UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM, individually and on behalf of all others similarly situated, Plaintiff, v. BANK OF AMERICA CORPORATION, et al., Defendants.	:	CIVIL ACTION NO: 11-CV-00733-WHP CLASS ACTION

MEMORANDUM OF LEAD PLAINTIFF, PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEMS, IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS THE CONSOLIDATED CLASS ACTION COMPLAINT

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INTRODUCTION AND OVERVIEW OF THE CASE[1]

The BAC Defendants have cherry-picked the allegations in the Consolidated Class Action Complaint ("Complaint) and mixed in a large number of purported facts and inferences not pleaded therein to construct a factual narrative that they then brand as implausible. The facts pleaded in the Complaint, however, tell a story that is not only plausible and cogent, it is deeply disturbing.

It is beyond dispute that soon after Bank of America Corp. ("BAC" or the "Company") acquired Countrywide Financial Corp. ("Countrywide"), a troubled subprime mortgage originator, in 2007, the BAC Defendants learned that many of the mortgage loans Countrywide had originated had been made to unqualified borrowers and lacked adequate documentation. ¶¶113, 114 (BAC's former CEO, Defendant Lewis, admitted that 89% of loans on BAC's books that Countrywide originated in 2005 and 2006 did not meet BAC's underwriting standards).

As BAC disclosed after the Class Period, which began on February 27, 2009 and ended on October 19, 2010, BAC and its "legacy" banks (including Countrywide) had sold approximately ***$2 trillion*** of mortgage loans to government-sponsored entities such as "Fannie Mae" and "Freddie Mac" ("GSEs") and private securitization trusts between 2004 and 2008. ¶178. Of the mortgage loans Countrywide originated in 2006 and 2007 alone, $118 billion were securitized into residential mortgage backed securities ("MBS"). ¶101. As the BAC Defendants have further admitted, by the end of 2009, 32% of the Alt-A (so-called "liars loans") and 52% of the Countrywide subprime loans were delinquent. *Id.* While BAC wrote off billions of dollars of mortgage loans acquired from Countrywide before and during the Class Period, the poor quality of these loans also created a massive undisclosed exposure to purchasers of securities that

[1] Due to space limitations, this section is intended as an overview of the facts alleged in the Complaint, not a comprehensive summary. Specific paragraphs of the Complaint are referred to throughout by the symbol ¶ and the paragraph number.

contained Countrywide-originated loans. In connection with the sale of these loans to securitization trusts, BAC and Countrywide (and other legacy banks acquired by BAC before the February 27, 2009 start of the Class Period) made representations and warranties regarding, among other things, the creditworthiness of the borrowers and ownership of the property. *See, e.g.*, ¶105. The securitization agreements permitted MBS purchasers to demand that BAC repurchase the loans upon a breach of representations and warranties.

Although the BAC Defendants disclosed repurchase claims by GSEs and monoline insurers during the Class Period, they downplayed the possibility of having any significant exposure to purchasers of so-called "private label" MBS (*e.g.*, securities issued by trusts BAC created). *See, e.g.*, ¶21 (Defendant Price told analysts that private repurchase claims were "unenforceable" and should not even be on analysts' "radar screen."). Meanwhile, BAC was actively concealing facts about possible breaches of representations and warranties from private purchasers of MBS and the trustees of the securitization trusts.

Among the representations and warranties typically made in connection with the sale of mortgage loans for purposes of securitization was that the seller of the loans had good title and that the mortgages and loans had been properly assigned. ¶106. This became especially important as the recession caused by the financial crisis in the fall of 2008 deepened and more and more borrowers defaulted on their mortgages. BAC never told investors or shareholders during the Class Period about its reliance on the Mortgage Electronic Registration Systems, Inc. ("MERS") to transfer title to the mortgage loans it bought and sold. More importantly, the Company never disclosed to investors that it was improperly using MERS as a substitute for physical recording in local government offices all transfers of interests in property, as required by the laws of virtually every jurisdiction in the United States. ¶¶7, 73-76.

As the Class Period began, the deepening global recession resulted in increased foreclosure activity around the country. A number of judicial decisions found that MERS was ineffective in transferring title and/or that MERS lacked standing to foreclose on mortgages titled in its name. *See* ¶84. The BAC Defendants, particularly Moynihan, who was BAC's General Counsel until he became CEO when Lewis resigned, ¶38, were informed of these judicial decisions by BAC's legal department. ¶86. But BAC never disclosed during the Class Period the risk that BAC would be unable to foreclose on defaulted loans and the risk that institutional purchasers of MBS sold by BAC would claim that the failure of MERS to transfer title constituted a breach of representations and warranties requiring BAC to repurchase the MBS.

Defendants concealed these risks for at least two inter-related reasons. First, concealing breaches of representations and warranties regarding title to mortgage loans forestalled repurchase claims by purchasers of MBS comprised of pools of subprime and other poor quality mortgages loans originated primarily by Countrywide. Second, the repurchase demands were likely to – and ultimately did – substantially weaken BAC's balance sheet, which the BAC Defendants feared would prevent BAC from raising capital to repay the $45 billion in TARP government bailout funds the Company had received in October 2008 and January 2009. ¶15. As the BAC Defendants stated publicly, the executive compensation restrictions imposed under TARP made it difficult to attract and maintain qualified executives. ¶¶ 64, 65. The repayment of the TARP funds at the end of 2009 enabled a number of the BAC Defendants to obtain sizeable increases in compensation the following year, including Moynihan, whose compensation increased by 67% from $6 million to $10 million when he took over as CEO in January 2010.

In late September 2010, a number of states attorneys general announced investigations into the foreclosure practices of certain mortgage lenders. The public outcry concerning these practices resulted in BAC announcing on October 8, 2010 that it was ceasing foreclosure activity in all 50 states. But it was not until October 19, 2010 that BAC revealed to the public its reliance on MERS. As *The Wall Street Journal* stated in an article published that day, "[t]he fear is that repurchase requests could swell if foreclosure problems are due to loans' legal status. In that case, private investors may jump into action." ¶161.

And that they did. By October 19, 2010, a group comprised mainly of institutional investors, including various mutual funds, the New York Federal Reserve Bank and others (the "PIMCO Group") formally demanded that BAC repurchase $47 billion of MBS sold by securitization trusts that Countrywide had created. ¶162. The BAC Defendants belatedly admitted in BAC's 2010 10-K, filed after the end of the Class Period, that a "substantial portion" of BAC's residential mortgage loans had used MERS, and that such use of MERS could cause problems that "could have a material adverse effect on [BAC's] cash flows, financial condition and results of operations." ¶167.

I. THE COMPLAINT STATES A VALID SECTION 10(b) CLAIM

A. The Complaint Alleges False or Misleading Statements by the BAC Defendants

The BAC Defendants' argument that the Complaint fails to allege a false or misleading statement is meritless. Because the Complaint alleges numerous false and misleading statements, we discuss them below by subject matter.

1. The Failure to Disclose the Use of MERS and its Resulting Problems

The BAC Defendants argue that the Complaint does not allege affirmative misstatements regarding MERS during the Class Period. While true, that is simply because BAC *never said anything* about MERS in its statements to shareholders during the Class Period, despite the critical role that MERS played in BAC's mortgage-related business and the problems regarding its use that had arisen by the start of the Class Period. Rather than being a defect in the Complaint, however, the failure of BAC to discuss MERS is evidence of defendants' efforts to conceal material facts.

The BAC Defendants attempt to refute the fact that BAC did not disclose its use of MERS to its shareholders by pointing to two securitization trust prospectuses issued well before the start of the Class Period. One of these was filed by a Countrywide subsidiary before Countrywide had any connection with BAC, and the second was issued by an indirect BAC subsidiary. As the court noted in *In re Countrywide Financial Corp. Sec. Litig*., 588 F.Supp.2d 1132, 1160 (S.D. Cal. 2008), securitization trust prospectuses are intended for private investors, not purchasers of stock on the open market or in public offerings. The BAC Defendants have not, and cannot, point to similar disclosures in documents intended for purchasers of securities issued by BAC, such as its 10-Ks, 10-Qs or the prospectus for the December 2009 public offering of Common Equivalent Securities ("CES").

