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12  
13 **UNITED STATES DISTRICT COURT**  
14 **NORTHERN DISTRICT OF CALIFORNIA**

15 IN RE THE PMI GROUP, INC.  
SECURITIES LITIGATION

) Case No. C-08-1405-SI

) CLASS ACTION

16  
17 THIS DOCUMENT RELATES TO:  
ALL ACTIONS.

) **REPLY MEMORANDUM OF POINTS  
AND AUTHORITIES IN SUPPORT OF  
18 MOTION TO DISMISS  
19 CONSOLIDATED COMPLAINT FOR  
VIOLATION OF THE FEDERAL  
20 SECURITIES LAWS**

) Date: December 12, 2008  
) Time: 9:00 a.m.  
) Courtroom: 10, 19th Floor

**TABLE OF CONTENTS**

	<b>Page</b>
INTRODUCTION .....	1
ARGUMENT .....	3
I.    THE COMPLAINT FAILS TO MEET THE HEIGHTENED PLEADING REQUIREMENTS FOR FALSITY.....	3
A.    The Complaint Does Not Plead With Particularity That Defendants’ Statements Regarding PMI’s Risk Exposure, Underwriting Practices Or Loss Reserves Were False Or Misleading When Made .....	3
B.    The Complaint Does Not Plead With Particularity That Defendants’ Statements Regarding FGIC Were False Or Misleading .....	5
II.   THE COMPLAINT FAILS TO SATISFY THE HEIGHTENED PLEADING STANDARD FOR SCIENTER .....	7
A.    The Opposition Says Nothing That Overcomes The Complaint’s Failure To Plead Facts Giving Rise To A Strong Inference Of Scienter.....	7
B.    The Absence Of Any Motive To Commit Fraud Further Undermines Plaintiffs’ Scienter Allegations.....	9
III.  THE PSLRA’S SAFE HARBOR AND THE BESPEAKS CAUTION DOCTRINE IMMUNIZE DEFENDANTS’ FORWARD-LOOKING STATEMENTS.....	10
IV.  THE COMPLAINT DOES NOT PLEAD LOSS CAUSATION .....	12
V.   PLAINTIFFS CANNOT AVOID DISMISSAL OF THE CLAIMS AGAINST SHUSTER BY INVOKING THE GROUP PLEADING DOCTRINE .....	15
VI.  THE SECTION 20(a) CLAIM FAILS BECAUSE THE COMPLAINT DOES NOT ALLEGE PRIMARY LIABILITY ON THE PART OF ANY DEFENDANT .....	15
CONCLUSION .....	15

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
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16  
17  
18  
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23  
24  
25  
26  
27  
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**TABLE OF AUTHORITIES**

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

**Page**

**CASES**

*Aldridge v. A.T. Cross Corp.*,  
284 F.3d 72 (1st Cir. 2002) ..... 6

*Asher v. Baxter Int’l Inc.*,  
377 F.3d 727 (7th Cir. 2004)..... 12

*Berson v. Applied Signal Tech., Inc.*,  
527 F.3d 982 (9th Cir. 2008) ..... 8

*Brodsky v. Yahoo! Inc.*,  
No. C 08-02150 CW, 2008 WL 4531815 (N.D. Cal. Oct. 7, 2008) ..... 8, 13

*Dura Pharms., Inc. v. Broudo*,  
125 S. Ct. 1627 (2005)..... 14

*Fecht v. Price Co.*,  
70 F.3d 1078 (9th Cir. 1995)..... 9

*Harris v. Ivax Corp.*,  
182 F.3d 799 (11th Cir. 1999)..... 11, 12

*Hayley v. Parker*,  
No. SA CV 01-69 DOC (EEx), 2001 U.S. Dist. LEXIS 23255 (C.D. Cal.  
Aug. 31, 2001) ..... 9

*Hess v. Am. Physicians Capital, Inc.*,  
No. 5:04-CV-31, 2005 WL 459638 (W.D. Mich. Jan. 11, 2005) ..... 11, 12

*In re Connetics Corp. Sec. Litig.*,  
No. C 07-02940 SI, 2008 U.S. Dist. LEXIS 62515 (N.D. Cal. Aug. 14, 2008) ..... 14

*In re Copper Mountain Sec. Litig.*,  
311 F. Supp. 2d 857 (N.D. Cal. 2004) ..... 11, 12

*In re CV Therapeutics Sec. Litig.*,  
No. C 03-03709 SI, 2004 U.S. Dist. LEXIS 17419 (N.D. Cal. Aug. 5, 2004) ..... 10

*In re Gilead Scis. Sec. Litig.*,  
536 F.3d 1049 (9th Cir. 2008)..... 2, 13, 14

*In re Impax Labs., Inc. Sec. Litig.*,  
No. C 04-04802 JW, 2008 WL 1766943 (N.D. Cal. Apr. 17, 2008)..... 14

*In re InterMune, Inc. Sec. Litig.*,  
No. C 03-2954 SI, 2004 U.S. Dist. LEXIS 15382 (N.D. Cal. July 30, 2004) ..... 10

*In re Kindred Healthcare Inc. Sec. Litig.*,  
299 F. Supp. 2d 724 (W.D. Ky. 2004) ..... 11

