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**UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF CALIFORNIA**

IN RE THE PMI GROUP, INC.  
SECURITIES LITIGATION

) Case No. C-08-1405-SI  
)  
) CLASS ACTION

THIS DOCUMENT RELATES TO:  
ALL ACTIONS.

) **REPLY MEMORANDUM OF POINTS  
) AND AUTHORITIES IN SUPPORT OF  
) MOTION TO DISMISS FIRST  
) AMENDED COMPLAINT FOR  
) VIOLATION OF THE FEDERAL  
) SECURITIES LAWS**

) Date: November 13, 2009  
) Time: 9:00 a.m.  
) Courtroom: 10, 19th Floor

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1 Complaint must be dismissed with prejudice.

2 **ARGUMENT**

3 **I. THE AMENDED COMPLAINT FAILS TO SATISFY THE HEIGHTENED**  
 4 **PLEADING STANDARD FOR SCIENTER**

5 **A. The Amended Complaint Does Not Plead The Facts Required To Support A**  
 6 **Strong Inference Of Scienter Based On The Core Operations Inference**

7 The Opposition insists that defendants' alleged "admissions" that they monitored PMI's  
 8 loan portfolio are sufficient to invoke the core operations inference. Opp. 8. This argument is  
 9 squarely at odds with the Court's prior ruling and settled Ninth Circuit authority. As this Court  
 10 held, to infer scienter based on the core operations doctrine, a complaint must allege not only the  
 11 defendants' involvement in the company's operations, but also the existence of facts or  
 12 circumstances that (a) contradict the defendants' statements when made *and* (b) are of such  
 13 magnitude that it would be "absurd to suggest" that the defendants were not aware of them. *See*  
 14 *Order 14-15; Metzler Inv. GMBH v. Corinthian Colls., Inc.*, 540 F.3d 1049, 1068 (9th Cir. 2008);  
 15 *South Ferry*, 542 F.3d at 784. As detailed in defendants' opening brief, the Amended Complaint  
 16 fails completely to allege contemporaneous facts and circumstances that contradict defendants'  
 17 statements and that are of such magnitude that it would be "absurd to suggest" that defendants  
 18 were unaware of them. MTD 17-19.

19 Plaintiffs also argue that the core operations inference should be invoked because certain  
 20 statements were allegedly "objectively out of line" with PMI's actual business practices. These  
 21 allegations, however, do not create a strong inference of scienter because they are not supported  
 22 by the particularized, contemporaneous facts required by this Court and the Ninth Circuit.

23 Plaintiffs rely heavily on *Nursing Home Pension Fund v. Oracle Corp.*, 380 F.3d 1226,  
 24 1234 (9th Cir. 2004), and *In re Countrywide Fin. Corp. Sec. Litig.* ("*Countrywide Sec. Litig.*"),  
 25 588 F. Supp. 2d 1132, 1193 (C.D. Cal. 2008). The Amended Complaint, however, does not  
 26 remotely present the sort of detailed allegations of contemporaneous facts contradicting the  
 27 defendants' public statements found in those decisions.

28 The complaint in *Oracle* alleged that the defendants concealed declining revenues by  
 publicly denying any slowdown in business and fraudulently recognizing \$230 million in past

1 customer overpayments as revenue. 380 F.3d at 1228-29. The complaint contained “hard  
2 numbers” and “specific allegations regarding large portions of Oracle’s sales data.” *Id.* at 1231.  
3 These allegations included a former VP of Finance’s statement that, six weeks before the class  
4 period, defendants knew that Oracle would miss revenue projections by 50%. *Id.* The complaint  
5 also established that “a large number of deals were either lost or delayed,” four of which totaled  
6 75% of the total revenue shortfall for the quarter. *Id.* at 1231-1232. The Ninth Circuit held that it  
7 was reasonable to infer that Oracle executives would have been aware of the alleged accounting  
8 fraud because it was “of such significant magnitude that the company would have missed its  
9 quarterly earnings projection but for the adjustments.” *Id.* at 1234. The Court’s conclusion was  
10 also informed by other indicia of scienter, including the CEO’s substantial insider sales of over  
11 \$900 million in stock one month before the disclosure of decreased revenues and specific  
12 allegations of the defendants’ “detail-oriented management style.” Based on the “totality of the  
13 allegations,” the complaint pled a strong inference of scienter. *Id.*