In any event, nothing in the prospectuses to which the BAC Defendants point remotely indicates the extent to which BAC relied on MERS or the growing body of evidence from before and during the Class Period that MERS would not adequately preserve the mortgage holder's security interest in mortgages purportedly recorded using it – the two facts necessary for investors to properly assess the risk that MERS created to BAC's financial condition. The absence of any disclosure of MERS to shareholders or investors does not absolve the BAC Defendants from liability because it is axiomatic that once corporations and their officers speak on an issue, they are obligated to disclose facts necessary to ensure that their statements are not misleading. *In re Marsh & McLennan Cos., Inc. Sec. Litig.*, 501 F.Supp.2d 452, 469 (S.D.N.Y. 2006);.

The Complaint alleges the omission of material facts about MERS that rendered materially misleading numerous statements made throughout BAC's SEC filings regarding BAC's enormous mortgage loan portfolios. *See, e.g.,* ¶¶185-86 (2008 10-K), ¶¶237-38 (2009 10-K). BAC made reference to its mortgage loan portfolios – in which MERS played a critical role – throughout its SEC filings. For example, BAC's 2008 10-K discloses: on page 93 that the average balance of residential mortgages was $260,213 billion; on page 95 that the balance of residential mortgages as of 12/31/08 was $247,999 billion; and on page 96 that the balance of nonperforming residential mortgages as of 12/31/08 was $7,044 billion.[2] BAC's description of these assets as "mortgage loans" contained an implied representation that BAC held valid mortgage liens on the real property securing the loans and thus that BAC had the right and ability to foreclose in the event of default. Such implied representations, if false, may be the basis for liability under the securities laws. *See S.E.C. v. First Jersey Securities, Inc.*, 101 F.3d 1450, 1469 (2d Cir. 1996); *S.E.C. v. Conaway*, 698 F.Supp.2d 771, 827 (E.D. Mich. 2010. BAC's implied representation that its mortgage liens were valid and effective was particularly significant to investors in light of the high percentage of mortgages on BAC's balance sheet originated by Countrywide and Merrill Lynch that were subprime or Alt-A, the upsurge of foreclosures among such loans, and the likelihood that foreclosure attempts would continue to climb. *See* ¶192 (quoting statement in BAC's 2008 10-K that foreclosures had increased by $1.2 billion in 2008 "driven primarily by the addition of Countrywide"); *see also* ¶¶208, 220 (quoting Defendant Price as stating, "[f]ormal [foreclosure] moratoriums have now been lifted …. [O]nce a loan has been evaluated under all our various programs, if no other alternative exists, those

[2] BAC's 10-Qs during the class period contained similar references, as did its 2009 10-K. *See* Musoff Decl., Exh. B at 27, 28; Exh. D at 30, 31; Exh. C at 95, 99-102. Similar references to "mortgage loan" portfolios appear in BAC's July 17, 2009 and October 16, 2009 press releases announcing financial results for the second and third quarters of 2009. ¶¶ 205, 216-17.

loans will be released into foreclosure."). As alleged in ¶¶186, 237-38, these implied representations[3] were materially misleading because the BAC Defendants knew then that a growing number of judicial decisions had determined that mortgage liens recorded through the MERS system, which comprised the bulk of BAC's mortgages, were not enforceable by it, which would undermine future foreclosure attempts and diminish the value of the mortgage loan assets held by BAC. *See In re Citigroup, Inc. Sec. Litig.*, 753 F.Supp.2d 206, 235 (S.D.N.Y. 2010). Because of the high percentage of BAC's assets in "mortgage loans"[4] and the well-known turmoil in the housing market, once the BAC Defendants made statements regarding matters affected by the use of MERS, they had a duty to "make such additional disclosures as are necessary to avoid rendering the statements [they made concerning BAC's mortgage loan portfolio] … misleading." *In re Par Pharmaceuticals, Inc. Sec. Litig.*, 733 F. Supp. 668, 675 (S.D.N.Y. 1990).

In the 2008 and 2009 10-K, defendants represented that "[w]e originate, fund and service mortgage loans, which subject us to credit, liquidity and interest rate risks…." 2008 10-K at 86; 2009 10-K at 83. However, nowhere did defendants discuss the risk that there were systemic problems inherent in utilizing the MERS system that would impede the foreclosure process, delaying foreclosures and creating uncertainty and possible financial loss to BAC. ¶¶185-86, 237-38. This non-disclosure of risk rendered these statements materially misleading. *See In re Am. Int'l Group, Inc. 2008 Sec. Litig.*, 741 F.Supp.2d 511, 530-31 (S.D.N.Y. 2010) ("*AIG*").

[3] The BAC Defendants made similar implied representations regarding BAC's ability to foreclose on defaulting mortgage loans during the July 17, 2009 and October 16, 2009 earnings conference calls. *See* ¶¶208-210, 220-222.

[4] According to BAC's 2008 10-K, as of 12/31/08, its $248 billion residential mortgage loan portfolio represented approximately 13.6% of its $1,818 billion in total assets. *See* Musoff Decl. Exh. A at 111, 132. *See also id.* Exh. C at 95 (as of 12/31/09, residential mortgage loans of $249 billion represented approximately 10.2% of total assets of $2,437 billion).

The BAC Defendants argue that "[t]he handful of decisions cited in the Complaint found only problems, mostly curable, with foreclosing specific mortgages registered through MERS." BAC Br. at 22. The practical implications of the decisions cited in the Complaint, taken as a whole, are factual issues that cannot be decided on a motion to dismiss, and especially cannot be decided based upon defendants' *ipse dixit*. *See Citigroup*, 753 F.Supp.2d at 231**.** In any event, the BAC Defendants are wrong in stating that there is no duty to disclose the risks implied by these decisions unless the outcome is a "foregone conclusion." *See Citigroup*, 753 F.Supp.2d at 238 (Defendants had duty to disclose risks to CDS portfolio "even absent knowledge that the CDO holdings would certainly suffer losses.").

2. Misrepresentations and Omissions Regarding Repurchase Claims

The Complaint alleges a number of false and misleading statements regarding BAC's exposure to repurchase claims for breaches of representations and warranties. For example, ¶190 quotes the following from the discussion in BAC's 2008 10-K's of representation and warranty claims: "[T]he Corporation's contractual liability arises only when the representations and warranties are breached. The Corporation attempts to limit its risk of incurring these losses by ***structuring its operations to ensure consistent production of quality mortgages*** and servicing those mortgages at levels that meet secondary mortgage market standards.[5] (Emphasis added.)" This patently false statement, *see, e.g.*, ¶¶ 128, 130, which implies that BAC's mortage loan origination and securitization activity was carefully controlled to minimize representation and warranty claims, is actionable. *See, e.g., Countrywide*, 588 F.Supp.2d at 1153; *In re CIT Group Sec. Litig*., 2010 WL 2365846, at *2 (S.D.N.Y. June 10, 2010); *In re Ambac Fin. Group, Inc. Sec. Litig.*, 2010 WL 727227, at *23 (S.D.N.Y. Feb. 22, 2010); *Shapiro v. UJB Fin. Corp.*, 964

[5] The same language appears, *inter alia*, on page 144 of BAC's 2009 10-K and on page 32 of BAC's 10-Q for the quarter ended March 31, 2009. *See* Musoff Decl., Exhs. C and B.

F.2d 272, 282 (3d Cir. 1992), *cert. denied*, 506 U.S. 934 (1992).

By BAC Defendants own admissions, BAC and its legacy banks failed to screen out mortgages of poor quality from securitizations. As Lewis admitted after the Class Period, BAC tightened Countrywide's loan origination criteria following the Countrywide acquisition in July 2008, so that 89% of the legacy mortgage loans originated in 2005 and 2006 acquired by BAC would have been ineligible for origination under the new criteria. ¶114. And as Moynihan admitted on October 19, 2010, there were "origination defects" in Countrywide loans during the period from 2004 through 2007. ¶155. Countrywide had sold many similar loans for securitization before it was acquired, and BAC continued to securitize the poor quality Countrywide loans after the acquisition, which increased BAC's exposure to repurchase claims. As confirmed by "trending reports" provided to the FCIC by Clayton Holdings, Inc., a vendor BAC used to select loans for securitization, BAC and Merrill Lynch had a practice of "waiving in" loans that did not meet the underwriting guidelines for BAC securitizations. ¶¶128-29. BAC routinely ignored borrowers' deficient qualifications so it could keep its mortgage securitization pipelines full, as corroborated by a former Clayton employee. ¶130.

