Complaint (docket no. 110), filed on March 25, 2009. The Court has considered the moving, opposition and reply documents submitted in connection with this Motion. The matter came on for hearing on September 21, 2009, at which time the parties were in possession of the Court's tentative decision to grant Defendants' Motion with prejudice. Following oral argument, the matter was taken under submission. For the reasons and in the manner set forth below, Defendants' Motion is GRANTED WITHOUT PREJUDICE.

I. EVIDENTIARY RULINGS

Defendants request that the Court take judicial notice of a variety of SEC filings; transcripts from earnings calls and an investor presentation during the class

27
28

1 period; a HUD lender list used by Plaintiff to conduct an analysis of Fremont
2 General Corporation's industry "peers," *see* SAC ¶ 157; a LexisNexis report of
3 Fremont General Corporation's daily common stock prices; publicly filed documents
4 from other federal court proceedings; accounting rules; and analyst reports
5 referenced in the SAC. Lead Plaintiff made no objection to the Court taking judicial
6 notice of any of these items, and the items of which Defendants ask the Court to take
7 judicial notice are either (a) publicly-filed records, (b) otherwise capable of accurate
8 and ready determination by resort to sources whose accuracy cannot be reasonably
9 questions, or (c) documents on which the allegations Plaintiff's SAC necessarily
10 rely. Accordingly, the Court GRANTS Defendants' requests for judicial notice
11 (docket nos. 111 and 117).

12 **II. FACTUAL BACKGROUND AND PROCEDURAL HISTORY**

13 This putative class action arises out of a decline in the price of shares in
14 Defendant Fremont General Corporation ("Fremont General"). Fremont General is
15 a financial services holding company whose lending operations included national
16 sub-prime residential real estate loans; it operated its commercial and residential real
17 estate lending business in the United States through its wholly-owned California
18 industrial bank subsidiary, Fremont Investment & Loan ("FIL").¹ On behalf of itself
19 and other putative class members who purchased or acquired Fremont General
20 common stock during the time period between October 27, 2005 and March 2, 2007
21 (the "Class Period"), Lead Plaintiff alleges that Defendants made a series of
22 materially false and misleading statements in press releases, conference calls with
23 investors and analysts, and in Securities and Exchange Commission ("SEC") filings.

24 On September 4, 2007, this litigation commenced with the filing of a
25 Complaint against Fremont and several of the former officers of Fremont and FIL.

26
27 ¹For purposes of this Order, the Court refers to Defendant Fremont General and
28 FIL collectively as "Fremont."

1 On March 5, 2008, Lead Plaintiff New York State Teachers' Retirement System
2 ("Lead Plaintiff") filed its Amended Consolidated Class Action Securities Complaint
3 ("AC") against Fremont General and the following individuals who were senior
4 officers of Fremont during the class period ("Individual Defendants"): Louis
5 Rampino, former President and CEO of Fremont General; Wayne R. Bailey, former
6 Executive Vice President and COO of Fremont General; Patrick E. Lamb, former
7 Senior Vice President, CFO, and Chief Accounting Officer, and Treasurer of
8 Fremont General; Kyle R. Walker, former President and CEO of FIL; Ronald J.
9 Nicolas, Jr., former Executive Vice President and CFO of FIL; and James A.
10 McIntyre, a former Chairman of the Board and director of Fremont General.

11 On June 16, 2008, Fremont and the Individual Defendants moved to dismiss
12 the AC for failure to allege facts sufficient to satisfy the PSLRA pleading
13 requirements for the "material misrepresentation or omission" (or "falsity") and
14 "scienter" elements of Plaintiff's Section 10(b) and Rule 10b-5 claims.² Briefing on
15 Defendants' motion to dismiss the AC closed on October 2, 2008. On October 28,
16 2008, the Court granted that motion without prejudice to Plaintiff filing a Second
17 Amended Consolidated Class Action Securities Complaint ("SAC"). In the October
18 28, 2008 Order, the Court explained various ways in which the allegations in the AC
19 were insufficient:

20 Although the materiality allegations at pages 107-112 do explain
21 the materiality of certain statements (*e.g.*, valuation of residual interest
22 important because it served as a benchmark for the quality of
23 underwriting, AC ¶207; repurchase reserves, alleged to be materially
24 misstated in 3Q of 2006, important because the need to increase them
25 by 300% the next quarter was reflected in the reported net loss for that

26
27 ²On July 9, 2008, Fremont filed a Notice of Filing of Chapter 11 Bankruptcy.
28 Thereafter, the action was stayed as to Fremont but proceeded against the Individual Defendants.

1 quarter, AC ¶208), they do not link that materiality analysis to
2 particular statements by one or more of the defendants. Additionally,
3 the allegations of material misstatements at pages 125-166 cross
4 reference[] allegations made throughout the AC (but not necessarily
5 those in the “materiality” section at pages 107-111) without further
6 explanation. . . .

7 In the “material misstatements” section of the AC, Lead Plaintiff
8 lists, in no particular order with regard to chronology, individual
9 defendant, or theory of materiality, a variety of statements made during
10 the Class Period about Fremont’s loan origination and underwriting
11 standards, financial statements, and internal controls. AC ¶¶244-270.

12 The Court has scoured the 175 pages of the AC in an effort to
13 link Lead Plaintiff’s allegations of specific statements with the alleged
14 reason(s) those statements are misleading. However, in many cases, the
15 internal cross references to other allegations in the AC fail to
16 substantiate Lead Plaintiff’s conclusory allegations that the statements
17 were false and, in nearly all cases, they fail to illuminate why or how
18 the falsity was material. Additionally, the numerous references to
19 representations by or knowledge of “Defendants,” collectively, do not
20 facilitate a reasoned assessment of the statements and knowledge
21 attributable to the Individual Defendants. . . . Beyond that, more often
22 than not, the cross-referenced allegations intended to evidence the
23 falsity of the alleged misrepresentations fail to adequately plead
24 scienter in connection with those statements.

25 Oct. 28, 2008 Order at 7:28-9:13 (footnote omitted). The Court went on to discuss
26 illustrative examples of the shortcomings of the allegations in the AC, *id.* at 10:1-
27 12:27, concluding that:

28 [A]s pleaded, the allegations in the AC do not clearly articulate

1 the bases of Lead Plaintiff's Section 10-b and Rule 10b-5 claims
2 against the Individual Defendants. It follows that the Motion to
3 Dismiss is also granted as to Plaintiff's Section 20(a) claims.

4 *Id.* at 12:28-13:3.

5 On January 9, 2009, Lead Plaintiff filed its 215-page Second Amended
6 Complaint ("SAC"), in which Lead Plaintiff asserts the following claims against all
7 Defendants: (1) violations of Section 10(b) of the Exchange Act, 15 U.S.C. §
8 78(j)(b), and Rule 10b-5, 17 C.F.R. §240; and (2) violations of Section 20(a) of the
9 Exchange Act, 15 U.S.C. § 78(t)(a).