14 Unlike the Amended Complaint, the complaint in *Countrywide Sec. Litig.* contained  
15 numerous particularized allegations of widespread financial fraud within the company. 588 F.  
16 Supp. 2d at 1144. The defendants were alleged to have publicly denied that Countrywide’s  
17 underwriting standards had changed, when they had in fact deteriorated to the point that they  
18 were virtually abandoned by the end of the class period. *Id.* at 1145-46. Countrywide allegedly  
19 concealed its regular approval of loans outside its guidelines, including approval of loans with  
20 FICO scores as low as 500 that it falsely characterized as “prime” loans. *Id.* at 1147. To further  
21 perpetuate the fraud, Countrywide allegedly set up an “incentive system that encouraged [its  
22 corporate underwriters] to approve as many loans as possible.” *Id.* at 1148. A Countrywide  
23 employee was alleged to have directly reported to the board on several dates that appraisers were  
24 fraudulently inflating appraisal values to facilitate mortgage closings. *Id.* at 1149. Countrywide’s  
25 CEO was alleged to have personally participated in improper mortgage originations while, at the  
26 same time, explicitly reassuring investors that he did not “see any deterioration in the quality of  
27 those loans being originated.” *Id.* at 1193. Because the CEO’s statements were “so objectively  
28 out of line with Countrywide’s practices,” the court held that they supported a strong inference of

1 scienter under the core operations inference. *Id.* at 1185.

2 In contrast to the specific allegations in *Oracle* and *Countrywide Sec. Litig.* the Amended  
3 Complaint contains only conclusory allegations that statements by Smith and Katkov were  
4 “objectively out of line” with PMI’s business practices. As shown below, the Amended  
5 Complaint offers no facts to contradict these statements or any allegations suggesting that any  
6 defendant believed their statements were false or misleading when made.

7 1. **Statements On PMI’s 3Q06 Earnings Conference Call Do Not Support**  
8 **Any Inference Of Scienter**

9 The Opposition asserts that statements by Smith and Katkov on PMI’s 3Q06 earnings  
10 conference call were contradicted by PMI’s business practices. *See Opp.* 13. On the call, PMI  
11 reported net income of \$104.2 million for the quarter (\$70.8 million of which was attributable to  
12 PMI’s U.S. Mortgage Insurance Operations), and claims paid and loss reserve additions on its  
13 U.S. Mortgage Insurance Operations within its financial guidance. By focusing extensively on  
14 this early conference call, plaintiffs are engaging in classic fraud-by-hindsight pleading,  
15 attempting to create scienter by claiming that earlier statements were false because later  
16 misfortunes occurred. Plaintiffs are also attempting to use PMI’s third quarter 2006 earnings  
17 results as a virtual guarantor of future performance. Both attempts are squarely at odds with  
18 settled law. *In re Convergent Techs. Sec. Litig.*, 948 F.2d 507, 514 (9th Cir. 1991).

19 The Opposition asserts that Smith’s statement that PMI “continued to focus on prudent  
20 growth, while maintaining high credit quality” was knowingly false. The Amended Complaint  
21 alleges nothing that contradicts Smith’s statement or even suggests that Smith did not believe that  
22 PMI’s growth was prudent or that its credit quality was high. Plaintiffs claim that the statement  
23 that PMI was focused on “prudent growth” was false because PMI was actually insuring  
24 “whatever was in the market.” *See Opp.* 13. The Amended Complaint offers no particularized  
25 facts establishing such a practice. To the contrary, the Amended Complaint notes several  
26 instances in which PMI declined to insure loans that were not performing within its expectations.  
27 *See Am. Compl.* ¶¶ 77-79, 84-86. On the call, Smith also provided specific data backing up his  
28 claim of “high credit quality” in PMI’s portfolio:

1 In the third quarter, we continue to focus on prudent growth, while maintaining our  
2 high credit quality. This was evident in our sequential increase in our flow and  
3 structured new insurance written. ***Credit quality remains strong, as 93.5% of our  
risk in force in the flow channel is prime credit. In our structured channel  
approximately 83% of our risk in force is prime, up from 74% one year ago.***

4 RJN Ex. 34 at 2 (emphasis added). The Opposition does not dispute the accuracy of this data.

5 And unlike the complaint in *Countrywide Sec. Litig.* there are no particular allegations in the  
6 Amended Complaint suggesting that PMI was insuring loans as prime that were in fact subprime.

