LINKS: 187, 191, 192, 195

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In re COUNTRYWIDE FINANCIAL CORP. MORTGAGE-BACKED SECURITIES LITIGATION	Case No. 2:11-ML-02265-MRP (MANx)
MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, Plaintiff, v. COUNTRYWIDE FINANCIAL CORPORATION, et al., Defendants.	Case No. 2:11-CV-10414 MRP (MANx) **Order Re Motions to Dismiss the First Amended Complaint (Second Phase)**

I. Introduction & Background

Plaintiff Massachusetts Mutual Life Insurance Company ("MassMutual") purchased certain mortgage-backed securities ("RMBS,") and is suing the entities and individuals that originated and sold those securities for violations of the Massachusetts Uniform Securities Act ("MUSA"). After the case was transferred to this Court, briefing was split between issues of timeliness, statutory standing and jurisdiction and all other dismissal arguments. The Court dismissed part of the

complaint in April. Defendants Countrywide Financial Corporation ("CFC"), Countrywide Securities Corporation ("CSC," and collectively, the "Countrywide Defendants"), Bank of America Corporation, NB Holdings Corporation, Bank of America, N.A., and BAC Home Loans Servicing, LP, (the "Bank of America"), J.P. Morgan Securities LLC, UBS Securities LLC and Deutsche Bank Securities, Inc. (the "Underwriter Defendants") and Stanford L. Kurland, moved to dismiss on the other available grounds. Following its own precedent and a recent decision from the District of Massachusetts, the Court dismisses Plaintiff's claims that the Countrywide Defendants made material misstatements as to owner-occupancy rates. The Court finds, however, that MassMutual has sufficiently pled claims based on other material misstatements against the Countrywide and Underwriter Defendants. The Court finds that Delaware law applies to successor liability claims, which means that Bank of America is dismissed from this action with prejudice under the Court's prior ruling in *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 842 F. Supp. 2d 1216 (C.D. Cal. 2012) ("*Allstate II*"). The Court denies Stanford Kurland's motion to dismiss, because MassMutual has stated a claim as to his control of the primary violators.

II. Plaintiff has Stated a Claim against the Countrywide and Underwriter Defendants, Except those Claims Based on Owner-Occupancy Rates

Under the MUSA, Mass. Gen. Laws ch. 110A, § 410(a), any person who "offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading" is liable to the purchaser of that security.[1] Plaintiff alleges that the offering

[1] MUSA is modeled after the Securities Act of 1933, and courts interpreting the law should "coordinate the interpretation and administration of [the] chapter with the related federal legislation." *Marram v. Kobrick Offshore Fund, Ltd.*, 442 Mass. 43, 50–51, 809 N.E.2d 1017, 1025 (2004); *MassMutual v. RFC*, 843 F. Supp. 2d 191, 199 (D. Mass. 2012).

documents issued by the Countrywide Defendants that accompanied the securities they purchased (the "Offering Documents,") included such untrue and misleading statements. Forensic review, the Plaintiff argues, proves that the Offering Documents stated inflated percentages of borrower occupation of the mortgaged properties. The Complaint also includes assertions that the mortgages pooled by the Countrywide Defendants did not meet the underwriting standards or conform with the loan-to-value ratios described in the Offering Documents.

As this Court has held on a number of occasions involving Countrywide entities, contentions that the Offering Documents included misleading statements as to underwriting standards and loan to value ratios are sufficient to satisfy the elements of a claim of fraud. *Dexia Holdings, Inc. v. Countrywide Fin. Corp.*, 11-cv-7165-MRP (MANx), ECF No. 177 (C.D. Cal. Feb. 17, 2012); *Thrivent Fin. for Lutherans v. Countrywide Fin. Corp.*, 11-cv-7154-MRP (MANx), ECF No. 170 (C.D. Cal. Feb. 17, 2012); *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F. Supp. 2d 1164 (C.D. Cal. 2011); *Me. State Ret. Sys. v. Countrywide Fin. Corp.*, 10-cv-0302- MFP (MANx), 2011 WL 4389689 (C.D. Cal. May 5, 2011). Defendants do not offer any argument distinguishing MassMutual's complaint or the relevant legal standard from the prior rulings, and instead "merely recite[] in summary form the reasons for dismissal." Countrywide's Mem. in Supp. of Mot. to Dismiss The First Am. Compl. ("Countrywide MTD"), at 7, ECF No. 188. The Court again refuses to dismiss those claims against the Countrywide or Underwriter Defendants predicated on the deviation from underwriting standards and loan to value ratios.