**TABLE OF AUTHORITIES**  
(continued)

		<b>Page</b>
1		
2		
3	<i>In re Omnivision Techs., Inc.</i> ,	
4	No. C-04-2297 SC, 2005 U.S. Dist. LEXIS 16009 (N.D. Cal. July 29, 2005).....	9
5	<i>In re Portal Software, Inc. Sec. Litig.</i> ,	
6	No. C-03-5138 VRW, 2006 WL 2385250 (N.D. Cal. Aug. 17, 2006).....	12
7	<i>In re SeeBeyond Techs. Corp. Sec. Litig.</i> ,	
8	266 F. Supp. 2d 1150 (C.D. Cal. 2003) .....	9, 12
9	<i>In re Stac Elecs. Sec. Litig.</i> ,	
10	89 F.3d 1399 (9th Cir. 1996).....	4, 5
11	<i>In re Syntex Corp. Sec. Litig.</i> ,	
12	No. 92-20548 SW, 1993 WL 476646 (N.D. Cal. Sept. 1, 1993).....	5
13	<i>In re Tellium, Inc. Sec. Litig.</i> ,	
14	No. Civ. A. 02cv5878 FLW, 2005 WL 2090254 (D.N.J. Aug. 26, 2005).....	14
15	<i>In re Vantive Corp. Sec. Litig.</i> ,	
16	283 F.3d 1079 (9th Cir. 2002).....	10
17	<i>Ind. State Dist. Council of Laborers &amp; Hod Carriers Pension &amp; Welfare Fund v.</i>	
18	<i>Omnicare, Inc.</i> ,	
19	527 F. Supp. 2d 698 (E.D. Ky. 2007) .....	6
20	<i>McCasland v. Formfactor, Inc.</i> ,	
21	No. C 07-5545 SI, 2008 WL 2951275 (N.D. Cal. July 25, 2008) .....	15
22	<i>Metzler Inv. GMBH v. Corinthian Colls., Inc.</i> ,	
23	540 F.3d 1049 (9th Cir. 2008).....	2, 7, 8, 10, 12, 13, 14
24	<i>No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. West Holding</i>	
25	<i>Corp.</i> ,	
26	320 F.3d 920 (9th Cir. 2003).....	9, 10, 12
27	<i>Ronconi v. Larkin</i> ,	
28	253 F.3d 423 (9th Cir. 2001).....	10
29	<i>Rubin v. Trimble</i> ,	
30	No. C-95-4353 MMC, 1997 WL 227956 (N.D. Cal. Apr. 28, 1997) .....	4
31	<i>South Ferry LP v. Killinger</i> ,	
32	542 F.3d 776 (9th Cir. 2008).....	1, 7, 8, 9
33	<i>Tellabs, Inc. v. Makor Issues and Rights, Ltd.</i> ,	
34	127 S. Ct. 2499 (2007).....	7
35	<b><u>STATUTES</u></b>	
36	15 U.S.C. § 78u-4(b)(1) .....	5

1  
2  
3  
4  
5  
6  
7  
8  
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12  
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24  
25  
26  
27  
28

**TABLE OF AUTHORITIES**  
**(continued)**

	<b>Page</b>
15 U.S.C. § 78u-5(b)(2)(A).....	11
15 U.S.C. § 78u-5(c)(1) .....	12
15 U.S.C. § 78u-5(i)(1)(A).....	11
<b><u>RULES</u></b>	
Fed. R. Civ. P. 9(b) .....	5

## INTRODUCTION

1  
2 The Complaint's central premise is that because PMI suffered severe losses when the  
3 housing and mortgage markets collapsed, PMI's previous statements regarding its risk  
4 assessments must have been the result of fraud. Such a classic fraud-by-hindsight theory requires  
5 the Court to assume that defendants possessed extraordinary prescience. No one predicted the  
6 speed, breadth or onset of the unprecedented crisis now threatening to undermine global financial  
7 markets. Yet the Opposition relies exclusively on this theory because plaintiffs cannot remedy  
8 the Complaint's fatal deficiencies. Indeed, the Opposition does nothing to address the  
9 Complaint's failure to plead particularized allegations of falsity, its failure to plead scienter as to  
10 any defendant, its reliance on alleged misstatements that are inactionable under the safe harbor for  
11 forward-looking statements and its failure to plead loss causation.

12 The Opposition attempts to obscure the Complaint's lack of particularized allegations  
13 showing—through confidential witnesses, internal reports or any other sources—that defendants'  
14 public statements were false or misleading when made. Instead, the Opposition merely reiterates  
15 the Complaint's insufficient allegations coupled with plaintiffs' conclusory refrain that the  
16 allegations are adequate. Nor does the Opposition provide any basis for holding defendants liable  
17 for purported "omissions that were, in fact, plainly disclosed in PMI's public filings.

18 The Complaint is similarly deficient in its failure to allege facts giving rise to a strong  
19 inference of scienter. The Opposition argues that the Court should infer that officers of a public  
20 company engaged in fraud—despite the risk of irreparable harm to their reputations and careers  
21 and the prospect of civil and criminal penalties—based solely on their corporate positions. The  
22 Opposition noticeably fails to identify any suspicious insider trading or other pecuniary motive on  
23 the part of any defendant. Nor does the Opposition point to any specific allegations that a  
24 confidential witness, internal report or other source put defendants on notice that their public  
25 statements were untrue. Plaintiffs cannot shoehorn this case into the "exceedingly rare  
26 circumstance by which the Ninth Circuit would permit this Court to impute knowledge based  
27 solely on defendants' positions within the company. *South Ferry LP v. Killinger*, 542 F.3d 776,  
28 785-86 & n.3 (9th Cir. 2008).