7 The Opposition claims that two statements by Katkov during the 3Q06 earnings call were  
8 contradicted by PMI's practices. *See* Opp. 13. In the first statement, Katkov explained that  
9 PMI's claims paid and loss reserves in the third quarter were more stable than those at other  
10 mortgage insurance companies because PMI "made very conscious choices about the types of risk  
11 we are taking in the market . . . . I think it's very consistent with the way we've run the company  
12 for years . . . ." RJN Ex. 34 at 6. The Opposition asserts that the statement that PMI was  
13 operating consistently "with the way we've run the company for years" was knowingly false  
14 because PMI was insuring higher risk loans than it had in the past. Opp. 13.

15 As an initial matter, plaintiffs mischaracterize Katkov's statement. Katkov did not state  
16 that PMI's risk profile was the same as it had been "for years." Rather, he stated that making  
17 "conscious choices" about risk was consistent with long-time company philosophy and practice.  
18 Plaintiffs' assertion that Katkov's statement was intended to conceal that PMI was insuring higher  
19 risk loan products is based on the false premise that PMI had not disclosed the changes to its  
20 insurance portfolio. In fact, PMI repeatedly disclosed that it was insuring higher risk loan  
21 products in its financial statements and frequently discussed the details of its loan portfolio in  
22 press releases and conference calls. *See* RJN Exs. 6-8, 10, 34, 38, 40, 42. Against this  
23 background, and in light of the changing characteristics of its insurance portfolio that PMI  
24 extensively disclosed, PMI indeed made "conscious choices" about the types of risk it insured.

25 Katkov's second allegedly false statement on the 3Q06 earnings call also does not support  
26 any inference of scienter. When asked why PMI's primary insurance in force had remained  
27 relatively flat quarter-to-quarter, Katkov stated that PMI had been "very careful in ensuring that  
28 whatever we put on the book we're happy to put on the book." Am. Compl. ¶ 97. As with

1 Katkov's first statement, the Opposition asserts that this statement was knowingly false because  
 2 PMI was ensuring higher risk loan products than in the past. Opp. 13. As noted above, PMI had  
 3 disclosed the changes in its risk profile. Moreover, nothing in the Amended Complaint suggests  
 4 that Katkov had any reason to believe, especially in 3Q06, that PMI's risk management was  
 5 flawed or that insuring certain higher risk loans at increased premiums was not prudent.

6 **2. Smith's Statement On The February 14, 2007 Conference Call Does**  
 7 **Not Support Any Inference Of Scienter**

8 The Opposition asserts that PMI's practices contradicted statements made by Smith during  
 9 a conference call on February 14, 2007. See Opp. 9 n.6, 10, 13. Discussing PMI's overall credit  
 10 outlook, Smith stated, "Number one, it's the core competency of our company. We're  
 11 professional risk managers. It's what we do day in and day out is the key point." RJN Ex. 37 at  
 12 4. Smith then explained the specific steps PMI had taken to manage the risk in its loan portfolio:

13 If you look at average loan amounts, less than 3% of our book of business has loan  
 14 amounts in excess of \$500,000. . . . And you will find since 2003 we've taken a  
 15 more conservative position in the overall credit profile of our book. And we've  
 16 actually improved the credit profile steadily and methodically as there have been  
 17 layering of risk characteristics in the marketplace since 2003. What does that  
 18 mean? In 2003, we had about 11.9% of our business below 620 in FICOs, but  
 19 above 575. In 2006, only 8% of our risk in force was below 620 and above 575.

20 The Opposition claims that Smith's statement that PMI "improved the credit profile" of its  
 21 portfolio was knowingly false because PMI was taking on more risk, in part due to increased "risk  
 22 layering" in the marketplace. See Opp. 9, 13. Risk layering is the accumulation of more than one  
 23 risk factor in a single loan, which increases the risk of borrower default for that loan. RJN Ex. 11.  
 24 A loan that is interest only and has a high loan-to-value ratio, for example, has a greater risk of  
 25 default than a loan with only one of those risk factors. The Opposition asserts that PMI did not  
 26 disclose "the extent of layered risk characteristics" in its portfolio until it filed its 2007 10-K.  
 27 Opp. 9.