10 The SAC describes Fremont's business model as follows: "Fremont made
11 money principally by originating a growing volume of subprime mortgages and then
12 quickly selling those mortgage loans to investment banks and other purchasers of
13 real estate-related debt." SAC ¶ 5. Fremont also securitized some of its loans.
14 Securitization was treated as a sale, and the loans were removed from the balance
15 sheet.³ Regarding Fremont's growth, the SAC explains:

16 _____
17 ³Regarding the securitization and sale of the loans Fremont originated, the SAC
18 explains:

19 Fremont originated subprime residential real estate loans
20 nationwide on a wholesale basis through independent loan brokers in
21 nearly all of the 50 states. Generally, Fremont sold most of the subprime
22 loans it originated to other financial institutions through whole loan
23 sales. After the sale, the Company retained no interest in the loans.
24 Depending upon market conditions, Fremont also securitized some of its
25 subprime loan production and retained a required junior residual interest
26 in the cash flows earned from the loans. Fremont earned income from
27 the gains realized upon selling or securitizing its loans. Fremont's
28 originations grew quickly and reached a record \$36.2 billion in 2005.
During 2005, Fremont sold \$29.5 billion in whole loan sales and
securitized \$6.5 billion of its loan origination volume.

SAC ¶ 55; *see also* SAC ¶ 60 (explaining that, Fremont was required to provide
representations and warranties to purchasers of the loans and "[i]f a purchaser of the
mortgage loans determined that Fremont violated its representations and warranties

1 Beginning in 1999[,] and continuing through the Class Period,
2 the Company originated subprime loans, lending to individuals who did
3 not satisfy the credit, documentation or other underwriting standards
4 prescribed by conventional mortgage lenders and loan buyers. By the
5 beginning of the Class Period, Fremont was one of the largest subprime
6 mortgage lenders in the nation[,] and the Company's reported 2004 and
7 2005 earnings were the highest in the Company's 42-year history.

8 SAC ¶54. However, at the end of the first quarter of 2006 ("1Q 2006"), subprime
9 delinquencies and repurchases began to increase. In response, Defendants
10 "repeatedly described 'modifications' to Fremont's loan underwriting practices
11 purportedly 'designed to lower early payment defaults' and 'to improve the overall
12 credit performance of the loans.'" SAC ¶ 63. However, "the loans that Fremont
13 underwrote and originated after Defendants claimed to have improved its practices
14 during the second quarter of 2006 performed even worse than the loans Fremont
15 originated just before it allegedly tightened its underwriting." SAC ¶ 172 (emphasis
16 in original).

17 Plaintiffs also allege that Fremont's financial statements were materially
18 misstated throughout the Class Period in that Defendants both (a) overvalued
19 Fremont's reported residual interest in the loans Fremont securitized and (b) set
20 Fremont's repurchase reserves artificially low in the third quarter of 2006 ("3Q
21 2006"). SAC ¶¶ 182-224. In the same vein, Lead Plaintiff alleges that, in Fremont's
22 quarterly financial statements, Defendants Rampino and Lamb made repeated
23 material misstatements certifying the design, operation and effectiveness of
24

25
26
27 _____
28 or if a borrower defaulted during the early months of the loan, the purchaser could
 require Fremont to repurchase the mortgage loan").

1 Fremont's internal controls. SAC ¶¶ 225-235.⁴

2 As it did previously, Lead Plaintiff alleges that, on February 27, 2007,
3 Fremont announced that it would have to delay the release of its financial statements;
4 after the close of trading on March 2, 2007, Fremont announced that it would
5 consent to a "Cease and Desist" order (the "Cease and Desist Order") with the FDIC,
6 which provided that the FDIC "had reason to believe that [Fremont] had engaged in
7 unsafe or unsound banking practices and had committed violations of law and/or
8 regulations." SAC ¶¶8-9 (internal quotations omitted).⁵ On this news, Fremont's
9 stock experienced a drop of over 32% (from a close of \$8.71 on March 2, 2007, to
10 a close of \$5.89 on March 5, 2007, the next trading day). SAC ¶ 8. Lead Plaintiff
11 summarizes its allegations against Defendants as follows:

12 _____
13 ⁴The SAC also includes sections containing allegations grouped as follows: (1)
14 materiality of misstatements and omissions, SAC ¶¶ 236-259 (section spanning pages
15 123 to 131 entitled "Defendants' Misstatements and Omissions During the Class
16 Period were Material"); (2) scienter, SAC ¶¶ 260-303 (section spanning pages 131 to
17 159 entitled "Defendants Acted with Scienter"); (3) falsity of class-period statements,
18 SAC ¶¶ 304-381 (section spanning pages 159-207 entitled "Defendants' Materially
False and Misleading Statements During the Class Period and Subsequent Post-Class
Period Disclosures").

19 ⁵The SAC further explains that the FDIC's March 7, 2007 Cease and Desist
20 Order:

21 [S]ought to prevent Fremont from operating "without effective
22 risk management policies and procedures in place in relation to the
23 Bank's primary line of business of brokered subprime mortgage
24 lending;" operating "with inadequate underwriting criteria and excessive
25 risk;" and making "mortgage loans without adequately considering the
26 borrower's ability to repay." The FDIC determined (contrary to
27 Defendants' repeated public statements to investors) that, among other
28 things, Fremont "had been operating without adequate subprime
mortgage loan underwriting criteria, and that it was marketing and
extending subprime mortgage loans in a way that substantially increased
the likelihood of borrower default or other loss to the bank."

SAC ¶ 9.

1 Despite causing Fremont to be one of the country’s most
2 deliberately reckless and harmful subprime lenders, Defendants
3 Rampino, Bailey, Lamb, Walker, Nicolas, and McIntyre each told
4 investors repeatedly that Fremont’s underwriting and lending practices
5 were “sound,” “appropriate,” and “improved” and that its accounting
6 was “conservative” and presented in accordance with Generally
7 Accepted Accounting Principles (“GAAP”). Plaintiffs allege that
8 Defendants’ statements regarding: (1) Fremont’s purportedly
9 “appropriate” and “sound” underwriting standards, including specific
10 claims that the underwriting standards purportedly were “improved”
11 and “tightened” beginning on August 8, 2006; (2) Fremont’s purported
12 compliance with GAAP; and (3) the purported adequacy of Fremont’s
13 internal controls, were each materially false and misleading when
14 made, causing substantial harm to Fremont investors when investors
15 were shocked to learn of the FDIC’s findings and severe regulatory
16 action against Fremont in March 2007. In fact, Fremont was the first
17 bank to be cited so extensively for such “unsafe and unsound” practices
18 related to subprime mortgage lending in over five years since the
19 implementation of the Interagency Expanded Guidance for Subprime
20 Lending Programs in 2001.

21 SAC ¶ 2. Lead Plaintiff further alleges that “Defendants intended to and did . . . (I)
22 deceive the investing public, including Plaintiffs and other members of the Class; (ii)
23 artificially inflate and maintain the price of Fremont securities; and (iii) cause
24 Plaintiffs and the members of the Class to purchase Fremont securities at artificially
25 inflated prices.” SAC ¶ 393. The class members “purchased Fremont common stock
26 at artificially inflated prices during the Class Period” and, “[b]ut for the fraud,” they
27 would not have done so. SAC ¶ 397.