1           The Complaint also fails because the alleged misstatements are inactionable under the  
2 PSLRA's safe harbor for forward-looking statements and the bespeaks caution doctrine. The  
3 Opposition unsuccessfully attempts to recast these forward-looking statements into statements of  
4 then-existing or historical fact to which the safe harbor does not apply. The Opposition also  
5 contends that the Court cannot determine, at the pleadings stage, whether the relevant cautionary  
6 language is sufficiently meaningful. Both arguments are flatly refuted by the case law. It is  
7 beyond reasonable dispute that PMI's financial guidance and loss reserves were forward-looking  
8 statements and were accompanied by the type of meaningful cautionary language courts routinely  
9 find sufficient as a matter of law.

10           The Complaint also must be dismissed because it fails to plead loss causation. Plaintiffs  
11 argue that *In re Gilead Sciences Securities Litigation*, 536 F.3d 1049 (9th Cir. 2008), so eroded  
12 the loss causation pleading standard that complaints can no longer be challenged on this ground  
13 on a motion to dismiss. To the contrary, *Gilead* requires a clear causal chain between disclosure  
14 of the alleged fraud and a decline in stock price—exactly what is missing from the Complaint. *Id.*  
15 at 1054, 1057-58. The Complaint merely identifies a series of disclosures from PMI and third-  
16 party sources regarding the negative trends experienced by PMI and the mortgage industry, and  
17 then concludes that PMI's stock price declined in response. This does not plead loss causation  
18 because the Complaint does not allege that the “market learned of and reacted to [the] fraud, as  
19 opposed to merely reacting to reports of the defendant's poor financial health generally. *Metzler*  
20 *Inv. GMBH v. Corinthian Colls., Inc.*, 540 F.3d 1049, 1063 (9th Cir. 2008).

21           Because the Complaint fails to meet the requirements to plead securities fraud, does not  
22 properly allege loss causation and cannot avoid the protection for forward-looking statements, it  
23 must be dismissed.

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**ARGUMENT**

**I. THE COMPLAINT FAILS TO MEET THE HEIGHTENED PLEADING REQUIREMENTS FOR FALSITY**

**A. The Complaint Does Not Plead With Particularity That Defendants' Statements Regarding PMI's Risk Exposure, Underwriting Practices Or Loss Reserves Were False Or Misleading When Made**

The Complaint fails to satisfy the heightened pleading requirements of the PSLRA and Rule 9(b) because it does not plead with particularity what unique information defendants possessed—and the market did not—that rendered defendants' statements regarding PMI's risk exposure, underwriting practices or loss reserves false or misleading when made. The Opposition merely recites the Complaint's allegations regarding the CWs, PMI's delegated underwriting program, and its loss reserves without even attempting to respond to the deficiencies identified in defendants' opening brief. The Opposition also does nothing to address an insurmountable barrier to pleading securities fraud—that defendants disclosed and the market acknowledged the very information that was allegedly concealed.

The Complaint's CW allegations are devoid of particularized facts, and the Opposition does nothing to address this shortcoming. Plaintiffs argue that CW1 “confirms that defendants knew certain loans were underperforming (Opp. 12:4-5), but the allegations attributed to CW1 are entirely conclusory and do not show why this information was inconsistent with PMI's public statements. Nor do plaintiffs explain how the allegations attributed to CW3, a FGIC employee, regarding information “widely recognized throughout FGIC was ever communicated to the individual defendants—much less how CW3's information rendered defendants' statements false or misleading when made. *See* Mot. to Dismiss 17:11-22. The Opposition never mentions CW2, conceding CW2's irrelevance.

The Opposition insists that the mere allegation that certain delegated lenders' portfolios were “underperforming is sufficient to show that defendants' statements were false or misleading when made. But such an allegation cannot establish falsity without additional facts regarding the extent of any underperformance and whether or when anyone at PMI believed the underperformance would have a material impact on PMI's financial condition. Plaintiffs further

1 fail to acknowledge that the two lawsuits that PMI filed were not brought against delegated  
2 underwriters and therefore do not relate to loans generated within that program. In any event, the  
3 timing of these lawsuits does not place any of defendants' statements in question and actually  
4 supports a more plausible non-culpable inference: when PMI learned that a lender was not  
5 complying with its guidelines, it promptly took appropriate action. *See* Mot. to Dismiss 12:8 -  
6 13:3 (discussing same deficiency in allegations regarding disqualification of IndyMac). These  
7 allegations, therefore, do not establish that any statement was false when made.

8 Plaintiffs argue that PMI's loss reserves reveal a scheme to "catch up with losses that  
9 should have been reported earlier by "developing progressively wider ranges between the 'low'  
10 estimate of the reserve and the 'high' estimate of the reserve. Opp. 12:9-11 and 13:8-12. The  
11 Opposition does not identify any particularized allegations in the Complaint corroborating this  
12 alleged "scheme ; its existence is based only on plaintiffs' purported discernment of a "pattern  
13 in PMI's loss reserves and the unsupported conclusion that this "pattern demonstrates the falsity  
14 of PMI's reported loss reserves. Opp. 12:28. The argument that the wider range misleadingly  
15 gave the impression that PMI was "successfully managing risks is not only unsupported in the  
16 Complaint, it ignores the more plausible and immediately apparent explanation: PMI broadened  
17 the loss reserves range to reflect increasingly greater uncertainty regarding the markets'  
18 deterioration.