The BAC Defendants argue that the quotes from this former Clayton employee "should be stricken or disregarded" because they were taken from a "complaint filed by AIG." BAC Br. at 24-25. A majority of decisions from courts in this district, however, hold to the contrary and permit such use of other complaints. *See, e.g.*, *S.E.C. v. Lee*, 720 F.Supp.2d 305, 340-41 (S.D.N.Y. 2010); *Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC*, 376 F.Supp.2d 385, 395 (S.D.N.Y. 2005); *de la Fuente v. DCI Telecomms., Inc.*, 259 F.Supp.2d 250, 260 (S.D.N.Y. 2003); *Tabor v. Bodisen Biotech, Inc.*, 579 F.Supp.2d 438, 454 (S.D.N.Y. 2008). Therefore, the BAC Defendants' request to strike or disregard these allegations should be denied.

In addition to misrepresenting the quality of mortgages originated by BAC and its legacy mortgage origination businesses, the BAC Defendants' created the false impression that BAC had resolved the problem of the toxic Countrywide assets by writing down the value of the acquired mortgage loan portfolio. ¶¶255, 258. These statements were materially misleading by failing to disclose that billions of dollars of the same type of toxic assets had been securitized and sold as MBS, and that BAC had received repurchase demands from purchasers of these MBS, and many more were likely to be made.

Moreover, BAC's reliance on MERS resulted in breaches of representations and warranties concerning good title because (a) BAC and its legacy entities routinely failed to physically deliver the original promissory notes and security instruments for the mortgage loans to the trusts created to hold the MBS, as the law required; (b) BAC and its legacy entities routinely failed to execute valid endorsements of the notes at the time of their claimed transfer, as the law required; and (c) trusts created to hold these obligations did not possess good title to many of the loans and lacked legal authority to foreclose on mortgages in the event of a default. ¶107.

While the BAC Defendants point to representations that the Company's reserves for representation and warranty claims increased over the Class Period, the Complaint alleges that BAC systematically by-passed internal controls in establishing allowances for representation and warranty claims. At the direction of Moynihan, BAC did not record an allowance for such claims until the Company received a formal demand through the trustee or notice that litigation had been filed, contrary to industry practice and in violation of GAAP. *See* ¶136(d). Moreover, because the BAC Defendants by-passed internal controls in making these determinations, as discussed in sub-section 3 below, the stated reserves were inherently unreliable. ¶136(n). On the investor call following the release of BAC's fourth quarter 2009 financial results, Price falsely implied that BAC had no representation and warranty exposure to private purchasers of MBS. ¶21 ("[P]rivate representation and warranty claims were generally 'unenforceable' and that the analysts should not put private claims on their 'radar screen.'").

The BAC Defendants' argument that BAC adequately disclosed it receives repurchase claims for breaches of representations and warranties must be rejected. While BAC's disclosures treated repurchase claims as a routine business risk, such as would be faced by any large financial institution, in fact, BAC faced extraordinary and unique exposure as a result of its sales of what effectively amounted to a defective product – MBS backed by mortgages that had a high likelihood of default, coupled with defects in the chain of title. *See Citigroup*, 753 F.Supp.2d at 239-40. By concealing the extent of BAC's exposure to representation and warranty claims, and misrepresenting the quality of its mortgage loans, the BAC Defendants were able to forestall repurchase demands from purchasers of MBS backed by pools of mortgages of similar vintages and quality to those for which representation and warranty claims had been made. *See* the October 18, 2010 PIMCO Repurchase Demand referenced in ¶159, a copy of which is attached to the Declaration of Mark R. Rosen ("Rosen Declaration") as Exhibit 1. This demand makes clear that BAC's Countrywide unit knew that mortgage loans in the collateral pools for MBSs purchased by the PIMCO Group were in breach of representations and warranties made in connection with the securitizations, and Countrywide had a duty to notify the bond purchasers of the breaches. But, according to the PIMCO Group, "[a]lthough there are tens of thousands of loans in the MBS pools that secure the Certificates, the Trustee has advised the Holders that the Master Servicer has *never* notified it of the discovery of *even one* mortgage that violated applicable representations and warranties at the time it was purchased by the Trusts." *Id.* at 2 (emphasis in original.).

Despite the disclosures defendants cite, the market was stunned when BAC revealed that it had received a repurchase demand on October 18, 2010 from the PIMCO Group for $47 billion. ¶159. And on October 19, 2010, the market learned that BAC had previously received more than $26 billion in repurchase claims, it expected another $9 billion in repurchase claims from GSEs alone, and that it "could not give an estimate of its total potential exposure." ¶162.

3. Misstatements and Omissions Regarding BAC's Internal Controls

The Complaint alleges that the use of MERS resulted in internal control problems and false certifications of internal controls by the BAC Defendants. *See* ¶¶89-93, 193-94. The BAC Defendants argue that these allegations should be dismissed because the regulations cited in the Complaint pertain only to financial controls and not "operational controls." BAC Br. at 25. The BAC Defendants are wrong. BAC's reliance on MERS certainly has financial statement implications. To the extent MERS does not effectively transfer title, as a number of courts have determined, this calls into question whether a substantial portion of the "mortgage loans" on BAC's balance sheet are properly listed as assets. But, in any event, the SEC regulations governing the internal control certification required by Section 404 of the Sarbanes Oxley Act expressly discuss two types of internal controls: "disclosure controls," 17 C.F.R. § 240.13a-15e and 17 C.F.R. § 240.15d-15e, and "controls over financial reporting," 17 C.F.R. § 240.13a-15f and 17 C.F.R. § 240.15d-15f. MERS was intended to serve as a disclosure control by enabling BAC to track, and therefore disclose, the dollar value of mortgages on its books. As the Complaint alleges, however, because MERS was ineffective in tracking the "mortgage loans" for which BAC had valid, enforceable mortgage liens, BAC's reliance on it undermined the reliability of BAC's financial statements and other disclosures. ¶290.

The BAC Defendants also contend that the fact that senior executives of the Company regularly bypassed the internal procedure set up to determine repurchase allowances is not an internal control weakness because "such estimates are highly judgmental." BAC Br. at 26. This completely misses the point. Making reserve estimates unilaterally by senior management, in blatant contravention of procedures designed to ensure accuracy and reliability, is a paradigm example of a weakness in internal controls, regardless of whether the estimate is "highly judgmental." *See S.E.C. v. Spiegel, Inc.*, 2003 WL 22176223 at *101 (N.D. Ill. Sept. 15, 2003) (discussing Statement on Auditing Standard No. 60, AU 325); *Matrix Capital Mgt. Fund, LP v. BearingPoint, Inc.*, 576 F.3d 172, 199 (4th Cir. 2009) (concurring opinion).

4. Defendants' Statements are Not Protected Under the PSLRA's Safe Harbor

Finally, the BAC Defendants argue that a single paragraph from the Complaint, ¶255, contains a "forward-looking statement" that is shielded from liability under the PSLRA's "safe harbor" provision. BAC Br. at 26. But this statement by Moynihan is clearly more than a prediction. While Moynihan talks about "the trends that we'll discuss over the next few quarters," he also refers to current "results … Decreasing charge-offs, potential reserve releases, and those types of things that dominate the credit discussion." ¶255. He states more clearly: "With legacy asset write-downs ***now*** down to an immaterial amount … that also ***shows*** the worst of the crisis is behind us we believe." *Id.* (emphasis added). Moreover, Moynihan's statement was not preceded by meaningful cautionary language. To take advantage of the safe harbor, the cautionary language "must relate directly to that by which plaintiffs claim to have been misled." *Hunt v. Alliance North Am. Gov't Income Trust, Inc.*, 159 F.3d 723, 729 (2d. Cir. 1998); *see also In re Prudential Sec. Ltd. P'ships. Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996). Here, defendants merely provided a general disclaimer at the beginning of the conference call that did not specifically address Moynihan's issues.

5. All BAC Defendants Made a False or Misleading Statement

The BAC Defendants' argument that the Complaint fails to allege that each of the BAC Defendants made a false statement is without merit. First, each BAC Defendant was, at some point during the Class Period, a senior executive of the Company liable for false statements in its SEC filings and press releases under the "group pleading" doctrine. The group pleading doctrine allows a plaintiff "for pleading purposes only, to rely on a presumption that statements in prospectuses, registration statements, annual reports, press releases, or other group-published information, are the collective work of those individuals with direct involvement in the everyday business of the company." *Freudenberg v. E*Trade Fin. Corp.*, 712 F.Supp.2d 171, 195-196 (S.D.N.Y. 2010).