28 On March 25, 2009, Defendants filed this Motion to Dismiss, arguing the SAC

1 does not contain allegations sufficient to satisfy the PSLRA's standard for pleading
2 falsity and scienter. On June 8, 2009, Lead Plaintiff filed its Opposition, and
3 Defendants filed their Reply thereto on August 7, 2009. On August 14, 2009, the
4 parties filed a stipulation to continue the hearing on this matter to September 21,
5 2009.

6 III. APPLICABLE LEGAL STANDARD

7 Rule 12(b)(6) of the Federal Rules of Civil Procedure permits a defendant to
8 seek dismissal of a complaint that "fail[s] to state a claim upon which relief can be
9 granted." Fed. R. Civ. P. 12(b)(6). Generally, all material factual allegations in the
10 complaint are assumed to be true and construed in the light most favorable to the
11 plaintiff. *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226,
12 1229 (9th Cir. 2004) ("The general rule for 12(b)(6) motions is that allegations of
13 material fact made in the complaint should be taken as true and construed in the light
14 most favorable to the plaintiff.") (citing *Burgert v. Lokelani Bernice Pauahi Bishop*
15 *Trust*, 200 F.3d 661, 663 (9th Cir. 2000)). However, the Court "is not required to
16 accept legal conclusions cast in the form of factual allegations if those conclusions
17 cannot be reasonably drawn from the facts alleged." *Clegg v. Cult Awareness*
18 *Network*, 18 F.3d 752, 755 (9th Cir. 1994) (internal citations omitted). Additionally,
19 claims asserting violations of the Private Securities Litigation Reform Act of 1995
20 (the "PLSRA"), 15 U.S.C. §78u-4(b), must satisfy a heightened pleading
21 requirement. *Desaigoudar v. Meyercord*, 223 F.3d 1020, 1021 (9th Cir. 2000).

22 If the Court dismisses the complaint, it must decide whether to grant leave to
23 amend. Denial of leave to amend is "improper unless it is clear that the complaint
24 could not be saved by any amendment." *Livid Holdings Ltd. v. Salomon Smith*
25 *Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005) (citation omitted); *see also Allen v.*
26 *City of Beverly Hills*, 911 F.2d 367, 373 (9th Cir.1990) ("The district court's
27 discretion to deny leave to amend is particularly broad where plaintiff has previously
28 amended the complaint.").

IV. DISCUSSION

1
2 The instant Motion challenges the adequacy of Lead Plaintiff's allegations
3 with respect to the falsity and scienter pleading requirements for securities fraud
4 cases.

5 Generally, Section 10(b) of the 1934 Act and Rule 10b-5 promulgated
6 thereunder "prohibit[] any person from using or employing any 'manipulative or
7 deceptive device' in connection with the sale of a security." *In re Verifone*
8 *Securities Litigation*, 11 F.3d 865, 868 (9th Cir. 1993) (citing 17 C.F.R. §
9 240.10b-5); *see also Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S.
10 148, ___, 128 S.Ct. 761, 768 (2008) ("Rule 10b-5 encompasses only conduct
11 already prohibited by §10(b)."). A violation of Section 20(a) of the 1934 Act
12 requires : "(1) a primary violation of federal securities laws . . . and (2) that the
13 defendant exercised actual power or control over the primary violator." *Howard*
14 *v. Everex Systems, Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000). A primary violation
15 consists of the "transactions giving rise to the alleged securities violation." *Id.*
16 (internal citations omitted). Accordingly, if the SAC fails to articulate a Section
17 10(b) claim, Lead Plaintiff's Section 20(a) claim must also be dismissed.

18 "In a typical §10(b) private action a plaintiff must prove (1) a material
19 misrepresentation or omission by the defendant;⁶ (2) scienter; (3) a connection
20 between the misrepresentation or omission and the purchase or sale of a security;
21 (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6)
22 loss causation." *Stoneridge*, 128 S.Ct. at 768. The PSLRA requires that both
23 falsity and scienter be pleaded with particularity. *In re Vantive Corp. Securities*
24 *Litigation*, 283 F.3d 1079, 1084 (9th Cir. 2002). The Ninth Circuit has
25 summarized the pleading requirement as follows:

26 The PSLRA significantly altered pleading requirements in
27

28 ⁶This requirement is also referred to as the "falsity" requirement.

1 private securities fraud litigation by requiring that a complaint plead
2 with particularity both falsity and scienter. The purpose of this
3 heightened pleading requirement was generally to eliminate abusive
4 securities litigation and particularly to put an end to the practice of
5 pleading “fraud by hindsight.” A securities fraud complaint must
6 now “specify each statement alleged to have been misleading, the
7 reason or reasons why the statement is misleading, and, if an
8 allegation regarding the statement or omission is made on
9 information and belief, the complaint shall state with particularity all
10 facts on which that belief is formed.” 15 U.S.C. § 78u-4(b)(1). If
11 the challenged statement is not false or misleading, it does not
12 become actionable merely because it is incomplete. Further, the
13 complaint must “state with particularity facts giving rise to a *strong*
14 inference that the defendant acted with the required state of mind.”
15 15 U.S.C. § 78u-4(b)(2) (emphasis added). Thus the complaint must
16 allege that the defendant made false or misleading statements either
17 intentionally or with deliberate recklessness or, if the challenged
18 representation is a forward looking statement, with “actual
19 knowledge . . . that the statement was false or misleading.” 15 U.S.C.
20 § 78u-5(c)(1)(B)(I).

21 *Id.* at 1084-85 (footnotes omitted and citations to all but quoted statutory
22 provisions omitted) (emphasis in original). Regarding the scienter requirement,
23 the Ninth Circuit has also explained that the required state of mind consists of
24 defendants acting “with the intent to deceive or with deliberate recklessness as to
25 the possibility of misleading investors.” *Berson v. Applied Signal Technology,*
26 *Inc.*, 527 F.3d 982, 987 (9th Cir. 2008). “It does not suffice that a reasonable
27 factfinder plausibly could infer from the complaint’s allegations the requisite state
28 of mind. To qualify as ‘strong’ within the intendment of § 21D(b)(2), . . . an

1 inference of scienter must be more than merely plausible or reasonable – it must
2 be cogent and at least as compelling as any opposing inference of nonfraudulent
3 intent.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314, 127
4 S.Ct. 2499, 2504-05 (2007) (emphasis added). Accordingly, the factual basis for
5 the scienter requirement must be pleaded with particularity:

6 It is not enough for [a plaintiff] to state facts giving rise to a
7 mere speculative inference of deliberate recklessness, or even a
8 reasonable inference of deliberate recklessness. . . . We understand
9 this to mean that [plaintiff] must plead in great detail facts
10 demonstrating, at a minimum, a degree of recklessness that strongly
11 suggests the required degree of intent.

12 *In re Silicon Graphics Inc. Securities Litigation*, 183 F.3d 970, 985 (9th Cir.
13 1999) (internal citation omitted).