19 Defendants' opening brief showed that the very risks that the Complaint contends were  
20 concealed from the market—such as PMI's shift into insuring higher risk mortgages and other  
21 loan products—were plainly disclosed in PMI's SEC filings, discussed by PMI management in  
22 analyst conference calls and acknowledged in analyst reports. Mot. to Dismiss 13:9-19. Other  
23 than a baseless attempt to exclude judicially noticeable documents, plaintiffs offer no response to  
24 this argument, nor can they. Controlling Ninth Circuit precedent, *In re Stac Electronics*  
25 *Securities Litigation*, 89 F.3d 1399, 1409-10 (9th Cir. 1996), mandates that where alleged  
26 statements are not false or misleading in the context of other disclosures, a motion to dismiss  
27 must be granted. *See also Rubin v. Trimble*, No. C-95-4353 MMC, 1997 WL 227956, at \*13  
28 (N.D. Cal. Apr. 28, 1997) (dismissing claims based on allegations that company concealed shift

1 into a new product line where SEC filings disclosed market sales data showing such shift); *In re*  
2 *Syntex Corp. Sec. Litig.*, No. 92-20548 SW, 1993 WL 476646, at \*7 (N.D. Cal. Sept. 1, 1993)  
3 (dismissing complaint where defendant “provided accurate hard data from which analysts and  
4 investors can draw their own conclusions about the company’s condition ).

5 PMI’s disclosures on this score were pointed and frequent. For example, during the Q1  
6 2006 earnings conference call, Smith responded to an analyst, “[A]s you know, the Alt-A has  
7 been and continues to be a significant part of the overall mortgage market. So obviously, we are  
8 a part of that and that number has increased in terms of NIW [New Insurance Written]. RJN  
9 Ex. 31 at 12; *see also* RJN Ex. 1 at 41 (disclosing percentages in PMI’s portfolio of high LTV  
10 loans, ARMs, Alt-A loans, interest only loans, payment option ARMs, and less than A quality  
11 loans).

12 **B. The Complaint Does Not Plead With Particularity That Defendants’**  
13 **Statements Regarding FGIC Were False Or Misleading**

14 The Complaint does not plead with particularity that defendants’ statements were false  
15 and misleading concerning the risk presented by PMI’s investment in FGIC or PMI’s accounting  
16 judgment regarding that investment. As shown in defendants’ opening brief, PMI disclosed the  
17 very information that plaintiffs allege was concealed, *i.e.*, that since the time of PMI’s 42%  
18 investment in FGIC in December 2003, FGIC had shifted its business from public finance to  
19 markets and assets having both higher returns and higher default rates. RJN Ex. 33 at 8.

20 Because plaintiffs cannot explain—and the Complaint does not allege—how defendants’  
21 statements could have been misleading in light of these disclosures, the Opposition merely  
22 restates the Complaint’s conclusory allegations that statements regarding PMI’s approach to risk  
23 management were misleading because its investment in FGIC exposed it to greater risk of high  
24 default loans. Opp. 13-14. This failure to specify “the reasons why defendants’ statements are  
25 misleading is fatal to plaintiffs’ claims. *See* 15 U.S.C. § 78u-4(b)(1); Fed. R. Civ. P. 9(b); *Stac*  
26 *Elects.*, 89 F.3d at 1410.

27 The Opposition also asserts that pursuant to SFAC No. 1, PMI should have identified  
28 “certain transactions, other events, and circumstances and “explain[ed] their ‘financial impact’

1 on FGIC. Opp. 14:14-15 (citing SFAC No. 1). The Opposition, however, does not identify a  
2 single allegation in the Complaint identifying any “transactions, other events, and circumstances  
3 known to defendants that were not already disclosed to or known by investors. The “key  
4 indicators such as housing prices, interest rates and foreclosure rates cited in the Complaint were  
5 well known and discussed in the market. Opp. 14:8-10; Mot. to Dismiss Appendix A. The  
6 Complaint’s vague reference to credit surveillance systems does not bolster these allegations  
7 because it fails to allege specific information generated by these systems that would have  
8 revealed that PMI was exposed to greater risk through FGIC than previously disclosed. *See* Mot.  
9 to Dismiss 7:17-26. The Opposition’s assertion that, according to SFAC No. 1, “management  
10 knows more about the enterprise and its affairs than investors, creditors, or other ‘outsiders’ is an  
11 empty platitude offering no insight into whether management had specific information that was  
12 inconsistent with any statements made to the market. Opp. 14:12-13; *see* Mot. to Dismiss 17-18.

13 Like the Complaint, the Opposition asserts that certain market information should have  
14 “led inexorably to the determination that PMI’s investment in FGIC was more than temporarily  
15 impaired by mid-2007. Opp. 14:24. This assertion is insufficient because it is not supported by  
16 particularized facts showing that PMI’s accounting judgments regarding FGIC were inaccurate  
17 when made. Mot. to Dismiss 6-7. That PMI has never restated any accounting determinations  
18 only bolsters the conclusion that no facts exist showing that these determinations were inaccurate  
19 when reported. *See Ind. State Dist. Council of Laborers & Hod Carriers Pension & Welfare*  
20 *Fund v. Omnicare, Inc.*, 527 F. Supp. 2d 698, 707 (E.D. Ky. 2007). Plaintiffs’ only attempt to  
21 sidestep the significant impact that the absence of a restatement has on their claims is to offer up a  
22 misreading of *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72 (1st Cir. 2002). There, the First Circuit  
23 held that the absence of a restatement was not dispositive but should be considered among the  
24 totality of the complaint’s allegations. *Id.* at 83. Here, the absence of a restatement is not only  
25 one of many facts undercutting the Complaint’s allegations, it underscores the Complaint’s failure  
26 to advance any cogent theory of falsity and scienter.