28 The Amended Complaint does not contain a single particularized, contemporaneous fact  
 that contradicts Smith's statement. Moreover, as shown by Smith's statement above, PMI  
 acknowledged and addressed the risk layering in its portfolio early in the class period. Smith's  
 statement explains that – along with increasing its premiums – PMI increased the FICO scores

1 within its portfolio to compensate for the increased risk created by risk layering. This approach  
2 was heard, understood and endorsed by a Goldman Sachs analyst during a conference on  
3 February 12, 2007, also cited in the Amended Complaint. *See* Am. Compl. ¶ 103 (citing RJN Ex.  
4 36 (risk layering is a major factor in default but “if you can compensate with good FICO and  
5 other good characteristics [. . .] that could actually, even in the current situation, be a fairly good  
6 loan”). In addition to these disclosures, PMI in fact provided even more detail about the steps  
7 taken to address risk layering in its less than A quality loans, along with the specific  
8 characteristics of all the loans in its portfolio, in its March 15, 2007 press release discussed below.  
9 *See* RJN Ex. 17.

10           3.       **Katkov’s Statements In PMI’s March 15, 2007 Press Release Do Not**  
11                   **Support Any Inference Of Scienter**

12           The Opposition asserts that Katkov’s statements in a March 15, 2007 press release were  
13 “objectively out of line” with PMI’s practices and therefore knowingly false. In the press release,  
14 PMI updated investors regarding its U.S. mortgage insurance business and the characteristics of  
15 its loan portfolio. Katkov stated, “We believe that we have taken a prudent approach, managing  
16 the dispersion of risk by credit score, loan and property type, geographic region, and other key  
17 characteristics.” RJN Ex. 17. The Opposition claims that this statement of Katkov’s belief is  
18 contradicted by objective facts, but it fails to identify a single one. In fact, the very press release  
19 in which Katkov’s statement appeared provided detailed information regarding PMI’s loan  
20 portfolio (including data on risk layering, discussed *supra*), and plaintiffs do not dispute the  
21 accuracy of any of that information. *Id.*

22           4.       **Smith’s Statements On The June 26, 2007 Wachovia Securities CEO**  
23                   **Summit Do Not Support Any Inference of Scienter**

24           The Opposition finally asserts that Smith’s statement on a June 26, 2007 conference call  
25 that FGIC was “doing very well” was contradicted by FGIC’s actual financial condition. *Opp.* 14  
26 (citing Am. Compl. ¶ 113). The objective facts do not support this assertion. For 2Q07, FGIC  
27 reported net income of \$68.9 million, a 10% increase over its net income for the same quarter the  
28 previous year. RJN Ex. 101. The Amended Complaint contains no allegations demonstrating

1 that Smith had reason to believe that FGIC's financials were unreliable during this period. Nor  
2 does it assert that FGIC's 2Q07 financials were false.

3 \* \* \*

4 To apply the core operations doctrine in a case such as this would effectively remove the  
5 heightened pleading standard for scienter established by Congress and approved by the Supreme  
6 Court in *Tellabs v. Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499 (2007). The Amended  
7 Complaint does not even remotely present the type of exceptional case like *Oracle* or  
8 *Countrywide*. There, the complaints contained specific allegations of contemporaneous facts  
9 relating to matters of significant financial magnitude coupled with particular allegations  
10 demonstrating fraudulent intent. Here, the Amended Complaint fails to allege any such particular  
11 facts that contradict defendants' statements when they were made. Nor do plaintiffs offer  
12 anything to dispute the hard data accompanying and supporting those statements. Without  
13 contemporaneous facts contradicting the challenged statements, plaintiffs cannot begin to  
14 transform the Amended Complaint into the sort of exceptional case that merits reliance on the  
15 core operations inference. Because plaintiffs have no other basis to establish a strong inference of  
16 scienter, the Amended Complaint should be dismissed with prejudice.

17 **B. The Amended Complaint Fails To Plead Facts Regarding PMI's**  
18 **Underwriting Practices And Exposure To Losses Giving Rise To Any**  
19 **Inference Of Scienter**

20 The Opposition does not address the deficiencies defendants identified in their opening  
21 brief regarding the allegations related to delegated underwriting practices and exposure to losses.  
22 Instead, the Opposition merely repeats the allegations, followed by the conclusory assertion that  
23 they are sufficient to demonstrate scienter.