In addition, the Complaint identifies the speaker of numerous misstatements pleaded. *See, e.g.,* ¶21 ("Defendant Price had told analysts during BAC's fourth-quarter 2009 earnings conference call held on January 20, 2010 that private representation and warranty claims were generally 'unenforceable' and that the analysts should not put private claims on their 'radar screen.'"). BAC, its CEOs (Lewis and Moynihan), and its CFOs (Price, Cotty and Noski) told market participants that the Company's systems of controls were effective throughout the Class Period and they had sufficiently tested, and appropriately attested to, the effectiveness of the Company's internal controls. *See* ¶¶88, 184, 193-95 (Lewis and Price), 203-04 (same), 214-15 (same), 226-27 (same), 250-51 (Moynihan and Cotty), 263-64 (same), 274-75 (Moynihan and Noski). The Complaint specifically alleges which BAC Defendants sought to disabuse investors of any concerns about foreclosure moratoriums and the perceived risks related to representation and warranty claims. *See* ¶¶207-210 (Price's misstatements during the July 17, 2009 earnings conference call), 219-222 (Price's misstatements on October 16, 2009 Earnings Conference Call), 254-260 (misstatements by Moynihan and Cotty on the April 16, 2010 Earnings Conference Call).

B. THE COMPLAINT PLEADS THE BAC DEFENDANTS' SCIENTER

Ignoring most of the facts alleged that present a compelling picture of intentional or reckless misconduct, the BAC Defendants focus their efforts on showing that the allegations of scienter are not plausible. Under *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007), an inference of fraud need not follow irrefutably from the facts alleged or even be the most plausible inference. It is enough that it be as plausible as an inference of innocent behavior. *Id.* Here, given defendants' pattern of conduct, their detailed knowledge of the problems facing BAC, and their need to avoid disclosing BAC's deepening exposure to repurchase claims, the inference of fraud is far stronger than just plausible.

1. A Strong Inference of Intentional Misconduct or Recklessness is Alleged

Scienter may be pleaded by allegations that create a strong inference of intentional misconduct or recklessness. *Novak v. Kasaks,* 216 F.3d 300, 307 (2d Cir. 2000); *see also Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190, 195 (2d Cir. 2008). Here, the Complaint sufficiently pleads scienter by alleging with particularity that the BAC Defendants engaged in conduct to further the fraud. For example, the BAC Defendants deliberately circumvented established procedures and internal controls in establishing allowances for repurchases by making these decisions themselves rather than through the Allowance Committee, which was established for this purpose. ¶¶136(c), 136(n). This is strong evidence of scienter. *See U.S. v. McCall*, 441 Fed.Appx. 515, 2011 WL 2620438, at *15 (9th Cir. Oct. 20, 2011); *Hall v. Children's Place Retail Stores, Inc.*, 580 F.Supp.2d 212, 232-33 (S.D.N.Y. 2008).

In addition, as BAC's CEO, Moynihan took an extremely aggressive policy to fight each repurchase claim, ¶136(d); BAC deliberately kept repurchase reserves low so as not to encourage other repurchase claims. ¶136(f). *See In re Omnicom Group, Inc. Sec. Litig.*, 2005 WL 735937, at *14 (S.D.N.Y. March 30, 2005) (intentional violation of GAAP is evidence of scienter). And BAC engaged in or tolerated fraudulent practices on a massive scale for the purpose of covering up known title deficiencies resulting from its use of the MERS system, such as "robo-signing" of mortgage affidavits and filing numerous affidavits or other mortgage-related documents that were not properly notarized, including those not signed or affirmed in the presence of a notary. ¶¶83, 175.

BAC failed to notify MBS purchasers that mortgages in the securitization pools were in breach of representations and warranties, as it was required to do under the MBS Pooling and Servicing Agreements. ¶162; *see also*, the PIMCO Repurchase Demand, Rosen Decl., Exh. 1, at 2. In addition, BAC refused requests by government agencies and MBS purchasers to examine loan files, ¶326, while it was concealing from the public and investors its "substantial" use of MERS and the extent of repurchase claims until forced to make disclosures as a result of pressure from governmental entities and the disclosure by third parties of investigation results. *See* ¶¶148, 155-59.

The Complaint pleads with particularity that the BAC Defendants knew and failed to disclose facts relevant to BAC's exposure to representation and warranty and repurchase claims. *See, e.g.*, ¶¶101; 115; 120; 124-25; 133; 136(c), (e), (i), (j)-(m). These allegations, together with the others in the Complaint, are sufficient to plead the BAC Defendants' scienter. *See New Orleans Employees Ret. Sys. v. Celestica*, 2011 WL 6823204, at *2 (2d Cir. Dec. 29, 2011); *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 73 (2d Cir.2001).

Contrary to defendants' contention (BAC Br. at 2, 18-21), the allegations that the Complaint attributes to confidential sources are sufficient to support the claims made because the Complaint's "descriptions of these persons are sufficiently particular . . . to sustain [plaintiff's] burden on a motion to dismiss." *Celestica*, 2011 WL 6823204, at *2 (citing *Novak*, 216 F.3d at 314). The Complaint describes all eight confidential witnesses cited "with sufficient particularly to support the probability" that these witnesses knew the information alleged, *Novak*, 216 F.3d at 314, and describes the confidential witnesses' positions and sources of their knowledge in detail. *See* ¶83 (CW-1); ¶89 (CW-2); ¶¶115-120 (CW-3); ¶121 (CW-4); ¶133 (CW-5); ¶134 (CW-6); ¶136(g) (CW-7); ¶136(i) (CW-8). The facts presented by these sources specify with particularity the reports the BAC Defendants received, s*ee, e.g.*, ¶¶123-24, 136(d),(e),(j)-(m), and the facts these reports contained that were contrary to BAC's public disclosures. *Compare, e.g.*, ¶¶89-90 with ¶¶106, 176 (faulty internal controls due to MERS); ¶¶130, 133, 136(a), (c), (d), (m) (n) with ¶¶182, 190 (faulty internal controls and misrepresentations regarding representation and warranty claims). The Complaint thereby adequately alleges facts provided by these confidential witnesses. *See Celestica*, 2011 WL 6823204, at *2; *Scholastic Corp.*, 252 F.3d at 73.[6] It also specifies the information in reports or forecasts presented to top management. *See, e.g.*, ¶¶123-24, 133, 136(c), 136(i), 136(j)-(m). These allegations are sufficient for the Court to consider the evidence presented by these confidential sources. *See Celestica*, 2011 WL 6823204, at *1-2.

The Complaint provides additional facts supporting a strong inference that the BAC Defendants intentionally concealed the extent of BAC's repurchase exposure. While BAC had

[6] Defendants' reliance on *Local No. 38 Intern. Broth. of Elec. Workers Pens. Fund v. American Exp. Co.*, 724 F.Supp.2d 447, 461-62 (S.D.N.Y. 2010), and *In re Am. Express Co. Sec. Litig.*, No. 02 Civ. 5533 (WHP), 2008 WL 4501928, at *7 (S.D.N.Y. Sept. 26, 2008), is misplaced. Those cases hold that information from confidential witnesses showing defendants' awareness of facts that are inconsistent with their public statements is probative of defendants' scienter. The facts provided by the confidential witnesses, taken together, do just that.

far more exposure to these demands than any other bank because, following its acquisitions of Countrywide and Merrill Lynch, it had the largest market share in MBS securitizations of any major bank, *see* ¶149, BAC nevertheless accrued reserves for repurchase claims at a level substantially lower than its peers. ¶136(f). In fact, after the fraud was revealed in October 2010, BAC radically increased its allowance for these repurchase demands in 2011. ¶¶166-174.

Finally, the size of the concealed liability in this case is strong circumstantial evidence of scienter. While the BAC Defendants assured analysts in January 2010 that they should not even put private repurchase claims on their radar screens, ¶21, by October of that year they revealed that they had received a repurchase claim from one group of private MBS purchasers for $47 billion and that there were billions of additional claims outstanding. These facts strongly suggest concealment of this exposure during the Class Period. *See In re Leslie Fay Companies, Inc. Sec. Litig.*, 835 F. Supp. 167, 175 (S.D.N.Y. 1993) (when "tidal waves" of fraud are alleged, "it may be determined that the [defendants'] failure to discover [the] fraud raises an inference of scienter on the face of the pleading."); *accord In re MTC Elec. Technologies S'holders Litig.*, 898 F. Supp. 974, 989 (E.D.N.Y. 1995). Here, the fraud resulted in what one press report described as a "tsunami" of repurchase claims. *See* ¶162.