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1 **II. THE COMPLAINT FAILS TO SATISFY THE HEIGHTENED PLEADING**  
2 **STANDARD FOR SCIENTER**

3 **A. The Opposition Says Nothing That Overcomes The Complaint's Failure To**  
4 **Plead Facts Giving Rise To A Strong Inference Of Scienter**

5 The Complaint is devoid of particularized facts showing that any individual defendant was  
6 aware that PMI's statements were false or misleading when made. Instead, the Complaint relies  
7 on two categories of allegations to plead scienter: (1) the purported statements of three CWs, and  
8 (2) conclusory assertions that the severe losses that PMI ultimately incurred when the housing  
9 and mortgage markets collapsed show that defendants' earlier statements were intentionally false  
10 and misleading. None of the CWs, however, claims to have knowledge of any defendant's state  
11 of mind and the Complaint's assertions regarding PMI's losses are classic fraud-by-hindsight  
12 allegations. Thus, these allegations do not give rise to a strong inference of scienter.

13 The Opposition does not attempt to defend the Complaint's failure to plead facts showing  
14 that any defendant had contemporaneous knowledge of falsity. Rather, the Opposition argues that  
15 under Ninth Circuit authority, particularly *South Ferry LP v. Killinger*, 542 F.3d 776 (9th Cir.  
16 2008), a plaintiff may satisfy the PSLRA's stringent pleading requirements simply by alleging  
17 that defendants are company officers who may be presumed to have knowledge of the company's  
18 "core operations. Neither *South Ferry* nor other Ninth Circuit precedent endorses the "core  
19 operations inference upon which plaintiffs rely.

20 In *South Ferry*, the Ninth Circuit ruled that it would be improper to disregard allegations  
21 that defendants were key officers with presumed knowledge of core operations, even if such  
22 allegations, standing alone, did not show scienter. 542 F.3d at 784. Instead, courts must assess  
23 all of a complaint's allegations collectively to determine whether they show a cogent and  
24 compelling inference of scienter. *Id.* at 782 (citing *Tellabs, Inc. v. Makor Issues and Rights, Ltd.*,  
25 127 S. Ct. 2499, 2510 (2007)). The Ninth Circuit made clear, however, that "[w]here a complaint  
26 relies on allegations that management had an important role in the company *but does not contain*  
27 *additional detailed allegations about the defendants' actual exposure to information, it will*  
28 *usually fall short of the PSLRA standard.* *Id.* (emphasis added). This reasoning closely follows  
the Ninth Circuit's analysis in *Metzler Investment*, 540 F.3d at 1068, demonstrating that *South*

1 *Ferry* does not represent a departure from settled law. *South Ferry* quoted *Metzler* with approval  
2 for the proposition that “[a]s a general matter, ‘corporate management’s general awareness of the  
3 day-to-day workings of the company’s business does not establish scienter—at least absent some  
4 additional allegation of specific information conveyed to management and related to the fraud’ or  
5 other allegations supporting scienter. 542 F.3d at 784-85; see also *Brodsky v. Yahoo! Inc.*, No. C  
6 8-02150 CW, 2008 WL 4531815, at \*10 (N.D. Cal. Oct. 7, 2008) (construing *South Ferry* and  
7 dismissing complaint because “Defendants’ high level positions in the company do not provide a  
8 strong inference of scienter ).

9       Aside from considering a defendants’ job position as part of the totality of allegations,  
10 *South Ferry* described two other circumstances under which a core operations inference may  
11 satisfy the pleading requirement without specific allegations of contemporaneous fraudulent  
12 intent. First, a complaint may show scienter where it contains “detailed and specific allegations  
13 about management’s exposure to information sources within the company that give rise to a  
14 strong inference that they must have known that their public statements were false. 542 F.3d at  
15 785. Second, in an “exceedingly rare category of cases, such as in *Berson v. Applied Signal*  
16 *Technology, Inc.*, 527 F.3d 982 (9th Cir. 2008), a relevant fact may be of such specificity and  
17 prominence that it would be “absurd to suggest that management had no knowledge of the  
18 matter. In *South Ferry*, the court explained that plaintiffs successfully pled scienter in *Berson*  
19 because it would have been absurd to suggest that management was unaware of stop-work orders  
20 received from two customers comprising 80% of the company’s revenue. *South Ferry*, 542 F.3d at  
21 785-86 & n.3.

22       The Complaint falls far short of meeting the Ninth Circuit’s standards in *South Ferry*,  
23 *Metzler* and *Berson*. The Complaint has no particularized allegations showing any defendant  
24 received contemporaneous information from internal reports, databases, or any other source that  
25 was inconsistent with PMI’s statements. The Opposition claims “internal information told  
26 [defendants] of problems of the loan portfolio but conspicuously fails to identify any source in  
27 the Complaint regarding this “internal information, and no such allegations exist. Opp. 17:24.  
28 While PMI’s ability to assess risk was an important part of its business model, nothing contradicts

1 the reasonable inference that management simply failed to predict the accelerated downturn of the  
 2 housing and mortgage markets. Such an inference is not “absurd within the meaning of *South*  
 3 *Ferry*. The failure to predict an unprecedented, global financial crisis does not present the sort of  
 4 “exceedingly rare circumstance under *South Ferry* that would permit a core operations inference  
 5 alone to satisfy the PSLRA’s stringent standards for pleading scienter.