24 The Opposition repeats the allegations attributed to CW4 and CW5 regarding PMI's  
25 decision to stop insuring bulk transactions with certain lenders whose loans were not performing  
26 within PMI's loss estimates. *See Opp.* 15. As shown in defendants' opening brief, these  
27 allegations lack any information showing that the transactions at issue had a material impact on  
28 PMI's financial statements. MTD 14-15. The allegations also contradict plaintiffs' suggestion  
that PMI was "insuring whatever was in the market." Plaintiffs' assertion that Katkov was

1 “definitely aware” of these decisions does not overcome this deficiency because the allegations  
 2 also fail to describe what Katkov purportedly knew and when he knew it. Opp. 13-14; MTD 15.  
 3 And the Amended Complaint alleges no facts suggesting that any CW was ever in a position to  
 4 know such information regarding Katkov. *See Zucco Partners*, 552 F.3d at 996 (dismissing  
 5 complaint where confidential witnesses were not positioned to know information alleged).

6 The Opposition also fails to explain how the vague, additional allegations taken from the  
 7 litigation between PMI and IndyMac demonstrate scienter as to any defendant. As shown in  
 8 defendants’ opening brief, PMI’s demand that IndyMac adhere to more stringent standards, its  
 9 investigation of the loans underwritten by IndyMac, and its termination of IndyMac as a  
 10 delegated underwriter are consistent with PMI’s class period disclosures. MTD 16:19-27.

11 The Opposition asserts that additional allegations regarding PMI’s internal reports and  
 12 monitoring tools cure the defects noted by this Court. *See, e.g.*, Order 13:9-11. The additional  
 13 allegations, however, still do not describe any actual information generated by the reports or  
 14 tools, much less information contradicting defendants’ public statements. MTD 16. The  
 15 additional allegations regarding CW1’s internal reports, for example, describe only general  
 16 information categories. *See Am. Compl.* ¶ 71. There are no allegations of the specific  
 17 information that these reports actually conveyed about PMI’s financial condition. The same is  
 18 true of the Amended Complaint’s superficial allegations regarding other reports and monitoring  
 19 tools. *See, e.g., id.* ¶¶ 211 (alleging reports containing “delinquency data” with no details  
 20 regarding the content of any specific report); 32 (regarding pmiAura and pmiTerra tools).<sup>1</sup>

21 C. **The Amended Complaint Fails To Plead Facts Regarding PMI’s Investment**  
 22 **In FGIC Giving Rise To Any Inference Of Scienter**

23 The Opposition repeats the Amended Complaint’s allegations regarding PMI’s investment  
 24 in FGIC – including those previously found insufficient by this Court. The Opposition asserts  
 25

26 <sup>1</sup> The Opposition also asserts that scienter may be inferred from defendants’ access to PMI’s  
 27 “automated underwriting risk analysis assistant.” As Smith stated, however, “[w]e publish that  
 28 data. It’s on our website.” *See Opp.* 16 (citing *Am. Compl.* ¶ 123). The Opposition does not  
 explain how defendants’ access to publicly available information shows that they knew their  
 statements were false or misleading when made.

1 that scienter may be inferred based solely on the fact that Smith, Shuster and Lofe were FGIC  
 2 board members during the class period.<sup>2</sup> As explained below, this allegation fails because the  
 3 Amended Complaint is devoid of particularized allegations of any fraudulent activity at FGIC,  
 4 much less fraud of the magnitude required to infer that any individual defendant was aware of it.  
 5 *See South Ferry*, 542 F.3d at 784-85.

6 The allegation that Smith, Shuster and Lofe served on FGIC's board of directors and on  
 7 board committees does not support any inference of scienter. The Opposition asserts that the  
 8 court in *In re Countrywide Financial Corp. Derivative Litigation* held that the defendants' service  
 9 on Countrywide's Audit and Ethics committees supported a strong inference of scienter. Opp. 17.  
 10 In the *Countrywide Deriv. Litig.*, however, the court identified two "red flags" alleged in the  
 11 complaint that were of such magnitude that it could infer that defendants "must necessarily have  
 12 examined and considered them: (i) the massive rise in negative amortization resulting from pay-  
 13 option ARMs held for investment, and (ii) the increasing delinquencies in Countrywide's riskiest  
 14 loans." 554 F. Supp. 2d 1044, 1060 (C.D. Cal. 2008). The Amended Complaint pleads no such  
 15 "red flags" that contradict defendants' public statements.<sup>3</sup>