14 Here, as an initial matter, the Court notes that despite an effort to add
15 allegations that would address the problems identified in the Court’s October 28,
16 2008 Order, the SAC still suffers from inadequate organization and insufficient
17 specificity to adequately plead falsity and the requisite level of scienter. *Cf.*
18 *Wenger v. Lumisys, Inc.*, 2 F.Supp.2d 1231, 1244 (N.D.Cal. 1998) (citing several
19 “securities class action complaints, [in which] courts have repeatedly lamented
20 plaintiffs’ counsels’ tendency to place the burden [] on the reader to sort out the
21 statements and match them with the corresponding adverse facts to solve the
22 ‘puzzle’ of interpreting Plaintiffs’ claims” and refusing to do so where the plaintiff
23 “failed to craft a Complaint in such a way that a reader can, without undue effort,
24 divine why each alleged statement was false or misleading” (internal citations and
25 quotations omitted)).

26 With Section VII(A) of the SAC, Plaintiff sets out in chronological order
27 each challenged statement but still merely “cross references all facts
28 demonstrating falsity, materiality and, collectively, supporting a strong inference

1 of scienter for each Defendant.” SAC at 159 n.6. This “puzzle pleading” makes it
2 extremely difficult for the Court to identify or follow Plaintiff’s reasoning and to
3 determine – with specificity – which allegations are intended to establish the
4 falsity and scienter requirements in relationship to each challenged statement
5 identified in Section VII(A). This, in turn, renders it both difficult and
6 unnecessary for the Court to discuss the insufficiency of each and every cross-
7 referenced allegation. Although the Court believes it would be justified in
8 dismissing the SAC on this basis alone, the following discussion identifies and
9 briefly addresses a representative sampling of some of the major, substantive
10 problems with the SAC that support dismissal with prejudice.

11 Simply put, Lead Plaintiff’s factual allegations are neither sufficient, nor
12 sufficiently particularized, to satisfy the pleading standard for the falsity
13 requirement, nor do they articulate facts sufficient to give rise to the requisite
14 *strong* inference that one or more of the Defendants made the challenged
15 statements with the requisite level of scienter. Stated otherwise, although the
16 allegations in the SAC set out a strong case for finding – particularly with the
17 benefit of hindsight – that Fremont’s underwriting was woefully inadequate and
18 that some or all of the Defendants utterly failed to implement policies and
19 procedures sufficient to halt the company’s downward spiral, the factual
20 allegations in the SAC are not sufficient to substantiate Plaintiff’s conclusions that
21 each Defendant, knowingly or with deliberate recklessness, made statements (or
22 omissions) that were, in fact, materially false or misleading at the time. Rather,
23 even taking all the factual allegations in the SAC as true, they are less likely to
24 support an inference of securities fraud than they are to support an inference of
25 profoundly misguided corporate mismanagement. *Cf. Santa Fe Industries, Inc. v.*
26 *Green*, 430 U.S. 462, 479-80, 97 S.Ct. 1292, 1304 (1977) (“We thus adhere to the
27 position that Congress by [§] 10(b) did not seek to regulate transactions which
28 constitute no more than internal corporate management. There may well be a need

1 for uniform federal fiduciary standards to govern mergers such as that challenged
2 in this complaint. But those standards should not be supplied by judicial
3 extension of § 10(b) and Rule 10b-5 to cover the corporate universe.” (internal
4 quotations, citations, and footnotes omitted)).

5 Lead Plaintiff describes in considerable detail how and why information
6 about Fremont’s underwriting practices, valuation of residual interests, statement
7 of repurchase reserves, use of GAAP, and maintenance of adequate internal
8 controls are material.⁷ Opp’n at 3-7; SAC ¶¶ 237-259. However, the question
9 before the Court is not whether information about Fremont’s handling of these
10 areas of its operations was material; rather, the question is whether Plaintiff has
11 adequately alleged (a) that the challenged statements about Fremont’s
12 underwriting practices, GAAP compliance, and internal controls were *materially*
13 *false when they were made*, and (b) that one or more of the Defendants made the
14 challenged statements *with an intent to deceive, or with deliberate recklessness* as
15 to the possibility of misleading, investors.

16 The Court has considered all the allegations, separately and as a whole, in
17 the SAC. The following discussion addresses a few of the overarching problems
18 with Plaintiff’s pleading by examining several of the Plaintiff’s challenges to
19 statements regarding both (a) underwriting practices and (b) GAAP compliance
20 (namely, residual interests and repurchase reserves) and internal controls.

21
22
23 ⁷ “[A] fact is material if there is a substantial likelihood that a reasonable
24 investor would consider it important in his or her decision making.” *In re Immune*
25 *Response Secs. Litig.*, 375 F.Supp.2d 983, 1020 (S.D.Cal.2005) (quoting *America*
26 *West*, 320 F.3d 920, 934 (9th Cir. 2003) (internal citations omitted)); *see also Basic*
27 *Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (expressly adopting the following
28 standard for materiality in Section 10(b) cases: “there must be a substantial likelihood
that the disclosure of the omitted fact would have been viewed by the reasonable
investor as having significantly altered the ‘total mix’ of information made available”
(internal citations omitted)).

1 **A. Allegations and Argument Regarding “Defendants,” Collectively**

2 Despite the Court’s previous admonition to Plaintiff that “the numerous
3 references to representations by or knowledge of ‘Defendants,’ collectively, do
4 not facilitate a reasoned assessment of the statements and knowledge attributable
5 to the Individual Defendants[,]” Oct. 28, 2008 Order at 8:28-9:10, Plaintiff has not
6 presented the relevant facts in a manner or format that permits the Court (or
7 Defendants) to readily identify the allegations relevant to each individual
8 defendant’s scienter.⁸ As the discussion in Sections IV(B) & (C) *infra* further
9 illustrates, although the SAC identifies to which of the individual Defendants
10 (Rampino, Bailey, Lamb, Walker, Nicolas, and McIntyre) each challenged
11 statement is attributable, neither the SAC nor Plaintiff’s Opposition to the instant
12 Motion ties *each* challenged statement to factual allegations regarding the
13 specified Defendant’s knowledge of (or reckless disregard for) the possibility of
14 the challenged statement misleading investors.⁹ The Court is left to conclude that

15 _____
16 ⁸Defendants somewhat overstate the matter in their Reply. Although Plaintiff
17 does make reference in its Opposition to “Defendants’ representations,” the portions
18 of the Opposition cited by Defendants are not so impermissibly vague as to be
19 misleading. Reply at 2 n. 2 (citing Opp’n at 21 n.10 and Opp’n at 17). It is possible
20 to discern to which particular statements Plaintiff is referring in the referenced
21 portions of the Opposition.