Plaintiff also alleges that a forensic study of the mortgage loans underlying the purchased securities show a lower level of owner-occupancy rates than represented in the Offering Documents. MassMutual considers owner-occupancy statistics relevant because homeowners who live in the mortgaged properties are less likely to default than owners who purchase the home as an investment or as a second home. First Am. Compl. ("FAC") ¶ 354, ECF No. 56. The Countrywide

Defendants respond that the Offering Documents do not include false statements regarding owner-occupancy, because they state that occupancy statistics were "based upon representations of the related borrowers at the time of origination." Countrywide MTD, at 7 n.12 (citing the Offering Documents filed with EDGAR appended as Requests for Judicial Notice).

Statements can be literally accurate but nonetheless misleading because of their presentation. *See Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 775 (1st Cir. 2011). However, Judge Ponsor of the Massachusetts District Court, in a case addressing similar issues governing other MassMutual-filed RMBS cases, held that defendants could not be liable for accurately repeating information about occupancy provided by borrowers, because the offering documents explicitly stated that borrowers might have made misrepresentations at the time of origination. *RFC*, 843 F. Supp. 2d at 204–05. The Offering Documents here did include such specific warnings. Countrywide MTD, at 8 n.13 (citing the Offering Documents). The mere fact that the Offering Documents included "data charts" does not undermine the repeated warnings about the possibility of misrepresentations, or transform the accurate repetition of occupancy rates into misstatements. The Court therefore dismisses only those claims by MassMutual based on misstatements regarding owner-occupancy rates.

III. Plaintiff's Claim against Bank of America Fails

Plaintiff repeats previously-levied allegations against Bank of America. The Complaint charges that Bank of America is liable as a successor of Countrywide because Bank of America entered into a de facto merger, or transferred assets in a constructively fraudulent manner, or assumed Countrywide's liabilities. This Court has already determined that similarly situated plaintiffs have not sufficiently pled a constructive fraudulent transfer under Illinois law or *de facto* merger or assumption of liabilities under Delaware law. *Allstate II*, 842 F. Supp. 2d at 1220–

34. Massachusetts, like Illinois, has adopted the Uniform Fraudulent Transfer Act. Mass. Gen. Laws ch. 109A, § 5(a). Since the allegations in MassMutual's complaint are the same as those in *Allstate II*, the constructive fraudulent transfer claim must be dismissed, since it merely contains legal conclusions equally consistent with non-culpable behavior. *Allstate II*, 842 F. Supp. 2d at 1227, 1230.

With respect to the *de facto* merger and assumption of liability claims, jurisdictions that look to the "internal affairs doctrine," Restatement (Second) Conflict of Laws § 302 (1971), apply the law of Delaware to claims arising from the merger of Countrywide Financial Corporation into a Bank of America subsidiary, since Delaware is the state of incorporation for each relevant entity. *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F. Supp. 2d 1164, 1171–74 (C.D. Cal. 2011). Delaware law does not allow a claim of *de facto* merger or assumption of liabilities to proceed against Bank of America. *Allstate II*, 842 F. Supp. 2d at 1230–34. In order to avoid this result, MassMutual argues that the Massachusetts' choice of law rules (which this Court applies as the transferee court) do not follow the internal affairs doctrine, and instead applies a "functional" test that considers a "variety of factors." MassMutual's Mem. in Opp. to Mot. to Dismiss ("MassMutual Opp."), at 3 n. 3, ECF No. 203. According to MassMutual, this test would point to New York law for the merger and assumption claims.