16 The Opposition also asserts that scienter may be inferred from the allegation that in  
 17 January 2008, FGIC attributed its increase in loss reserves to the "poor underwriting quality" of  
 18 the mortgages underlying the financial instruments that it insured. Opp. 18:1-4. Plaintiffs  
 19 contend defendants were aware of such "poor underwriting quality" earlier in the class period  
 20 because they "had a responsibility to be aware of" it. Opp. 18:4-5. Again, the Amended  
 21 Complaint has not added any allegations showing what specific information was presented to

22  
 23 <sup>2</sup> The Amended Complaint does not cite the source for its allegation that Lofe served as Chairman  
 of FGIC's Audit committee during the class period. *See* Am. Compl. ¶¶ 17, 19, 90. In fact, Lofe  
 did not join FGIC's Audit committee until 2009.

24 <sup>3</sup> The Opposition asserts that the lack of any restatement at PMI does not mean that the Amended  
 25 Complaint cannot demonstrate scienter. Opp. 17 n.15. But the cases plaintiffs cite merely hold  
 26 that the lack of a restatement does not exonerate a defendant where plaintiffs have "otherwise met  
 the pleading requirements of the PSLRA." *In re LDK Solar Sec. Litig.*, 584 F. Supp. 2d 1230,  
 1245 (N.D. Cal. 2008) (quoting *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 83 (1st Cir. 2002)).  
 27 Here, plaintiffs have not pled a strong inference of scienter and the lack of a restatement strongly  
 28 supports a non-culpable inference that PMI did not fraudulently misstate its financials during the  
 class period. *See Indiana State Dist. Council of Laborers And Hod Carriers Pension And  
 Welfare Fund v. Omnicare, Inc.*, 527 F. Supp. 2d 698, 707 (E.D. Ky. 2007).

1 FGIC's board or any of the defendants showing that FGIC's financial statements were ever  
2 inaccurate. MTD 8-11. Without such particularized facts, this assertion is merely another  
3 unsupported attempt to attribute knowledge to defendants early in the class period of conditions  
4 in the financial markets that would not emerge until several months later. *See* MTD 17-19.

5 The Opposition also repeats the allegations regarding CW3's presentation to the FGIC  
6 board in November 2007. As defendants previously noted, CW3 is alleged to have reported in  
7 this presentation that the losses on the collateral underlying FGIC's financial instruments were at  
8 a percentage where FGIC *did not have exposure to losses*. MTD 10-11. The Opposition  
9 acknowledges this fact but fails to address how it somehow supports an inference of scienter. Nor  
10 does the Opposition explain how an inference of scienter may be based on these allegations given  
11 that by October 2007, PMI had disclosed that it would incur \$28.9 million in losses in 3Q07 on  
12 the proportionate share of its investment in FGIC. RJN Exs. 10, 26, 29.

13 The Opposition also asserts that scienter may be inferred from the increase in the range of  
14 PMI's loss reserves during the class period. Opp. 18 (citing Am. Compl. ¶¶ 222, 224). The Court  
15 found these same allegations insufficient in the consolidated complaint. *See* Cons. Compl. ¶¶  
16 185, 187. Moreover, PMI explained that the wider range of its loss reserves was based in part on  
17 unprecedented efforts by lenders to re-negotiate failing mortgages and keep mortgage holders in  
18 their homes. *See, e.g.*, RJN Ex. 39 at 4. Naturally, the success or failure of such efforts could  
19 impact the amount of PMI's losses. *Id.* Nothing in the Amended Complaint suggests that the  
20 range of loss reserves was inappropriate based on the facts then available to PMI.

21 **D. The Insider Trading Allegations Negate Any Inference Of Scienter**

22 The Amended Complaint's insider trading allegations are identical to the allegations in the  
23 consolidated complaint this Court found insufficient. Order 15. Plaintiffs concede the Amended  
24 Complaint still fails to plead the defendants' prior trading history, without which this Court held  
25 it "cannot conclude that the stock sales are suspicious." Order 15:16; *see also* Opp. 21 n.17. As  
26 this Court also noted, Smith, Shuster and Lofe *increased* their holdings during the class period – a  
27 fact that is consistent with an inference that defendants did not believe PMI's stock was  
28 artificially inflated. Order 15:17-18.