22 ⁹As illustrated in greater detail *infra* in Section IV(B), the Court has endeavored
23 to link the allegations related to each statement by each Defendant to allegations
24 relevant to (a) falsity and (b) scienter. Both the format and content of the SAC render
25 this task both unduly tedious and unfruitful. For example, the challenged statements
26 made by Defendant Bailey on an October 27, 2005 conference call are set out in
27 paragraph 305. The SAC then directs the Court to paragraphs 62 through 181 and
28 paragraphs 237 through 246 to locate allegations relevant to the materiality and falsity
of Bailey’s statements. Only some of the allegations contained in the referenced 128
paragraphs relate specifically to Bailey, and those paragraphs do not adequately plead
falsity. Additionally, although the Court was not able to locate a specific cross-
reference to paragraphs setting out allegations relating to Bailey’s scienter in
connection with the challenged October 27, 2005 statements, the various allegations

1 Plaintiff has not made separate allegations regarding the knowledge attributable to
2 each separate defendant in relationship to each challenged statement because
3 Plaintiff cannot do so.

4 **B. Underwriting Statements**

5 The challenged statements regarding Fremont's underwriting practices, and
6 the referenced support for finding that the falsity and scienter requirements are
7 satisfied, include:

8 • On an October 27, 2005 conference call, in response to a question
9 about whether Fremont had seen "any inkling of any cracks" in the credit
10 of its residential mortgage customers, Defendant Bailey responded, in part:
11 "Not really, no. I think , again, the subprime spectrum, it's a wide
12 spectrum. And we tend to play at the upper end of that spectrum. . . . And
13 I think that we have a pretty good reputation as a good, sound originator."

14 SAC ¶305.

15 • The 10-Q for the third quarter of 2005 ("3Q 2005") signed by
16 Defendants Rampino and Lamb and filed with the SEC explained the
17 company's subprime underwriting practices and stated that "FIL seeks to
18 mitigate its exposure to credit risk through underwriting standards that
19 strive to ensure appropriate loan to collateral valuations." SAC ¶ 306.

20 The SAC references paragraphs 62 through 181 as setting forth "in detail,
21 numerous sources of evidence demonstrat[ing] that Fremont, in fact, employed
22 extremely 'unsafe and unsound' underwriting practices . . ." and paragraphs 237
23 through 246 as containing allegations that establish the material falsity of the
24 above statements. The SAC also references a May 17, 2007 speech by Federal

25 _____
26 that are clearly intended to relate to scienter, *e.g.*, paragraphs regarding confidential
27 witness statements, statements in the FDIC Cease-and-Desist Order, and subsequent
28 statements by the Massachusetts Attorney General, are not sufficient to create the
requisite inference of knowledge or reckless disregard.

1 Reserve Chairman Ben Bernanke as evidence of the “materiality of Fremont’s
2 subprime underwriting to investors.” SAC ¶ 308.

- 3 • The Form 10-K filed for the year 2005 and signed by Defendants
4 McIntyre, Rampino, Bailey and Lamb described Fremont’s underwriting
5 as follows: “Lending is substantially all done on a senior and secured basis
6 and the Company seeks to minimize credit exposure through loan
7 underwriting that is focused upon appropriate loan to collateral valuations
8 and cash flow coverages.” It goes on to explain that the residential loans
9 are “sub-prime” and “[t]o mitigate the higher potential for credit losses
10 that accompanies these types of borrowers, the Company attempts to
11 maintain underwriting standards that require appropriate loan to collateral
12 valuations. The underwriting guidelines are primarily intended to assess
13 the ability and willingness of the potential borrower to repay the debt and
14 to evaluate the adequacy of the mortgaged property as collateral for the
15 loan.” SAC ¶ 323.

16 The SAC again references paragraphs 62 through 181 as setting forth “in
17 detail, numerous sources of evidence demonstrat[ing] that Fremont, in fact,
18 employed extremely ‘unsafe and unsound’ underwriting practices . . .” and
19 paragraphs 237 through 246 as containing allegations that establish the material
20 falsity of the above statements. SAC ¶ 324. Plaintiff also references paragraphs
21 260 through 303 as substantiating the allegation that “there is a strong inference
22 that all individual Defendants responsible for these specific material
23 misstatements acted with scienter in making their materially false and misleading
24 statements on March 9, 2006 in Fremont’s 2005 Form 10-K.” SAC ¶ 326.

25 The SAC contains similar allegations regarding statements in Fremont’s 10-
26 Q for 1Q 2006. SAC ¶¶ 327-334. The SAC goes on to allege that numerous
27 important misrepresentations were made in the second quarter of 2006:

- 28 • August 8, 2006 press release stated “with an objective of reducing its

1 early payment delinquencies, the Company made modifications in its loan
2 origination parameters during the second quarter of 2006, including
3 eliminating or reducing certain higher loan-to-value products and lower
4 FICO bands.” SAC ¶ 335.

5 • On an August 8, 2006 conference call Defendant Bailey stated that, in
6 response to an increasing trend in early payment defaults developing at
7 Fremont and throughout the industry, “[w]e determined that we needed
8 to tighten up some of our loan sale conditions and that modifications
9 in our loan production parameters required adjustments.” Bailey went
10 on to state that “[t]hese changes were implemented during the second
11 quarter and we’ve begun to see impact on our production of these
12 during July” and that “[w]e have really gone through to identify where
13 these loan repricing and repurchases are coming from, and again, we
14 have made changes and it appears from our production that these
15 changes are altering what we are producing.” SAC ¶ 336.

16 • The Form 10-Q for 2Q 2006 again contained the statement that “FIL
17 seeks to mitigate its exposure to credit risk through underwriting standards
18 that strive to balance appropriate loan to collateral valuations with a
19 borrower’s credit profile.” The 10-Q also noted the modifications
20 including modification or elimination of “certain higher loan-to-value
21 products and lower FICO bands.” SAC ¶¶ 337-228.

22 The SAC again references paragraphs 62 through 181 as setting forth “in
23 detail, numerous sources of evidence demonstrat[ing] that Fremont, in fact,
24 employed extremely ‘unsafe and unsound’ underwriting practices . . .” and
25 paragraphs 237 through 246 as containing allegations that establish the material
26 falsity of the above statements. The SAC also references paragraphs 172 through
27 180 as containing allegations showing that the subprime loans Fremont originated
28 at the time the above statements were made in late 2006 performed “even worse,

1 rather than improved” and “performed so poorly, so quickly, that their demise
2 could not have been the result of general market forces.” SAC ¶ 339.