2. The Fraudulent Scheme Alleged Is Plausible and Cogent

The BAC Defendants make a number of arguments attacking as implausible the allegation that they were motivated to conceal the threat to BAC's financial condition out of a desire to repay the $45 billion in TARP loans from the federal government. These attacks are misguided. While the TARP motive is one fact to be considered as supporting the BAC Defendants' scienter, the Supreme Court has mandated that courts should not scrutinize each allegation in isolation but assess all the allegations holistically. *Tellabs*, 551 U.S at 326. Even if the Court were to reject the motive allegations alleged in the Complaint (which it should not), "the absence of a motive allegation is not fatal.… [A]llegations must be considered collectively; the significance that can be ascribed to an allegation of motive, or lack thereof, depends on the entirety of the complaint. *Id.*, 551 U.S. at 325. Here, Lewis' own statements make it perfectly clear that repaying the TARP loans was a strong motivation. *See* ¶¶65-66. Regardless of whether the alleged desire on the part of BAC to repay the TARP loans is sufficient to establish scienter, it cannot be discounted as implausible.

The BAC Defendants argue that the alleged fraud is implausible because "the allegedly concealed information about operational problems that would flow from the use of MERS and the exposure to repurchase claims was allegedly known for years before the TARP repayment motive was formed." BAC Br. at 14. Virtually all of the materials the BAC Defendants cite to support this argument, however, are neither quoted in the Complaint nor relied upon therein, and are therefore not appropriate for judicial notice. Accordingly, these materials should not be considered by the Court. *Tellabs*, 551 U.S. at 322; *Rothman v. Gregor*, 220 F.3d 81, 88 (2d Cir. 2000).[7]

But even if these materials were considered by the Court, they would show, at best, that challenges had been raised to MERS in certain instances, some of which had been successful and some not. As Bongiorno Decl. Exhs. T, X, and Z themselves state, MERS was providing the market with "reliable words of comfort" that lawsuits challenging it were without merit. *Newman v. Warnaco Gr., Inc.*, 335 F.3d 187, 194 (2d Cir. 2003). Such statements "discounting the possibility of malfeasance" or "allaying investors' concerns" make it clear that BAC investors were not put on notice of the fraud. *Alaska Elec. Pens. Fund v. Pharmacia Corp.*, 554 F.3d 342,

[7] *See also* letter from Jeffrey A. Barrack, Esq. to the Court requesting a pre-motion conference with regard to Lead Plaintiff's proposed Motion to Strike ("Barrack Letter"), Rosen Decl, Exh. 2.

350 (3d Cir. 2009); *In re Merck & Co. Sec. Litig.*, 543 F.3d 150, 167 n.14 (3d Cir. 2008). Indeed, the BAC Defendants argue that the lawsuits challenging MERS "do not involve a wholesale rejection of the MERS system" and "in no case did a court hold that the owner of a loan could not foreclose or file a proof of claim [in bankruptcy]." BAC Br. at 6. In any event, none of these materials reveals the facts disclosed after the end of the Class Period regarding the extensive use of MERS by BAC and Countrywide (¶¶148, 155-59), the failure of BAC and its legacy banks to control whether MERS was being used properly (¶¶89-92), or the likely implication on BAC's financial condition if MERS was determined to be ineffective in transferring title. ¶162. In particular, neither the lawsuits nor the articles defendants point to discuss the extent to which BAC relied on MERS or the implications on potential representation and warranty claims. Likewise, the news articles discussing decisions disallowing foreclosures by MERS rendered in 2008 by one New York state court judge did not disclose BAC's wholesale reliance on MERS and the resulting implications that the decision would have on BAC. *See Litwin v. Blackstone Group, L.P.*, 634 F.3d 706, 718-19 (2d Cir. 2011).

The BAC Defendants argue that BAC's "affiliates" use of MERS was "routinely disclosed" in MBS prospectus supplements. The only examples cited by the BAC Defendants, however, are not from any BAC SEC filings. One is from a Countrywide subsidiary from 2006, before BAC acquired Countrywide, and the other is from a BAC indirect subsidiary. Both of these were issued in connection with the sale of mortgage pass-through certificates. As noted in *Countrywide*, 588 F.Supp.2d at 1160, in rejecting the argument that disclosures in such documents established a "truth-on-the-market" defense, securitization prospectuses are intended for private purchasers, not public markets, and are insufficient to compensate for the Company's failure to make full disclosure in documents likely to affect the market price of BAC's publicly traded securities. It is uncontroverted that BAC itself never disclosed its use of MERS ***to shareholders or investors*** during the Class Period.

In any event, neither the extrinsic materials submitted by defendants nor BAC's disclosures undermine the plausibility of the fraud alleged here. Even if the extrinsic materials did show that the market was aware of problems with MERS and of potential repurchase claims prior to the Class Period, the BAC Defendants were in a unique position to understand the magnitude of these problems as, by the start of the Class Period, the "Great Recession" deepened, mortgage defaults increased, and BAC received an increasing number of repurchase demands. Additionally, by early 2009 adverse decisions regarding MERS from courts around the country increased. *See* ¶85. Thus, by the beginning of the Class Period, the BAC Defendants' awareness of the magnitude of the problems facing BAC had increased, as did the materiality of these problems and the imperative of disclosing them. These events coincided with the TARP bailout and the stated desire of the BAC Defendants to repay these loans as quickly as possible, to regain control over BAC's compensation decisions. ¶¶65, 66. Clearly, there is nothing implausible about the allegation that BAC's desire to raise capital to repay the TARP loans motivated the BAC Defendants to conceal BAC's known and potential exposure to repurchase claims, which would make raising the needed capital much more difficult, if not impossible.

The BAC Defendants rely on *Cervantes v. Countrywide Home Loans, Inc.*, 656 F.3d 1034 (9th Cir. 2011), to support their argument that the theory of this case is implausible. But defendants misread *Cervantes.* While that case did ***not*** decide whether MERS, or a transferee of a mortgage recorded through MERS, could foreclose on such a mortgage, the court did in fact recognize that other courts had disallowed foreclosures by MERS. *See* 656 F.3d at 1044. In any event, the argument that *Cervantes* has now somehow validated BAC's use of MERS ignores BAC's October 2010 suspension of all foreclosure activity due to questions raised about MERS. And it is contradicted by Moynihan's admission on October 19, 2010 that "you needed to take title in your own name prior to foreclosing out of MERS." ¶155. Whether or not BAC is ultimately able to deal with the "technical issue," as Moynihan termed the MERS problem, and find a way to foreclose on properties registered in MERS's name, the "technical issue" of title to mortgage loans transferred by MERS had, and continues to have, enormous implications for BAC's exposure to repurchase claims for breach of representation and warranty of title. *See* ¶¶158, 159, 161, 162, 167.

The BAC Defendants additional attempts to impugn the plausibility of the alleged fraud are easily answered. First, the BAC Defendants contend that BAC disclosed certain repurchase claims and that reserves for future repurchase payments increased over the course of the Class Period. Although BAC did make disclosures regarding certain repurchase requests it had received during the Class Period from GSEs such as Freddie Mac and Fanny Mae, it failed to disclose such requests from purchasers of "private label" MBS such as the PIMCO Group or the effect of its use of MERS on repurchase claims. ¶¶162, 115. Moreover, it failed to disclose its withholding of information about representation and warranty violations from MBS purchasers in order to suppress repurchase claims.

The BAC Defendants further argue that the fact that its senior executives received no bonuses in 2009 and that three of the five individual defendants were not in their positions at the time the TARP repayment motive was formulated undercuts the TARP repayment motive. These arguments miss the point. Defendants' stated time frame for repaying the TARP funds was by the end of 2009, which would enable BAC to regain control of executive compensation the next year, *i.e.*, in 2010. Therefore, the fact that BAC did not pay bonuses for 2009 is irrelevant. By repaying the TARP loans at the end of 2009, BAC was able to increase the compensation of newly hired or promoted executives in 2010. This included Defendant Moynihan, whose total compensation increased by 67% from $6 million for 2009 to $10 million for 2010. This contrasts with the zero dollars total compensation that his predecessor as CEO, Defendant Lewis, earned for 2009. *See* BAC 2011 proxy statement at 28, Musoff Decl., Exh. H. Moreover, BAC's stated purpose of repaying the TARP loans was to enable the Company to attract and maintain qualified executives going forward. This included promoting Moynihan from General Counsel to CEO, with a large increase in total compensation, promoting Price to CAO and Defendant Cotty to CFO, and hiring Defendant Noski. Noski and Cotty, who are not listed in the 2010 proxy statement because they were not named executive officers during 2009, received $6.5 million and $4.5 million respectively in total compensation for 2010.