6 **B. The Absence Of Any Motive To Commit Fraud Further Undermines**  
 7 **Plaintiffs’ Scienter Allegations**

8 As shown in defendants’ opening brief: (1) the absence of suspicious insider sales further  
 9 undermines the Complaint’s attempt to plead scienter, and (2) the Complaint’s failure to allege  
 10 defendants’ pre-Class Period trading history renders its insider trading allegations meaningless  
 11 because without such history, plaintiffs cannot show that defendants’ stock sales were  
 12 “dramatically out of line with prior trading practices. *No. 84 Employer-Teamster Joint Council*  
 13 *Pension Trust Fund v. Am. West Holding Corp. (“America West”)*, 320 F.3d 920, 938 (9th Cir.  
 14 2003) (citation and internal quotation marks omitted). The Opposition simply ignores controlling  
 15 Ninth Circuit authority on this score.<sup>1</sup>

16 In fact, defendants’ lack of suspicious sales effectively negates any inference of scienter.  
 17 Rather than divesting themselves of the majority of their PMI stock at allegedly artificially  
 18 inflated prices before the “truth of PMI’s financial condition came to light—behavior that may  
 19 be suggestive of scienter—Smith, Shuster and Lofe increased their holdings during the Class  
 20

21 <sup>1</sup> Plaintiffs rely on inapposite cases to suggest that lower levels of insider trading will support  
 22 scienter. *See* Opp. 19:11-19. *Fecht v. Price Co.*, 70 F.3d 1078 (9th Cir. 1995), was issued before  
 23 the PSLRA was enacted and thus plaintiffs were not required to satisfy the act’s stringent scienter  
 24 requirements. *Id.* at 1082 & n.4. Moreover, insider sales represented 50% of one defendant’s  
 25 total holdings and 100% of the class period options acquired by the other. *Id.* at 1084. In *In re*  
 26 *SeeBeyond Technologies Corp. Securities Litigation*, 266 F. Supp. 2d 1150 (C.D. Cal. 2003), a  
 27 defendant’s stock sales were 7.6% of his holdings, but resulted in over \$18 million in proceeds  
 28 and were dramatically out of line with prior trading patterns. *Id.* at 1169 & n.10. In *Hayley v.*  
*Parker*, No. SA CV 01-69 DOC (EEx), 2001 U.S. Dist. LEXIS 23255 (C.D. Cal. Aug. 31, 2001),  
 one defendant sold only 11% of his holdings but two defendants collectively sold over 70% of  
 their stock, another sold 20% and all defendants combined sold 30% of their holdings. *Id.* at \*16.  
 In *In re Omnivision Technologies, Inc.*, No. C-04-2297 SC, 2005 U.S. Dist. LEXIS 16009 (N.D.  
 Cal. July 29, 2005), one defendant sold 18% of his holdings, a level dramatically out of line with  
 his prior period sales of 7%. The other defendants sold at substantially greater amounts, with one  
 selling 64% of his holdings and two selling 100% of their holdings. *Id.* at \*14-15.

1 Period. Moreover, 98 percent of Smith's sales were pursuant to Rule 10b5-1 trading plans,  
2 further undermining any inference of scienter. *Metzler*, 540 F.3d at 1067 n.11. Smith and  
3 Shuster sold at levels below those sufficient in the Ninth Circuit to support an inference of  
4 scienter, Katkov sold at *de minimis* levels and Lofe did not sell at all. *E.g.*, *Metzler*, 540 F.3d at  
5 1067 (sale of 37% of holdings did not support an inference of scienter); *In re Vantive Corp. Sec.*  
6 *Litig.*, 283 F.3d 1079, 1092-94 (9th Cir. 2002) (holding that sales ranging from 17% to 74% did  
7 not give rise to inference of scienter). The lack of "corroborative insider sales by Katkov and  
8 Lofe also undermines an inference of scienter as to all individual defendants. *Metzler*, 540 F.3d  
9 at 1067; *accord Ronconi v. Larkin*, 253 F.3d 423, 436 (9th Cir. 2001).

10 Plaintiffs also argue that the value of stocks and options received by defendants during the  
11 Class Period substantially exceeded their base salaries. *Opp.* 18:22-25. But allegations that  
12 defendants received stock or options as compensation is not probative of scienter unless they  
13 made suspicious sales and profited from the alleged fraud. *America West*, 320 F.3d at 938.  
14 Because defendants held the majority of their PMI shares through the Class Period and suffered  
15 the same drop in share price as putative class members, the only reasonable inference is  
16 defendants did not believe that PMI's stock price was artificially inflated by any purported fraud.

### 17 **III. THE PSLRA'S SAFE HARBOR AND THE BESPEAKS CAUTION DOCTRINE** 18 **IMMUNIZE DEFENDANTS' FORWARD-LOOKING STATEMENTS**

19 The Complaint should also be dismissed because each of the alleged false or misleading  
20 statements is inactionable under the PSLRA's safe harbor and the bespeaks caution doctrine.  
21 *Mot. to Dismiss* 20:26-21:4. The Opposition asserts that these are "statements of *then-existing*  
22 *facts* rather than forward-looking statements."<sup>2</sup> *Opp.* 20:24-26. However, defendants' statements  
23 regarding PMI's 2007 financial guidance and events that could affect PMI's future performance  
24 fall squarely within the statutory definition of forward-looking statements because they contain "a  
25

26 <sup>2</sup> The Opposition cites two cases for the unremarkable proposition that statements of historical  
27 facts are not covered by the safe harbor. *In re InterMune, Inc. Sec. Litig.*, No. C 03-2954 SI, 2004  
28 U.S. Dist. LEXIS 15382, at \*14 (N.D. Cal. July 30, 2004); *In re CV Therapeutics Sec. Litig.*, No.  
C 03-03709 SI, 2004 U.S. Dist. LEXIS 17419, at \*33-34 (N.D. Cal. Aug. 5, 2004). Because the  
alleged statements are not reports of historical facts, this authority is inapposite.