3 None of the following “strongly demonstrate” that any one or more of the
4 individual Defendants made materially false statements with the requisite scienter:
5 (a) the above-referenced statements regarding Fremont’s underwriting practices;
6 (b) the statements contained in SEC filings and made during conference calls
7 during 3Q 2006, SAC ¶¶ 345-352; or (b) the further decline in the price of
8 Fremont’s common stock, SAC ¶ 354. More specifically, neither Bailey’s
9 generalization that he thought the company *tended* to play “at the upper end” of
10 the sub-prime spectrum nor the 10-Q statement that the company *sought* to
11 mitigate its exposure through standards that *strove* to ensure valuations constitute
12 materially false statements. *Compare In re Impac Mortg. Holdings, Inc.*
13 *Securities Litig.*, 554 F.Supp.2d 1083, 1097 (C.D.Cal. 2008) (“[T]he word ‘solid,’
14 like the words ‘robust’ and ‘strong,’ is such a vague expression of optimism that it
15 would not have conveyed a misleading impression of the future on which a
16 reasonable investor would rely.”); *with In re New Century*, 588 F.Supp.2d 1206,
17 1225 (C.D.Cal. 2008) (finding actionable a sub-prime lender’s more concrete
18 statements describing, *inter alia*, “ ‘a strategy [of selecting borrowers with
19 increasing credit scores],’ ‘strict underwriting and risk management disciplines,’
20 and ‘better credit quality.’ “). Additionally, although Plaintiff argues that
21 Defendants failed to take *any* steps to employ improved or adequate underwriting
22 standards, the internal cross reference to all of paragraphs 62 through 181 of the
23 SAC does not represent pleading that is sufficiently specific or clear to
24 substantiate that conclusion. Moreover, the fact that subsequent disclosures
25 revealed that the remedial measures were not sufficient does not render false the
26 individual Defendants’ contemporaneous statements about those measures. *See,*
27 *e.g., In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir.1994),
28 *superseded by statute on other grounds* (“In order to allege the circumstances

1 constituting fraud, plaintiff must set forth facts explaining why the difference
2 between the earlier and the later statements is not merely the difference between
3 two permissible judgments, but rather the result of a falsehood.”). Similarly, the
4 SAC identifies no objective measure against which Defendants or the Court can
5 evaluate the adequacy of the underwriting standards actually employed. *See*
6 *Vantive*, 283 F.3d at 1086 (explaining that a failure to provide an objective
7 measure against which allegedly “false” statements can be compared or quantified
8 renders generalized allegations insufficient under the heightened PSLRA pleading
9 standard).

10 At oral argument, Plaintiffs re-asserted their contention that a fairly recent
11 decision in this district found securities fraud claims were adequately pleaded on
12 facts similar to those now before the Court and, as such, compels the conclusion
13 that the pleading in this action is adequate. This argument ignores the fact that
14 Fremont never held itself out to be anything other than a sub-prime lender; in
15 contrast, *Countrywide* involved allegations of a lender’s “systematic shift *from*
16 sound underwriting” to “the point of nearly abandoning” its underwriting
17 guidelines over the course of less than three years.” *In re Countrywide Financial*
18 *Corp. Securities Litigation*, 588 F.Supp.2d 1132, 1145, 1159 (C.D.Cal. 2008)
19 (emphasis added).

20 As for the allegations of statements from the 42 confidential witnesses set
21 out at paragraphs 13, 74, 78 through 118, and 201 of the SAC, those allegations
22 are not sufficient to support a determination of either falsity or scienter with
23 respect to the challenged statements about underwriting. The strongest allegations
24 are that confidential witness 34 (“CW 34”), an Assistant Vice President in
25 Fremont’s Regulatory Risk Management (“RRM”) group during the Class Period,
26 “states that the RRM group “submitted numerous, repeated adverse written
27 findings to senior Fremont executives, including Defendants Walker, Nicolas and
28 Bailey, in 2005 and 2006, which ‘mirrored’ the FDIC’s eventual Cease & Desist

1 Order, one to two years later.” SAC ¶ 13. Lead Plaintiff further alleges:

2 CW 34 states that these repeated adverse reports specifically
3 highlighted, *inter alia*, unfair and deceptive acts that Fremont was
4 engaging in, “pretty obvious” poor underwriting and problematic
5 incentive compensation. CW 34 reports, however, that Defendants
6 McIntyre, Rampino, Bailey and other senior executives “dictated
7 policy and procedures” and that their push was to make more and
8 more loans with “no restraints” to increase their own personal
9 compensation at Fremont with increasing loan volume, while
10 deliberately ignoring the repeated adverse findings from Regulatory
11 Risk Management . . .

12 SAC ¶ 13. The SAC contains allegations that other confidential witnesses
13 employed as senior underwriters, account executives, and sales managers provided
14 information about the number of exceptions made to Fremont’s underwriting
15 standards, the fact that those exceptions were reported to Fremont’s executive
16 management, and that “everyone” knew that stated-income loans were based on
17 falsified documents. *See, e.g.*, SAC ¶¶ 78-84. Although these allegations point to
18 evidence of serious mismanagement, they are not sufficient to substantiate
19 Plaintiff’s allegations of falsity or scienter. The allegations are lacking in
20 specificity regarding precisely what information was reported regarding
21 exceptions to underwriting standards and how Defendants’ statements can be
22 judged to be materially false in light of those practices. *See Silicon Graphics*, 183
23 F.3d at 985 (“We would expect that a proper complaint which purports to rely on
24 the existence of internal reports would contain at least some specifics from those
25 reports as well as such facts as may indicate their reliability.”).¹⁰ Additionally,
26

27 ¹⁰In *Silicon Graphics*, the Ninth Circuit went on to further explain how the
28 absence of specific factual allegations hindered its analysis:

1 although allegations in the SAC are sufficient to establish that the various
2 confidential witnesses have personal knowledge of the work they did, the reports
3 they made, and their own experiences as Fremont employees, the allegations do
4 not establish that any of the confidential witnesses were in a position to gain
5 personal knowledge of what Defendants saw, knew, or thought. *See Zucco*
6 *Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 995 (9th Cir. 2009) (explaining
7 that “a complaint relying on statements from confidential witnesses must pass two
8 hurdles to satisfy the PSLRA pleading requirements. First, the confidential
9 witnesses whose statements are introduced to establish scienter must be described
10 with sufficient particularity to establish their reliability and personal knowledge.
11 Second, those statements which are reported by confidential witnesses with
12 sufficient reliability and personal knowledge must themselves be indicative of
13 scienter.”). Finally, even taking all the confidential witness statements as true,
14 they are not sufficient to establish that Defendants’ general statements about
15 tending to play at the upper end of the sub-prime spectrum or *striving* to maintain
16 particular loan-to-value ratios were *false* when they were made.

17 The Court also notes that Plaintiff’s reliance on statements in the FDIC’s
18 Cease & Desist Notice and statements by the Massachusetts Attorney General

19
20
21 In the absence of such specifics, we cannot ascertain whether there
22 is any basis for the allegations that the officers had actual or constructive
23 knowledge of SGI’s problems that would cause their optimistic
24 representations to the contrary to be consciously misleading. In other
25 words, in the absence of such specifics, we cannot determine whether
26 there is any basis for alleging that the officers knew that their statements
27 were false at the time they were made – a required element in pleading
28 fraud. Brody would have us speculate as to the basis for the allegations
about the reports, the severity of the problems, and the knowledge of the
officers. We decline to do so.

Silicon Graphics, 183 F.3d at 985 (internal citation omitted).

1 does not bolster the strength of the allegations in the SAC and does not support a
2 determination that the challenged statements were false *when they were made* or
3 that they were made with the requisite intent.