Unfortunately for MassMutual, "Massachusetts applies the internal affairs doctrine." *Mariasch v. Gillette Co.*, 521 F.3d 68, 71–72 (1st Cir. 2008) (citing *Harrison v. NetCentric Corp.*, 433 Mass. 465, 744 N.E.2d 622, 629 (2001)); Joseph W. Glannon & Gabriel Teninbaum, *Conflict of Laws in Massachusetts Part I: Current Choice-of-Law Theory*, 92 Mass. L. Rev. 12, 22 (2009). The Massachusetts Supreme Judicial Court specifically rejected a more flexible functional approach, since the internal affairs doctrine promotes "'certainty, predictability and uniformity of result, ease in the application of the law to be applied and, at least on occasion, protection of the justified expectations of the

parties.'" *Harrison*, 744 N.E.2d at 629 (citing Restatement (Second) Conflict of Laws § 302). Again, the internal affairs doctrine looks to Delaware law. MassMutual admits that its complaint is no different than that in *Allstate II*, so like the complaint in that case, the claims must be dismissed under Delaware law as insufficient. MassMutual Opp., at 4. Given the Court's previous rulings in this area, MassMutual's claims against Bank of America are **DISMISSED, WITH PREJUDICE.**

IV. MassMutual has pled Control Liability Claims Against Both Kurland and Countrywide Financial

The First Amended Complaint alleges that Stanford L. Kurland "controlled the day-to-day operations of one or more primary violators, including the securitizations at issue," because of his positions at Countrywide Financial Corporation, Countrywide Home Loans, and the Countrywide Depositor Defendants. FAC ¶ 565. This Court's April 16 ruling limited MassMutual's claim against Kurland to his alleged control over certificates underwritten by CSC before his departure from CFC on September 7, 2006.[2] As determined *supra*, some primary liability claims are adequately pled. Kurland, who was an officer of CFC but had no formal corporate role at CSC, argues that the Complaint does not include sufficient facts to show that he exercised control over CSC at the relevant time.

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[2] There is a dispute over which securities were covered by the April Order. Kurland cannot be liable for securitizations that CSC had "done work" to underwrite prior to his departure if they were not issued before he left CFC. *In re Alstom SA*, 406 F. Supp. 2d 433, 495 (S.D.N.Y. 2005) (rejecting control liability for claims that arose after defendant no longer had actual control over the entities). The only securities Kurland can be liable for are CWALT 2005-36 2A2, CWALT 2005-41 1A1, 2A1, CWALT 2005-59 1A1, CWALT 2005-IM1 1A1, CWABS 2006-BC3 M9, CWALT 2006-OA6 1A2, as well as CWALT 2006-OA9 2A1B and CWALT 2006-OA11 A5, A1B. These last two certificates were not included in Kurland's list in his memorandum of law, but the available evidence shows that they were underwritten by CSC and that the prospectus supplement was filed in May or June of 2006, well before Kurland left Countrywide Financial.

Control "means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405. Plaintiffs must show the defendant exercised control over the primary violators, which can be shown by coupling defendant's status as a high-ranking officer or director with "indicia of control." *SEC v. Todd*, 642 F.3d 1207, 1223 (9th Cir. 2011); *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 85 (1st Cir. 2002).[3]

MassMutual makes the following allegations about Kurland's control. *First*, he was a top officer and director at Countrywide Financial, CSC's parent corporation. FAC ¶ 39. *Second*, Kurland was a particularly influential executive at CFC, and was a "critical participant" in implementing CFC's business plan to originate other loans subject to this litigation. FAC ¶ 426–427. Since CFC operated its subsidiaries as a "collective enterprise," CFC directed and closely oversaw CSC's sales of mortgage-backed securities. FAC ¶ 404. *Third*, Kurland was an influential participant in the Countrywide enterprise, and sat on committees that exerted control over and directed the process by which CSC packaged and sold the flawed securities. FAC ¶ 428–429.[4]

It is a "plausible inference that a director or high-level officer of an entity exercised control over that entity," especially when that individual also signed