1 projection of revenues, income (including income loss), earnings (including earnings loss) per  
2 share, capital expenditures, dividends, capital structure, or other financial items. 15 U.S.C.  
3 § 78u-5(i)(1)(A). Defendants' statements regarding PMI's loss reserves are also necessarily  
4 forward-looking because "'the truth or falsity of the statement[s] cannot be discerned until some  
5 point in time after the statement is made.' *In re Copper Mountain Sec. Litig.*, 311 F. Supp. 2d  
6 857, 880 (N.D. Cal. 2004) (citation omitted); *accord Harris v. Ivax Corp.*, 182 F.3d 799, 806 (11th  
7 Cir. 1999) (statements about adequacy of reserves are forward-looking); *Hess v. Am. Physicians*  
8 *Capital, Inc.*, No. 5:04-CV-31, 2005 WL 459638, at \*8 (W.D. Mich. Jan. 11, 2005) (same); *In re*  
9 *Kindred Healthcare Inc. Sec. Litig.*, 299 F. Supp. 2d 724, 738 (W.D. Ky. 2004) (same).

10 The Opposition also seeks to exclude from the safe harbor defendants' statements  
11 regarding PMI's loss reserves and investment in FGIC based on the spurious argument that they  
12 were "included in a financial statement prepared in accordance with generally accepted  
13 accounting principles. Opp. 19:26-27 (quoting 15 U.S.C. § 78u-5(b)(2)(A)). All the forward-  
14 looking statements alleged in the Complaint, however, were made in press releases, earnings  
15 conference calls and investor conference calls—not in financial statements—and therefore are  
16 entitled to safe harbor protection. Compl. ¶¶ 62, 64-66, 68, 70, 72, 74-76, 79, 81-83, 86, 89, and  
17 97-98. Moreover, courts have routinely found forward-looking statements in Forms 10-Q and  
18 other SEC filings to be within the safe harbor if they are accompanied by meaningful cautionary  
19 language. *See, e.g., Hess*, 2005 WL 459638, at \*7-8 (statements contained in Forms 10-Q  
20 regarding the adequacy of the company's loss reserves were protected by the safe harbor). To  
21 accept plaintiffs' attempt to exclude these indisputably forward-looking statements from safe  
22 harbor protection merely because they happen also to be included in PMI's SEC filings would  
23 effectively render the safe harbor a dead letter, a result that Congress never intended.

24 Plaintiffs also argue that the safe harbor does not apply because defendants had "actual  
25 knowledge of the falsity of their statements. This argument is flawed on two grounds. First, as  
26 demonstrated in Section II, above, the Complaint falls far short of pleading scienter, much less  
27 pleading actual knowledge of falsity. Second, this argument is based on a misreading of the  
28 statute. According to the statute, a court must dismiss claims related to forward-looking

1 statements if *either* of two independent bases is met: (1) such statements are accompanied by  
2 meaningful cautionary language, *or* (2) such statements are not made with actual knowledge of  
3 their falsity. *See* 15 U.S.C. § 78u-5(c)(1). “[T]hese two prongs of the safe harbor provision are  
4 taken to be independent, alternative means by which a defendant may insulate itself from  
5 liability. *See Beyond*, 266 F. Supp. 2d at 1164. Thus, if a forward-looking statement is  
6 accompanied by meaningful cautionary language, the defendant’s state of mind is irrelevant.<sup>3</sup> *See*  
7 *Harris*, 182 F.3d at 803.

8 Finally, plaintiffs insist that the determination of whether cautionary language is  
9 meaningful cannot be made at the pleadings stage. *See* Opp. 21:13-18 (citing *Asher v. Baxter*  
10 *Int’l Inc.*, 377 F.3d 727 (7th Cir. 2004)). Courts in the Ninth Circuit, however, routinely grant  
11 motions to dismiss based on the safe harbor, particularly where, as here, the risk factors are  
12 unambiguous and specific to PMI’s business. *See Copper Mountain*, 311 F. Supp. 2d at 880;  
13 *See Beyond*, 266 F. Supp. 2d at 1167 n.9; *see also* RJN Ex. 16 (warning that, among other factors,  
14 “changes in housing values, unemployment rates, interest rates and refinancing activity could  
15 affect . . . total incurred losses and expense ratio, and/or our consolidated investment portfolio  
16 yield, and referring investors to PMI’s 2005 10-K and 3Q06 10-Q for a discussion of other risks  
17 and uncertainties, which included risks associated with reduced documentation loans); Mot. to  
18 Dismiss Appendix C at 1-5, 7. Far from the “vague or boilerplate disclaimers described in the  
19 Opposition (Opp. 21:11-12), PMI’s detailed and explicit warnings are more than sufficient to  
20 invoke the protection of the safe harbor as a matter of law. *See Hess*, 2005 WL 459638, at \*7.  
21 Accordingly, all claims related to defendants’ forward-looking statements must be dismissed.

#### 22 **IV. THE COMPLAINT DOES NOT PLEAD LOSS CAUSATION**

23 In its most recent pronouncement on the loss causation pleading requirement, *Metzler*  
24 *Investment GMBH v. Corinthian Colleges, Inc.*, the Ninth Circuit instructed that a complaint

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25 <sup>3</sup> Plaintiff cites to dicta from *America West*, 320 F.3d at 937 n.15., that does not appear to  
26 appreciate that the two prongs of the safe harbor are independent. *See, e.g., See Beyond*, 266 F.  
27 Supp. 2d at 1164 (noting that language from *America West* was non-binding dicta and  
28 inconsistent “with the use of the disjunctive ‘or’ in the PSLRA); *In re Portal Software, Inc. Sec.*  
*Litig.*, No. C-03-5138 VRW, 2006 WL 2385250, at \*12 (N.D. Cal. Aug. 17, 2006) (noting  
disjunctive).