4 **C. Statements Regarding GAAP Compliance and Internal Controls**

5 The challenged statements regarding Fremont's GAAP compliance and
6 internal controls, and the referenced support for finding that the falsity and
7 scienter requirements are satisfied, include:

- 8 • Statements in Fremont's Form 10-Q for 3Q 2005 indicating that the
9 financial statements were prepared in accordance with GAAP, that the report
10 did not contain any material misstatements, and that the company maintained
11 appropriate internal controls. SAC ¶¶ 313, 314(1)-(5).
- 12 • On a March 9, 2006 conference call to discuss the fourth quarter and year-
13 end 2005 financial results, Defendant Bailey stated regarding Fremont's
14 valuations of residual interest, "[w]e generally have realized a lower gain on
15 securitizations as we utilize what we believe are the most appropriate
16 assumptions for valuing residual interest that we retain. These residual
17 interests are inherently volatile and we have observed other industry
18 participants recording relative – higher relative levels for their retained
19 interest" and that Fremont booked its residual interests at "the most
20 appropriate levels and assumptions." SAC ¶ 318.
- 21 • The form 10-K filed on March 16, 2006, and signed by Defendants
22 McIntyre, Rampino, Bailey, and Lamb, stated that the discussion and analysis
23 of the company's financial condition was based on consolidated financial
24 statements prepared in accordance with GAAP. SAC ¶ 319.

25 The SAC contains similar allegations regarding statements in Fremont's 10-Q for
26 1Q 2006. SAC ¶¶ 327-34.

27 **1. Falsity**

28 In support of the conclusion that the above statements were materially false

1 and misleading when issued, Plaintiff cross-references the following paragraphs in
2 the SAC: 62 through 181, 182 through 206, and 225 through 235. The Court has
3 reviewed and considered those 153 paragraphs and concludes that, although
4 detailed, they do not establish falsity has been pleaded with the requisite
5 particularity as to any one or more of the individual Defendants.

6 Paragraphs 182 through 206 consist primarily of conclusory allegations that
7 Fremont's reported valuations of its residual interests were fraudulently inflated
8 throughout the Class Period.¹¹ Paragraph 189 alleges that, despite the
9 representation that the company's accounting for its residual interests complied
10 with GAAP:

11 Fremont's reported valuations for its residual interests were
12 fraudulently and materially inflated throughout the Class Period,
13 including at the time of the above-quoted 2005 Form 10K. The
14 Company failed to account for its extremely "unsafe and unsound"
15 underwriting standards, very poor loan quality, and increasing
16 defaults and delinquencies throughout 2005 and 2006. Rather than
17 appropriately account for the value of its Residual Interests
18 throughout the Class Period (which would have revealed to investors

19
20 ¹¹For example, paragraphs 182 and 184 contain conclusory allegations about the
21 falsity of information contained in financial statements issue by the company
22 throughout the class period. Paragraph 183 explain GAAP and how GAAP is
23 regulated. Paragraphs 185 and 186 explains that Fremont was required to hold
24 residual interests in the subprime mortgages it securitized in order to properly value
25 those residual interests according to GAAP. Paragraph 187 alleges that the company
26 attempted to minimize the amount of residual interest that it retained on its books.
27 Paragraph 188 sets out allegedly false statements about the company's compliance
28 with GAAP in accounting for its residual interests. SAC ¶ 188 (quoting the 2005
10-K, in relevant part, as follows: "The Company evaluates its residual interests for
impairment on a quarterly basis, taking into consideration trends in actual cash flows,
industry and economic developments, and other relevant factors.").

1 the true likelihood for repayment of Fremont’s poorly-underwritten
2 loans), Fremont *only admitted the poor quality of its Residual*
3 *Interests by taking a massive impairment of over \$161 million on*
4 *those interests after the end of the Class Period*, in belatedly
5 reporting its fourth quarter 2006 financial statements – an impairment
6 equal to more than 50% of the Company’s entire reported net income
7 for 2005 and over 80% of the Company's reported net loss for 2006.

8 SAC ¶ 189 (emphasis added).

9 First, construing the above allegations in the light most favorable to
10 Plaintiff, the first half of the paragraph contains conclusory allegations that do not
11 constitute facts pleaded with the requisite particularity. Second, other than
12 indicating that, in hindsight, it is clear that Plaintiff’s valuation of its residual
13 interests was inflated, Plaintiff identifies no objective means for determining
14 whether Fremont’s valuation of its residual interests was *fraudulently* inflated at
15 the time the referenced reports were signed.¹² See, e.g., *In re Countrywide Fin.*
16 *Corp. Deriv. Litig.*, 554 F.Supp.2d 1044, 1069-70 (C.D. Cal. 2008) (concluding
17 falsity was not pleaded with requisite particularity where plaintiffs “allege[d] that
18 the loan loss reserves violated GAAP because they were inadequate to account for
19 the risk presented by the mortgages in Countrywide’s portfolio” but “given the
20 discretion inherent in the setting of loan loss reserves, and the use of independent
21 auditors, Plaintiffs have not adequately pled particularized facts that show that the
22 loan loss levels were, in fact, so low that they were false and misleading”). Third,

23
24
25 ¹² Plaintiff goes on to allege that Defendants Rampino, Bailey, Lamb, Walker,
26 Nicolas, and McIntyre had “ample notice” that the quality of Fremont’s securitized
27 subprime loans was deteriorating such that, in order to comply with GAAP, the
28 company should have evaluated whether its interests were impaired. SAC ¶ 195.
However, the allegations Plaintiff references in support of that notion are identified
only as allegations that are “discussed above and elsewhere.” *Id.*

1 the SAC does not link the generalized allegation of GAAP violations to Fremont's
2 valuation of its residual interests during the relevant time period. *See In re Daou*
3 *Systems, Inc.*, 411 F.3d 1006, 1018 (9th Cir. 2005) (“[A]lthough overstatement of
4 revenues in violation of GAAP may support a plaintiff’s claim of fraud, the
5 plaintiff must show with particularity *how* the adjustments affected the company’s
6 financial statements and whether they were material in light of the company’s
7 overall financial position.” (emphasis added)); *cf. also In re Countrywide Fin.*
8 *Corp. Derivative Litig.*, 554 F.Supp.2d 1044, 1070 n. 28 (C.D.Cal. 2008) (noting
9 that an over-700% increase of loan loss reserves compared with the prior year was
10 not, standing alone, sufficient to establish scienter).

11 Accordingly, as discussed above in connection with Plaintiff’s allegations
12 purporting to establish the falsity of various statements related to underwriting
13 standards, the SAC also fails to plead with specificity facts that link one or more
14 of the individual Defendants’ alleged exposure to internal reports flagging
15 underwriting exceptions and other allegedly improper practices to public
16 statements that *contradicted* the information the Defendants are alleged to have
17 gleaned from the internal reports.

18 **2. Scienter**

19 In support of the conclusion that “there is a strong inference that all
20 individual Defendants responsible for these specific material misstatements acted
21 with scienter,” Plaintiff cross-references paragraphs 260-303. *See, e.g.*, SAC ¶¶
22 334, 344, 360. These are the same paragraphs Plaintiff cross-references as
23 support for the allegation that “all individual Defendants” acted with scienter in
24 making the allegedly material misstatements regarding Fremont’s underwriting
25 practices.