In any event, whether or not the Complaint adequately alleges an actionable motive is not dispositive of allegations of scienter. *See Tellabs*, 551 U.S. at 325. Although increasing executive compensation through maintaining a high stock price has been held ordinarily to be insufficient, by itself, to demonstrate scienter, courts have found that a defendant's desire to maintain a company's stock price is can be an indicator of fraud when the financial benefit from maintaining the stock price is "unique and substantial." *See In re WorldCom, Inc. Sec. Litig.*, 294 F.Supp.2d 392, 416 (S.D.N.Y. 2003). Here, the motivation to repay the $45 billion of TARP loans, coupled with the need to conceal BAC's growing problems, presented such a unique and substantial motive to perpetrate fraud.

The BAC Defendants next argue that it would be economically irrational to continue to use the MERS system, despite knowing of its flaws, when they knew it would be difficult or impossible to foreclose on mortgages registered using MERS. This argument amounts to nothing more than defense by hindsight. Most of the mortgages that were titled or transferred using MERS were originated in the period from 2004 through 2007, when foreclosures were relatively uncommon because rapidly rising housing prices allowed borrowers in financial difficulty to dispose of mortgaged properties for a profit. Prior to the onset of the financial crisis, there was very little evidence suggesting that the use of MERS would create problems with transferring title, and any risk that existed was outweighed by the cost savings and efficiencies that MERS achieved. However, by late 2008, before the start of the Class Period, once the deepening recession caused an upsurge of mortgage defaults and an attendant increase in foreclosure activity, the MERS problems became much more apparent to defendants. This was the same time frame in which BAC received $45 billion in TARP funds.

In sum, the detailed and extensive allegations of the BAC Defendants' conduct, knowledge, and motives, taken as a whole, can most plausibly be explained as demonstrating their intent to defraud or extreme recklessness. Thus, the Complaint adequately pleads scienter. *See Tellabs*, 551 U.S. at 311-313.

II. THE COMPLAINT STATES A CLAIM FOR VIOLATION OF SECTION 11

Defendants are liable under Section 11 of the Securities Act for the materially false statements and omissions in the Registration Statement and documents incorporated therein, including BAC's 2008 10-K (the "Offering Materials") for BAC's $19 billion December 2009 CES public offering.

A. The Complaint Adequately Alleges Each Defendant's Securities Act Liability

1. BAC, the Individual Defendants and the Underwriters

The liability of BAC, as the issuer of the CES "is virtually absolute." *Herman &*

MacLean v. Huddleston, 459 U.S. 375, 382 (1983). The Director Defendants, as well as Price, either signed the 2009 Registration Statement or served on the BAC Board at the time of the CES offering, thereby subjecting them to liability under Section 11 for the false and misleading statements in the Offering Materials. ¶¶360, 369-370. As set forth in ¶¶ 36-37, 44-53, 183-196, and 364-373, each of the Underwriter Defendants was an "underwriter" pursuant to §2(11) of the Securities Act for BAC's 2009 CES offering, and was therefore responsible for the material misrepresentations and omission in the Complaint. ¶¶361, 378. The Complaint alleges that these defendants failed to conduct a reasonable investigation and did not possess reasonable grounds for believing that the statements made in the Offering Materials were true, did not omit any material fact, and were not materially misleading. ¶¶369, 378, 381. The Complaint thus adequately alleges a claim under Section 11 against the Director Defendants and Defendant Price, *see, e.g., In re Citigroup Inc. Bond Litig.*, 723 F.Supp 2d 568, 587-95 (S.D.N.Y. 2010), and the against the Underwriters. *see AIG*, 741 F.Supp.2d at 539-41; *In re WorldCom, Inc. Sec. Litig.*, 346 F.Supp.2d 628, 689 (S.D.N.Y. 2004).

2. The Complaint States a Section 11 Claim Against PWC.

Plaintiffs' Section 11 claim against PwC is premised on false and misleading statements and omissions in BAC's 2008 10-K, the financial statements and accompanying notes, discussed in Section IA above, which were incorporated in the Offering Materials for BAC's December 2009 CES offering.[8] The Complaint alleges that PwC's certification of BAC's 2008 financial statements was materially untrue and/or misleading. An auditor may be liable under Section 11

[8] PwC argues that, because it did not provide a new consent for inclusion of its audit opinion in the prospectus supplements in connection with the CES offering, it can be liable only for facts as they existed in April 2009 when BAC's shelf registration statement became effective. But because the Complaint alleges the falsity of PwC's Feb. 25, 2009 audit opinion on BAC's 2008 financial statements, which was included in the Registration Statement with PwC's consent, ¶391, whether PwC is liable for any post-April 2009 statements is irrelevant.

for an untrue or misleading statement of material fact in an audit opinion that is included in a registration statement with the auditor's consent. *E.g., In re CINAR Corp. Sec. Litig.*, 186 F.Supp.2d 279, 310-11 (E.D.N.Y. 2002); *see also* 15 U.S.C. § 77k(a)(4).

The materiality of an accountant's statement or omission can be established through violations of GAAP or PCAOB auditing standards, [9] and Lead Plaintiff alleges that both were violated here. ¶¶277-308. Despite the obligations GAAP and PCAOB auditing standards imposed on PwC, PwC failed to find or, at the least, failed to require BAC to disclose in its 2008 10-K, material information that was required to be included in the financial statements to prevent them from being false and misleading.

Notwithstanding these failures, PwC claims that Lead Plaintiff has not established a duty on the part of PwC to disclose the omitted information. PwC is wrong. First, PwC's audit opinion stated affirmatively – and falsely – that BAC's financial statements were presented in conformity with GAAP, that PwC's audit was conducted in accordance with PCAOB auditing standards, and that BAC's internal controls were effective. ¶292. Second, at this stage, Lead Plaintiff need only plead that the omission was material and that PwC consented to the inclusion of the audited statements and footnotes thereto, and its audit reports, in the Offering Materials, which Lead Plaintiff has done. *See In re CINAR*, 186 F.Supp.2d at 310-11. Moreover, any resolution of Lead Plaintiff's allegations of GAAP and PCAOB violations is inappropriate on a motion to dismiss. *See, e.g., AIG*, 741 F.Supp.2d at 541.

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[9] Financial statements that violate GAAP are presumed misleading. *See* 17 C.F.R. § 210.4-01(a)(1). Thus, when an accountant certifies a financial statement that violates GAAP, that certification can render the accountant liable under Section 11. *In re WorldCom, Inc. Sec. Litig.*, 352 F.Supp.2d 472, 492 (S.D.N.Y 2005). Similarly, a representation in a registration statement that an audit was conducted in accordance with PCAOB standards can be a false statement under Section 11 if the auditor failed to comply with such standards. *See, e.g., In re Metropolitan Sec. Litig.*, 532 F.Supp.2d 1260, 1294 (E.D. Wa. 2007).

PwC also argues that the allegations regarding accounting for contingent losses under accounting standard FAS 5 (*see* ¶284) are insufficient because these allegations are "grounded in hindsight" and "concern losses that a company might incur in the future." PwC Br. at 11-15. These allegations are not grounded in hindsight, however, but rather relate to losses incurred by BAC before and during the Class Period. ¶¶14, 99, 104-109, 112-114, 126-131, 137-41. As such, PwC's reliance on the clearly distinguishable facts of *Charter Twp. of Clinton Police & Fire Ret. Sys. v. KKR Fin. Holdings, LLC*, 2010 WL 4642554 (S.D.N.Y. Nov. 17, 2010), is misplaced, and this argument should be rejected.