1           Nevertheless, the Opposition asserts that Smith's entry into his 10b5-1 trading plan on  
2           September 15, 2006, and subsequent entry into a new plan on February 20, 2007, are inherently  
3           suspicious and support an inference of scienter. Opp. 20:18-23. But without any allegations  
4           regarding Smith's prior trading history or material changes in his trading practices before and  
5           after he entered into his new trading plan, the Court has no basis to infer that Smith's plan was  
6           entered into for fraudulent purposes. See Order 15:10-16 (quoting *No. 84 Employer-Teamster v.*  
7           *Am. West Holding Corp.*, 320 F.3d 920, 938 (9th Cir. 2003)). Smith's class period trades – 98%  
8           of which were made pursuant to a Rule 10b5-1 plan – therefore rebut an inference of scienter.  
9           Order 15:18-21 (citing *Metzler*, 540 F.3d at 1067 n.11).

10           In fact, Smith's stock sales before and after he entered into his new 10b5-1 plan were  
11           entirely consistent, which is unsurprising because he entered into the new plan solely to change  
12           the plan's administrator. Smith sold 10,000 shares in December 2006; 30,000 shares in January  
13           2007; and 48,921 shares in early February 2007. RJN Ex. 105. After Smith entered into the new  
14           plan on February 20, 2007, his stock sales did not materially change. He sold 10,000 shares in  
15           March 2007, 30,000 shares in April 2007, and 13,900 shares in May 2007. *Id.* The cases cited by  
16           plaintiffs are therefore inapposite. For example, in *Countrywide Deriv. Litig.*, the CEO actively  
17           amended his trading plan so he could sell twice as many shares on the date Countrywide's stock  
18           reached an all-time high. 554 F. Supp. 2d at 1068; see also *Countrywide Sec. Litig.*, 588 F. Supp.  
19           2d at 1188 (noting frequent amendments to trading plan allowed for increased sales). Smith, by  
20           contrast, entered into a new trading plan only once and only for administrative purposes. The  
21           timing of the amendment does not correlate with any particular event alleged in the Amended  
22           Complaint, and his trading practices did not materially change after the amendment.<sup>4</sup> RJN Ex.  
23           105. Smith's stock sales therefore do not support an inference of scienter.

24 \_\_\_\_\_  
25 <sup>4</sup> The other cases cited by plaintiffs are similarly inapposite. In *Central Laborers' Pension Fund*  
26 *v. Integrated Electrical Services Inc.*, 497 F.3d 546, 554 (5th Cir. 2007), the court noted that a  
27 10b5-1 plan did not render sales pursuant to the plan non-suspicious because defendants failed to  
28 respond to plaintiffs' assertion that the plan was entered into during the class period. In *Croker v.*  
*Carrier Access Corp.*, No. 05-cv-01011-LTB-OES, 2006 U.S. Dist. LEXIS 48603 (D. Colo. July  
18, 2006), the court did not consider whether trading plans rendered trades innocuous because  
plaintiffs had argued that defendants exercised control over the entity that sold their stock. *Id.* at  
\*31. The Amended Complaint does not contain these types of allegations.

1 **II. THE PSLRA'S SAFE HARBOR AND BESPEAKS CAUTION DOCTRINE**  
 2 **IMMUNIZE DEFENDANTS' FORWARD-LOOKING STATEMENTS**

3 Many of the alleged false or misleading statements are inactionable under the PSLRA's  
 4 safe harbor and the Bespeaks Caution doctrine. MTD 20:19-22:3.<sup>5</sup> The Opposition asserts that  
 5 these are "statements of then-existing fact" rather than forward-looking statements.<sup>6</sup> Opp. 23:1-2.  
 6 However, defendants' statements regarding PMI's 2007 financial guidance and events that could  
 7 affect PMI's future performance fall squarely within the statutory definition of forward-looking  
 8 statements because they contain "a projection of revenues, income (including income loss),  
 9 earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or  
 10 other financial items." 15 U.S.C. § 78u-5(i)(1)(A). Defendants' statements regarding PMI's loss  
 11 reserves are also necessarily forward-looking because "the truth or falsity of the statement[s]  
 12 cannot be discerned until some point in time after the statement is made." *In re Copper*  
 13 *Mountain Sec. Litig.*, 311 F. Supp. 2d 857, 880 (N.D. Cal. 2004) (citation omitted); *accord Harris*  
 14 *v. Ivax Corp.*, 182 F.3d 799, 806 (11th Cir. 1999) (statement about reserves is forward-looking).