26 Lead Plaintiff alleges that, taken together, the allegations regarding the
27 contents of the FDIC Cease-and-Desist Order, the statements by Confidential
28 Witness 34 and other confidential witnesses, and the general knowledge imputed

1 to the individual Defendants by virtue of their management roles with the
2 company (*e.g.*, problems of the rising number of delinquencies, forced loan
3 repurchases, repricings, and non-accrual loans) “collectively demonstrate a strong
4 inference that each of these individual Defendants had actual knowledge that the
5 statements made by them were false and misleading when made, or acted with
6 deliberate reckless disregard for the truth or falsity of those statements. SAC ¶¶
7 260, 264-65. As discussed above, the cross-referenced paragraphs do not contain
8 *factual* allegations sufficient to support Plaintiff’s conclusion that any one or more
9 of the individual Defendants “*deliberately ignored . . . clear impairment indicators*
10 *. . . , causing Fremont’s reported financial statements to be materially overstated*
11 *throughout the Class period.*” SAC ¶ 199 (emphasis added). Rather, they
12 summarize and distill, *inter alia*, the allegations addressed – and found wanting –
13 above.

14 In the same vein, Plaintiff alleges that the individual Defendants “by their
15 own *public statements* during the Class Period, were admittedly aware of the poor
16 performance of their ‘primary line of business’ subprime loans and thus were
17 aware of the rising levels of delinquencies, forced loan repurchases, repricings,
18 and Non-Accrual of Loans.” However, the Court notes that this allegation does
19 little, if anything, to lend support to Plaintiff’s conclusion that other of
20 Defendants’ public statements were made with an intent to mislead. SAC ¶ 264.
21 The public disclosure of the company’s problems and its efforts to address those
22 problems (no matter how inadequate the efforts ultimately proved to be) weighs
23 against a conclusion that, taken together, the individual Defendants’ knowingly or
24 recklessly made misleading public statements.

25 Moreover, as Defendants point out and Plaintiff fails to adequately dispute,
26 as alleged, Plaintiff’s theory regarding scienter is undercut by the fact that
27 Fremont’s financial condition was deteriorating throughout the class period
28 (October 27, 2005 and March 2, 2007). *See, e.g.*, SAC ¶ 212 (describing how

1 Fremont's loan repurchases "dramatically increased" throughout 2006). In light
2 of this reality, the theory that the individual Defendants sought to personally profit
3 from a fraudulent scheme by misleading investors is largely, if not wholly,
4 inconsistent with a continued intentional or reckless pursuit of a course that would
5 inevitably result in the demise of the company. *Compare*, SAC ¶ 264 (alleging
6 that Defendants deliberately originated loans that were "destined to perform
7 poorly"); *with* SAC ¶ 298 (alleging that Defendants "had powerful financial
8 incentives to inflate Fremont's pretax earnings by aggressively increasing
9 subprime loan volume and improperly accounting for Residual Interests and
10 Repurchase Reserves, in order to achieve multi-million dollar cash and stock
11 bonuses in the near and long term."); *see, e.g., Fadem v. Ford Motor Co.*, 352
12 F.Supp.2d 501, 525 (S.D.N.Y. 2005) (concluding that the plaintiffs' scienter
13 theory "defie[d] economic reason" where it was "patently unreasonable to suggest
14 that [defendants] thought they would enhance their bonuses" by perpetrating a
15 fraud when they knew or should have known it was a "recipe for economic
16 disaster, which in fact came to pass, and [wa]s inconsistent with hopes for or
17 expectations of increased bonuses"). Similarly, the fact that only *one* of the
18 Defendants, McIntyre, is alleged to have engaged in insider trading in order to
19 benefit from the fraud they allegedly were perpetrating undercuts the allegations
20 of scienter as to the other individual Defendants, and Plaintiff fails to reconcile the
21 fact that McIntyre's stock in the company *lost* over \$100 million in value during
22 the class period, *see* Defs' Mot. at 48 (citing Ex. 16 to Motion), with the theory
23 that the \$9.6 million McIntyre earned on his sales of shares in August 2006 is
24 indicative of his "motive" to perpetrate the alleged fraud for his personal gain.
25 *See In re Hansen Natural Corp. Secs. Litig.*, 527 F.Supp.2d 1142, 1160 (C.D.Cal.
26 2007) (explaining that "insider stock sales are not inherently suspicious" that
27 "inference of scienter is defeated when an insider sells only a portion of his stock
28 holdings and ends up reaping the same large losses as did Plaintiff when the stock

1 price dropped” (internal citations, quotations, and alterations omitted).

2 For all the reasons discussed above, separately or taken together, *see South*
3 *Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 784 (9th Cir. 2008) (“*Tellabs* counsels
4 us to consider the totality of circumstances, rather than to develop separately rules
5 of thumb for each type of scienter allegation.”), Plaintiff’s allegations are not
6 sufficient to show that the individual Defendants had acted with the requisite
7 scienter when making the challenged statements about GAAP compliance in
8 various SEC filings during the Class Period.

9 **D. Claim 20(a) Claim**

10 Because the factual allegations in the SAC are not sufficient to articulate
11 Section 10-b and Rule 10b-5 claims against Defendants, it follows that the Motion
12 to Dismiss is also granted as to Plaintiff’s Section 20(a) claims.

13 **V. CONCLUSION**

14 Therefore, Defendants’ Motion to Dismiss the Second Amended
15 Consolidated Class Action Securities Complaint (docket no. 110) is GRANTED
16 WITHOUT PREJUDICE. Plaintiff may file an amended complaint within 30
17 days of the date of this Order; however the following statements are so broad or
18 vague as to not be actionable and may not be included in any amended pleading:

- 19 a. Defendant Bailey’s statements on the October 27, 2005 conference
20 call: “I think , again, the subprime spectrum, it’s a wide spectrum.
21 And we tend to play at the upper end of that spectrum. . . . And I
22 think that we have a pretty good reputation as a good, sound
23 originator.”
- 24 b. Statement in 10-Q for the 3Q 2005 and Form 10-Q for 2Q 2006,
25 signed by Defendants Rampino and Lamb, stating that “FIL seeks to
26 mitigate its exposure to credit risk through underwriting standards
27 that strive to ensure appropriate loan to collateral valuations.”
- 28 c. Statement in Form 10-K for 2005, signed by Defendants McIntyre,

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Rampino, Bailey and Lamb, also explaining that Fremont “seeks to minimize credit exposure through loan underwriting that is focused upon appropriate loan to collateral valuations and cash flow coverages” and stating that “[t]o mitigate the higher potential for credit losses that accompanies these types of borrowers [sub-prime borrowers], the Company attempts to maintain underwriting standards that require appropriate loan to collateral valuations. The underwriting guidelines are primarily intended to assess the ability and willingness of the potential borrower to repay the debt and to evaluate the adequacy of the mortgaged property as collateral for the loan.”

IT IS SO ORDERED.

Dated: September 25, 2009.

FLORENCE-MARIE COOPER, JUDGE
UNITED STATES DISTRICT COURT