PwC's reliance on *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011), is misplaced. Here, the omissions and misstatements in BAC's audited financial statements are matters of objective, existing fact, rather than the type of forward-looking estimates that were at the heart of *Fait*. PwC incorrectly construes *Fait* to compel the dismissal of all Securities Act claims that involve any application of judgment, no matter what type of judgment is involved, unless the plaintiff pleads that the defendant making the statement actually disbelieved that the statement was true. But some degree of judgment is involved in most, if not all, disclosures required by the securities laws. As such, PwC's expansive reading of *Fait* is in direct conflict with binding Supreme Court precedent. *See Herman & MacLean*, 459 U.S. at 382 ("Liability [under Section 11] against the issuer of a security is virtually absolute, even for innocent misstatements. Other defendants bear the burden of demonstrating due diligence."); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 208 (1976).

Further, the Second Circuit was quite explicit about the limited scope of its holding. *Fait*, 655 F.3d at 106. The goodwill and loan loss reserves involved in *Fait* belong to that category of accounting issues that not only involve disclosure but also involve estimating values to be recorded on the company's books. While goodwill and loan loss reserve estimates at issue in *Fait* are necessarily forward-looking, the accounting statements and omissions on which defendants' liability in this case is based involve only arithmetically quantifiable amounts and narrative risk disclosures that BAC was required, but failed, to make.[10]

PwC's argument that Lead Plaintiff's allegations regarding BAC's GAAP violations somehow bring its claims under the purview of *Fait* is also without merit. As the Complaint alleges, *see* ¶283, BAC was required under FIN 45 to disclose, among other things, guarantees in the form of repurchase commitments for breaches of representations and warranties and, for those guarantees, to disclose "the *maximum potential amount* of future payments (undiscounted) that the guarantor could be required to make under the guarantee," which BAC failed do. ¶283. Determining the *maximum* potential amount of future payments for repurchase claims in this case did not require estimation; it simply required an arithmetic computation based upon the terms of the MBS contracts. Similarly, *Fait* does not apply to the Complaint's claim that the Offering Materials violated FAS 5. As the Complaint makes clear, *see* ¶284, although FAS 5 deals, in part, with loss reserves, the Complaint does not challenge BAC's loss reserve estimates. Instead, the claim here is based on the provision in FAS 5 that requires *disclosure* when there is a "reasonable possibility" that further losses over and above stated reserves might have occurred. BAC failed to disclose such a "reasonable possibility," and this claim does not implicate the concerns addressed in *Fait*. ¶284.

[10] The Complaint makes abundantly clear that the claims asserted are premised on Defendants' failure to disclose facts existing at the time that BAC filed its audited financial statements, rather than the type of challenge at issue in *Fait* to forward-looking estimates or reserves future liabilities. In fact, the Complaint here explicitly states that while the material weaknesses alleged "made it likely that BAC in fact misstated the amount of loan repurchase accruals, these allegations are not intended to state or support a claim based on the misstatement of loan loss reserves." ¶136.

B. The Securities Act Claims are Not Subject to a Heightened Pleading Standard

The Complaint carefully and systematically segregates the allegations applicable to the Exchange Act counts from those applicable to the Securities Act counts, and Lead Plaintiff repeatedly makes clear that its Securities Act claims are not premised *at all* on any allegations of fraud or fraudulent intent. *See* ¶¶28-29, 353-356, 364, 369, 374, 378-81, 387, 392, 398. Furthermore, many of the defendants in the Securities Act claims – the Director Defendants, Underwriter Defendants, and PwC – are not even named as defendants in the Exchange Act claims in the Complaint, ***as PwC itself concedes***. PwC Br. at 4. Thus, the Securities Act counts constitute the equivalent of a stand-alone complaint.

This form of careful pleading of separate fraud-based and non-fraud based claims has been repeatedly sustained in lieu of filing separate complaints or subjecting the negligence-based claims to heightened pleading requirements. *See, e.g., AIG*, 741 F.Supp.2d at 537; *In re Refco, Inc. Sec. Litig.*, 503 F.Supp.2d 611, 631-33 (S.D.N.Y. 2007).[11] Because Lead Plaintiff pleaded its Securities Act claims separately from the Exchange Act claims, and, as to the former, alleges only strict liability and negligence-based misconduct, Rule 8 is the appropriate pleading standard.

C. The Securities Act Claims Were Timely

Section 13 of the Securities Act sets forth two relevant requirements for Section 11 claims: (a) pursuant to the "discovery rule," the claim must be brought within one year after the

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[11] Defendants' reliance on *Rombach v. Chang*, 355 F.3d 164 (2d Cir. 2004), and *In re JPMorgan Chase Sec. Litig.*, 363 F.Supp.2d 595 (S.D.N.Y. 2005), is misplaced. In *Rombach*, plaintiffs made repeated allegations of defendants' knowledge or reckless disregard of facts in establishing the basis for both their Securities Act and Exchange Act claims. *See Rombach* complaint ¶¶ 24-26, 28-30, 42, 64i-66i, 70i, 80i, 89i, 94i, 106i (attached as Exh. 3 to the Rosen Decl.) And in *JPMorgan* there is no indication that plaintiffs clearly and definitively separated the factual allegations relevant to Securities Act claims from the Exchange Act claims.

date when plaintiff discovered, or following the exercise of "reasonable diligence" should have discovered, the untrue statement or omission; and (b) in any event, the action may not be brought more than three years after the security was offered to the public. 15 U.S.C. § 77m. It is undisputed that the Complaint satisfies the second requirement, which constitutes a statute of repose, inasmuch as the CES were issued in December 2009 and the Complaint asserting Section 11 claims was filed on September 23, 2011.

As recent appellate decisions have made clear, the one-year-from-discovery period does not begin to run until the plaintiff discovered, or a reasonably diligent plaintiff would have discovered, sufficient information to plead an actionable claim. *See Merck & Co., Inc. v. Reynolds*, 130 S.Ct. 1784 (2010) (addressing statute of limitations under the Exchange Act); *City of Pontiac Gen'l. Employees' Ret. Sys. v. MBIA, Inc.*, 637 F.3d 169, 173-75 (2d Cir. 2011) (noting that *Merck* overturned the prior Second Circuit rule).[12] The majority of the courts in this District have applied *Merck*'s reasoning to the discovery rule in Securities Act claims. *See, e.g., Public Employees' Ret. Sys. of Mississippi v. Merrill Lynch & Co., Inc.*, 714 F.Supp.2d 475, 480 (S.D.N.Y. 2010); *In re Wachovia Equity Sec. Litig.*, 753 F.Supp.2d 326, 370-71 & n. 39 (S.D.N.Y. 2011). Under *Merck*, there can be no doubt that Lead Plaintiff's Securities Act claims are timely, given that the Complaint was filed on September 23, 2011, well within one year from the corrective disclosures that Lead Plaintiff alleges alerted the market to the materially misleading statements and material omissions in the Offering Materials. ¶¶147-62, 309-17.

Citing two cases issued without any detailed analysis, *In re IndyMac Mortgage-Backed Sec. Litig.*, 793 F.Supp.2d 637 (S.D.N.Y. 2011), and *In re Barclays Bank PLC Sec. Litig.*, 2011

[12] As this Court observed in construing the Exchange Act statute of limitations following *Merck*, "[t]his is not an 'inquiry notice' standard; the limitations period is not triggered merely upon knowledge of facts that would lead a reasonable person to 'begin investigating the possibility that his legal rights had been infringed.'" *In re Smith Barney Transfer Agent Litig.*, 765 F.Supp.2d 391, 400 (S.D.N.Y. 2011) (quoting *Merck*, 130 S.Ct. at 1797).

WL 31548 (S.D.N.Y. Jan. 5, 2011), however, defendants argue that the legal standards have not changed, and, therefore, the statute of limitations for Securities Act claims begins to run when a reasonably diligent plaintiff would have begun an inquiry into potential claims. But even under the now-rejected "inquiry notice" standard, defendants "bear a heavy burden in establishing that the plaintiff was on inquiry notice as a matter of law," *In re AOL Time Warner, Inc. Sec. & "ERISA" Litig.*, 381 F.Supp.2d 192, 209 (S.D.N.Y. 2004), and they are simply unable to meet this heavy burden based on the materials they have submitted here. "Inquiry notice exists ***only*** when ***uncontroverted*** evidence ***irrefutably*** demonstrates when plaintiff discovered or should have discovered" the misconduct. *AIG*, 741 F.Supp.2d at 538 (emphasis added); *see also Countrywide*, 588 F.Supp.2d at 1159. The Court of Appeals has repeatedly stressed that under this test, the existence of a claim "must be a probability, not a possibility," and that even when there are "ominous indicators" or storm warnings, investors "may not be considered to have been placed on inquiry notice because the warning signs are accompanied by reliable words of comfort from management." *Newman*, 335 F.3d at 194.