15 The Opposition also seeks to exclude from the safe harbor defendants' statements  
 16 regarding PMI's loss reserves and investment in FGIC because they were included in a financial  
 17 statement prepared in accordance with generally accepted accounting principles. Opp. 22:19-24  
 18 (quoting 15 U.S.C. § 78u-5(b)(2)(A)). All the forward-looking statements alleged in the  
 19 Amended Complaint, however, were made in press releases, earnings conference calls and  
 20 investor conference calls—not in financial statements—and therefore are entitled to safe harbor  
 21 protection. Am. Compl. ¶¶ 97, 99, 101, 103, 105, 107, 109, 111, 113, 115, 117, 120, 123, 131,  
 22 132. Moreover, courts have routinely found forward-looking statements in Forms 10-Q and other  
 23 SEC filings to be within the safe harbor if they are accompanied by meaningful cautionary

24 \_\_\_\_\_  
 25 <sup>5</sup> The Opposition contends that this Court previously held that defendants' statements were not  
 26 protected by the PSLRA safe harbor and the Bespeaks Caution doctrine. The Court's Order,  
 however, references neither the PSLRA safe harbor nor the Bespeaks Caution doctrine. The  
 Court was not required to reach these issues because the Court dismissed the consolidated  
 complaint for failure to plead a strong inference of scienter.

27 <sup>6</sup> The Opposition cites authority for the unremarkable proposition that statements of historical  
 28 facts are not covered by the safe harbor. Because the alleged statements are not reports of  
 historical facts, this authority is inapposite.

1 language. *See, e.g., Hess*, 2005 WL 459638, at \*7-8.

2 The Opposition also asserts that the safe harbor does not apply because defendants had  
3 “actual knowledge” of the falsity of their statements. *Opp.* 23:11-12. As discussed above, the  
4 Amended Complaint fails to plead scienter, much less actual knowledge of falsity. Moreover, a  
5 court must dismiss claims related to forward-looking statements if either of two independent  
6 bases is met: (1) such statements are accompanied by meaningful cautionary language, or (2)  
7 such statements are not made with actual knowledge of their falsity. *See* 15 U.S.C. § 78u 5(c)(1).  
8 “[T]hese two prongs of the safe harbor provision are taken to be independent, alternative means  
9 by which a defendant may insulate itself from liability.” *In re SeeBeyond Tech. Corp. Sec. Litig.*,  
10 266 F. Supp. 2d 1150, 1164 (C.D. Cal. 2003).

### 11 **III. THE COMPLAINT DOES NOT PLEAD LOSS CAUSATION**

12 The Opposition concedes that the Amended Complaint cannot plead loss causation for any  
13 drop in PMI's stock price following January 18, 2008. *Opp.* 21:9-11. The Opposition asserts that  
14 the Amended Complaint sufficiently pleads loss causation based on its pre-January 18, 2008  
15 allegations because plaintiffs are only required to allege “facts that, if taken as true, plausibly  
16 establish loss causation.” *Opp.* 22:4-5 (quoting *In re Gilead Sciences Sec. Litig.*, 536 F.3d 1049  
17 (9th Cir. 2008)). The Amended Complaint fails to plausibly establish loss causation under this  
18 standard, however, because it does not allege facts showing a causal connection between the  
19 revelation of fraud and the decline in PMI's stock price.

20 Each of the disclosures alleged to have caused PMI's stock price to fall reveals negative  
21 news about PMI's financial condition and future prospects, or disappointing news about the  
22 housing and mortgage markets at large. Such disclosures are not sufficient to plead loss causation  
23 because they do not show that the “market learned of and reacted to [the] fraud, as opposed to  
24 merely reacting to reports of the defendant's poor financial health generally.” *Metzler*, 540 F.3d at  
25 1063; *accord In re Tellium, Inc. Sec. Litig.*, No. Civ. A. 02cv5878 FLW, 2005 WL 2090254, at  
26 \*4 (D.N.J. Aug. 26, 2005) (“[L]oss causation is not pled upon allegations of drops in stock price  
27 following an announcement of bad news that does not disclose the fraud.”).

28 Plaintiffs' reliance on *Gilead* is misplaced because the complaint in that case established