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[3] There is a complex but irrelevant choice of law question here. The Ninth Circuit has held that transferee courts apply Ninth Circuit law to any federal claims, and the law of the transferor court to any state claims. *Newton v. Thomason*, 22 F.3d 1455, 1460 (9th Cir. 1994). There are no federal claims in this matter, suggesting that this Court must apply the law of Massachusetts. However, MUSA is co-extensive with the federal control liability statute and Massachusetts state courts would look to federal case law in interpreting the statute. *See RFC*, 843 F. Supp. 2d at 199. It is unclear whether the Court should apply the control liability test from the Ninth Circuit or First Circuit. Since the law of those jurisdictions is similar as to this question, the result does not change the outcome.

[4] MassMutual calls the first two allegations forms of "indirect" control, and the last as an example of "direct" control. This distinction is unhelpful: what matters is whether Kurland controlled CSC, regardless of whether his control was direct, indirect or some combination of the two.

financial statements. *Dexia*, 2012 WL 1798997, at *4. That status is a relevant element of the control analysis even where the director or officer is accused of controlling the corporate subsidiary of his or her employer. *Me. State*, 2011 WL 4389689, at 14; *cf. In re Tronox, Inc. Sec. Litig.*, 769 F. Supp. 2d 202, 220–21 (S.D.N.Y. 2011).[5] However, this factor does not create a presumption of control even against the director of the primary violator. *Todd*, 642 F.3d at 1223.

Countrywide Financial Corporation was the corporate parent of CSC. MassMutual has alleged that CFC operated its subsidiaries as a collective enterprise with respect to the origination of mortgage loans, while maintaining high-level control over CSC. FAC ¶ 404. Kurland controlled CFC by virtue of his status and "close involvement with the daily management of all aspects of Countrywide Financial's core operations." *Id.* ¶ 427. This is sufficient to create the inference that Kurland controlled CSC through CFC. *Me. State*, 2011 WL 4389689, at 14. Kurland attempts to distinguish *Maine State* because there, defendant-issuers were "limited-purpose subsidiaries of the parent corporation." Reply in Supp. of Mot. to Dismiss First Am. Compl., at 7, ECF No. 205. However, the "control person provisions were included in the federal securities laws to prevent people and entities from using dummies to do the things that they were forbidden to do by the securities laws." *Tronox*, 769 F. Supp. 2d at 220, n.118. As MassMutual pointed out at the hearing, the alleged independence of CSC from Countrywide Financial Corporation is a "factual rebuttal inappropriate for a motion to dismiss." *In re Charles Schwab Corp. Sec. Litig.*, 257 F.R.D. 534, 550 (N.D. Cal. 2009). While Kurland and CFC may ultimately prove that neither

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[5] Kurland argues that *Tronox* allowed control liability against the directors of a parent only where the senior officers were the "masterminds" of a fraudulent scheme. This is untrue; the *Tronox* court suggests that the discussion to the contrary in the case Kurland relies on, *Fezzani v. Bear, Stearns, & Co.*, 384 F. Supp. 2d 618 (S.D.N.Y. 2004), is *dictum*, and highlights that the "mastermind" allegation is a further basis for the control liability claim to proceed.

controlled CSC, that is not the only or most natural inference to be drawn from the complaint. *Id.*

MassMutual also alleges that Kurland was an influential member of the Countrywide enterprise and participated in committees that formulated the process by which CSC packaged and sold mortgage securities, and dictated priorities to CSC. These allegations buttress his role as a controller of Countrywide Securities.

Therefore, Kurland and the Countrywide Financial Corporation's motions to dismiss MassMutual's control liability claims are **DENIED.**

V. Conclusion

For the reasons given above, the Court denies the Countrywide Defendants' motion to dismiss except as to claims predicated on owner-occupancy rates, dismisses MassMutual's complaint against Bank of America with prejudice, and denies the motions of Stanford Kurland and Countrywide Financial Corporation to dismiss the control-liability claims.

IT IS SO ORDERED.

DATED: August 17, 2012

Mariana R. Pfaelzer

Hon. Mariana R. Pfaelzer
United States District Judge