Here, the Complaint clearly contains allegations concerning both Lead Plaintiff's discovery of the misleading nature of defendants' statements and omissions, ¶¶147-162, and that Lead Plaintiff and the Class did not know, and in the exercise of reasonable diligence could not have known, of the misstatements and omissions in the Offering Materials, ¶¶371, 384, 395. This is sufficient to plead compliance with the Securities Act's statute of limitations, judged under the liberal pleading standard of Rule 8.[13]

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[13] Defendants dispute the factual allegations of the Complaint, ¶¶ 147-65, 309-17, and contend that decisions in other lawsuits, news articles, and SEC filings, including filings made on behalf of entities other than BAC, constituted "storm warnings" sufficient to put Lead Plaintiff on inquiry notice of its claims. This is simply not the case. Defendants' exhibits in no way relate "directly to the misrepresentations and omissions" Lead Plaintiff has alleged in the Complaint sufficient to trigger inquiry notice. *See, e.g., Pub. Employees Ret. Sys. of Miss. v. Goldman*

A finding on a motion to dismiss under Rule 12(b)(6) is appropriate *only* if the facts needed to make the determination can be gleaned from the complaint and papers integral to the complaint, *see, e.g., In re Alcatel Sec. Litig.,* 382 F.Supp.2d 513, 524 (S.D.N.Y. 2005). Even here, where defendants have ventured far outside the four corners of the Complaint and papers integral to the Complaint, nothing defendants have submitted is sufficiently related to the misrepresentations and omissions alleged to place Lead Plaintiff on "inquiry" notice. Thus, a dismissal of Lead Plaintiff's claims on statute of limitations grounds would be inappropriate at this stage of the case. *See, e.g., Staehr v. Hartford Fin. Serv. Group, Inc.* 547 F.3d 406, 412 (2d Cir. 2009).[14]

D. Defendants' "Negative Causation" Argument Is Baseless

The Securities Act Defendants cannot attack the Complaint for failure to plead loss causation because even they must admit that the plaintiff is not required to plead loss causation to state a Section 11 claim.[15] *See, e.g., In re Giant Interactive Group, Inc. Sec. Litig.*, 643 F.Supp.2d 562, 571 (S.D.N.Y. 2009). Indeed, this Court recently held that even in an Exchange Act case the plaintiff is not required to prove loss causation at the class certification stage. *In re SLM Corp. Sec. Litig.*, 2012 WL 209095, *5 (S.D.N.Y. Jan. 24, 2012).

Sachs Group, Inc., 2011 WL 135821, at *8 (S.D.N.Y. Jan. 12, 2011); *N.J. Carpenters Vacation Fund v. Royal Bank of Scot. Group*, PLC, 720 F.Supp.2d 254, 267 (S.D.N.Y. 2010); *see also* Barrack Letter, Rosen Decl, Exh. 2.

[14] Moreover, as noted above, "storm warnings" do not place investors on inquiry notice when accompanied by "reliable words of comfort from management" such that an investor of ordinary intelligence would reasonably have relied on the statements to allay his or her concern. *Newman*, 335 F.3d at 194. Defendants made such reassuring statements throughout 2010, including on an April 16, 2010 conference call, ¶255, and at the end of the Class Period. ¶148.

[15] Although the BAC Defendants state in the Preliminary Statement Section of their brief that the Section 10(b) claim fails because the Complaint does not adequately allege loss causation, they do not discuss this point further in the Argument section. For the reasons stated above, moreover, such an argument has no merit.

The absence of loss causation, or "negative causation," is an affirmative defense that defendants could attempt to use to reduce or avoid liability under Section 11. *Levine v. AtriCure, Inc.*, 508 F.Supp.2d 268, 272-273 (S.D.N.Y. 2007). Courts are understandably reluctant to dismiss cases based on this affirmative defense "[b]ecause an analysis of causation is often fact-intensive, negative causation is generally established by a defendant on a motion for summary judgment or at trial," *id.*, and as such this affirmative defense "is generally not properly raised on a Rule 12(b)(6) motion." *In re Giant Interactive*, 643 F.Supp.2d at 572.

Defendants inappropriately attempt to turn their motion to dismiss into a motion for summary judgment by making a fact-intensive argument that Lead Plaintiff has suffered no loss. *See* Underwriter Br. at 15-23. Even if consideration of this argument, and the supposedly supporting documents referenced therein, were appropriate at this stage of the proceedings, which it is not, *In re Giant Interactive*, 643 F.Supp.2d at 573 (refusing to consider documents outside the complaint in deciding the motion to dismiss), defendants' negative causation affirmative defense is baseless.

Section 11 creates a "factual presumption that any decline in value is…caused by the misrepresentation in the registration statement." *Levine*, 508 F.Supp.2d at 272. Lead Plaintiff has sufficiently alleged injury in connection with the purchase of BAC's CES that was a direct and proximate result of the untrue statements and omissions contained in the Offering Materials. *See, e.g.*, ¶¶370, 372, 383, 385, 390, 394, 396. Further, the Complaint contains detailed allegations of loss causation that are more plausible than, and in any event directly conflict with, defendants' misguided argument here. *See* ¶¶148 - 153, 313; 154-163, 314- 316 (detailing instances where disclosure of previous false and misleading statements caused a decline in BAC's stock price). This is sufficient to allege loss causation for purposes of a motion to dismiss. *See In re Gen'l Elec. Co. Sec. Litig.*, 2012 WL 90191, at *30 (S.D.N.Y. Jan. 11, 2012).[16]

III. CONTROL PERSON LIABILITY IS PROPERLY ALLEGED

Defendants seek to dismiss the claims of control person liability under Section 15 of the Exchange Act and Section 20(a) of the Securities Act on two grounds. First, they assert that the Complaint does not allege a primary violation, which is a necessary predicate for control person liability. As demonstrated, however, this challenge must fail, as the Complaint does state a claim for primary liability. Second, defendants argue that the Complaint does not allege their culpable participation. This argument too must fail. Control person liability under the Securities Act does not involve any element of culpable participation and, therefore, need not be pleaded as part of the *prima facie* 1933 Act claim. *See, e.g., In re Refco,* 503 F.Supp.2d at 637 n.24. As to the BAC Defendants, the Complaint not only alleges their participation directly in the day-to-day management of the Company, it alleges that each of them made statements or engaged in conduct that furthered the fraudulent scheme. These allegations are sufficient to establish culpable participation for purposes of the Exchange Act claims. *In re AOL,* 381 F.Supp.2d at 235.

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[16] *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 272 F.Supp.2d 243, 254 (S.D.N.Y. 2003), and *In re Britannia Bulk Holdings Inc. Sec. Litig.*, 665 F.Supp.2d 404 (S.D.N.Y. 2009), do not compel a different result. There, the courts permitted the affirmative defense of loss causation raised by defendants' Rule 12(b)(6) motion where the loss had occurred ***before any corrective disclosure.*** Similarly distinguishable are *In re State St. Bank & Trust Co. Fixed Income Funds Inv. Litig.*, 774 F.Supp.2d 584 (S.D.N.Y. 2011) (whether a mutual fund's manager's statements about the composition of the fund could, as a matter of law, have caused a plaintiff's losses), and *Amorosa v. AOL Time Warner, Inc.*, 409 Fed. Appx. 412 (2d Cir. 2011) (plaintiff had no statutorily compensable loss because the price of the stock rose after the alleged corrective disclosure).

IV. CONTINGENT REQUEST TO REPLEAD

It is settled that "leave to amend 'shall be freely given' in the absence of countervailing factors such as undue delay, bad faith or dilatory motive, undue prejudice to the opposing party, or futility of the amendment." *In re Alcatel,* 382 F.Supp.2d at 535 (citing Fed.R.Civ.P. 15(a) and *Foman v. Davis,* 371 U.S. 178, 182 (1962)). None of the aforementioned countervailing factors are present here. Although Lead Plaintiff submits that defendants' motions to dismiss should be denied, in the event that the Court grants the motions in whole or in part, Lead Plaintiff hereby seeks leave to replead.

CONCLUSION

For the reasons stated herein, the motions to dismiss should be denied in their entirety.

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Respectfully submitted,

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