1 “must allege that *the practices that the plaintiff contends are fraudulent* were revealed to the  
2 market and caused the resulting losses. 540 F.3d at 1063 (emphasis added). The Complaint fails  
3 to allege any disclosure that revealed the alleged “truth to the market; therefore PMI’s stock  
4 price declines could not have been proximately caused by the alleged fraud.

5 The Opposition argues that a “court should not balance competing loss causation theories  
6 at the motion to dismiss stage. Opp. 21:25-27 (emphasis omitted). The Complaint does not,  
7 however, allege a cognizable loss causation theory in the first instance because it does not contain  
8 any allegations showing that the purported “fraud was ever revealed to the market. The Ninth  
9 Circuit has declared that conclusory allegations that the market interpreted negative news  
10 regarding a company or its industry as a “euphemism for fraud do not plead loss causation: “So  
11 long as there is a drop in a stock’s price, a plaintiff will always be able to contend that the market  
12 ‘understood’ a defendant’s statement precipitating a loss as a coded message revealing the fraud.  
13 Enabling a plaintiff to proceed on such a theory would effectively resurrect what *Dura*  
14 discredited . . . . *Metzler*, 540 F.3d at 1064; *accord Brodsky*, 2008 WL 4531815, at \*12  
15 (construing *Metzler* and dismissing complaint for failure to plead loss causation because it did not  
16 allege that fraud was revealed).

17 The Ninth Circuit’s earlier holding in *In re Gilead Sciences Securities Litigation* does not  
18 support plaintiffs’ position. In *Gilead*, the plaintiffs pled a clear causal connection between  
19 revelation of the alleged fraud and a decline in the company’s stock price. The defendants in  
20 *Gilead* allegedly engaged in an off-label marketing scheme in connection with Viread, one of the  
21 company’s most important drug products. The plaintiffs’ complaint alleged that when the FDA  
22 publicly disclosed Gilead’s unlawful off-label practices, physicians stopped prescribing Viread,  
23 the company suffered a sharp decline in end-user demand—the direct result of disclosure of the  
24 fraud to physicians—and the stock price fell in response to news of decreased demand. 536 F.3d  
25 at 1053-54, 1057-58. This Court, citing *Gilead*, recently concluded that the plaintiffs pled loss  
26 causation where they alleged that a sharp decline of a company’s stock immediately prior to the  
27 company’s disclosure of the alleged fraud was due to pre-disclosure leaks of the truth to the  
28

1 market. *In re Connetics Corp. Sec. Litig.*, No. C 07-02940 SI, 2008 U.S. Dist. LEXIS 62515, at  
2 \*34 (N.D. Cal. Aug. 14, 2008).

3 Unlike the complaints in *Gilead* and *Connetics*, the Complaint in this case must be  
4 dismissed because it does not allege a clear causal link between revelation of any alleged “fraud  
5 and a decline in PMI’s stock price. Each of the Complaint’s alleged disclosures from October  
6 2007 through January 18, 2008<sup>4</sup>—the date by which the Complaint alleges that all artificial  
7 inflation was removed from PMI’s stock price (Compl. ¶¶ 197-98)—reveals negative news about  
8 PMI’s or the mortgage industry’s financial condition and future prospects, or disappointing news  
9 about the housing market at large.<sup>5</sup> It is well settled that a complaint must allege the “market  
10 learned of and reacted to [the] fraud, as opposed to merely reacting to reports of the defendant’s  
11 poor financial health generally. *Metzler*, 540 F.3d at 1063; accord *In re Tellium, Inc. Sec. Litig.*,  
12 No. Civ. A. 02cv5878 FLW, 2005 WL 2090254, at \*4 (D.N.J. Aug. 26, 2005) (“*Dura* itself  
13 makes clear that loss causation is not pled upon allegations of drops in stock price following an  
14 announcement of bad news that does not disclose the fraud. ). Because the Complaint fails to tie  
15 any specific stock drop with any revelation that a prior statement was fraudulent, it does not  
16 adequately plead the element of loss causation.

17  
18  
19  
20 <sup>4</sup> The Opposition argues that the first “corrective disclosure was in July 2007. Opp. 23 n.4.  
21 Under the subheading “The Truth Begins To Be Revealed, however, the Complaint alleges that  
22 the first “corrective disclosure was in August 2007. Compl. ¶ 85. Aside from this conclusory  
allegation, the Complaint does not attempt to allege that any disclosure revealed the “truth to the  
market until October 2007. Compl. ¶ 95.

23 <sup>5</sup> Although none of the disclosures reveals the alleged fraud, only disclosures on or before  
24 October 31, 2007, are relevant to this analysis because Lead Plaintiff did not own PMI stock after  
25 this date. Where a plaintiff sells stock prior to revelation of the truth, it receives artificially  
26 inflated prices for its shares and has therefore suffered no harm. *Dura Pharms., Inc. v. Broudo*,  
125 S. Ct. 1627, 1631 (2005). Judge Ware recently dismissed a complaint for failure to plead loss  
27 causation for exactly this reason. See *In re Impax Labs., Inc. Sec. Litig.*, No. C 04-04802 JW,  
28 2008 WL 1766943, at \*7 (N.D. Cal. Apr. 17, 2008). The Opposition argues that Lead Plaintiff  
purchased additional shares of PMI stock on February 26, 2008. Opp. 23 n.4. The Complaint  
alleges, however, that all artificial inflation was removed from PMI’s stock price on January 18,  
2008. Compl. ¶¶ 197-98. Therefore, investors purchasing after that date, including Lead  
Plaintiff, could not have suffered harm from the alleged fraud because they did not purchase at  
artificially inflated prices.

