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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

ANGELO MOZILO, DAVID SAMBOL, AND ERIC SIERACKI,

Defendants.

Case No. CV 09-3994 JFW (MANx)

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S OPPOSITION TO DEFENDANT ANGELO MOZILO'S MOTION FOR SUMMARY JUDGMENT REGARDING INSIDER TRADING ALLEGATIONS

Date: August 30, 2010
Time: 1:30 p.m.
Place: Courtroom 16
(Hon. John F. Walter)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

FEDERAL REGULATIONS

I. INTRODUCTION AND FACTUAL BACKGROUND

As CEO, Angelo was the public face of Countrywide and its biggest booster. And for years, he put his money where his mouth was – accumulating equity in Countrywide and insisting that for as long as he worked there, he would not sell any Countrywide stock except to the extent he was forced to do so by expiring purchase options.

In late 2006, however, Mozilo experienced a change of heart. During that year, Mozilo became aware of numerous red flags concerning Countrywide's deteriorating underwriting guidelines and practices, its eroding credit risk profile and ability to manage that risk, the state of its portfolio, and the significant threats these trends posed to the company's financial well-being. For example, he learned that Countrywide would be forced to repurchase certain subprime second mortgages – which he described as "toxic" and "the most dangerous product in existence" – because of "errors in both judgment and protocol" by Countrywide. SF 320-29[1]. He received data that loan quality was deteriorating beyond expectations on pay-option adjustable loans, with a resulting increase in credit risk to Countrywide. *Id.*. Indeed, Mozilo urged others in senior management to sell off the pay-option loans held in the portfolio of Countrywide's internal bank because the company was "flying blind" as to the true severity of the credit risk they posed. SF 512, 513. Moreover, Mozilo knew by late 2006 that subprime loans originated in 2006 (the "2006 Vintage") would be the worst performing in history, in significant part because of Countrywide's virtual abandonment of its purportedly "prudent" underwriting standards. SF 514.

Deeply concerned by this information, Mozilo began to hedge his bets. On October 27, 2006 he executed two trading plans, one designed to sell 3,989,588 shares

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[1] Citations to "SF" refer to the facts and supporting evidence set forth in the Commission's Separate Statement of Genuine Issues of Fact, which includes all of the purported uncontroverted facts originally set forth in Defendants' Corrected Joint Statement Of Uncontroverted Facts And Conclusions Of Law In Support of Defendants' Motions For Summary Judgment, Docket No. 214-1, filed August 3, 2010.

of Countrywide stock and one designed to sell another 91,999 shares. SF82 & 83. On November 13, 2006 he executed a trading plan designed to sell another 100,000 shares of Countrywide stock. SF 84. On December 12, 2006 he executed a trading plan to sell another 1,389,580 shares of Countrywide stock. SF 85. And on February 2, 2007 Mozilo amended the December plan to sell an additional 1,393,197 shares (bringing the total number of shares to be sold under the December plan to 2,782,777). SF 86. The shares sold pursuant to those trading plans yielded Mozilo gross profits (net of the strike prices) of more than $140,000,000. SF 496-97.

II. ARGUMENT

Summary judgment is appropriate only where there are no genuine issues of material fact and where the moving party is entitled to prevail as a matter of law when the evidence is viewed in the light most favorable to the party opposing the motion. *SEC v. Seaboard Corp.*, 677 F.2d 1297, 1298 (9th Cir.1982). The Court should draw all justifiable inferences in favor of the non-moving party, *Anderson v. Liberty Lobby, Inc.* 477 U.S. 242, 255 (1986), and those inferences need not be the "most likely or the most persuasive," but only "rational" or "reasonable." *United Steel Workers of Am. v. Phelps Dodge Corp.*, 865 F.2d 1539, 1542 (9th Cir. 1989). "Summary judgment is generally inappropriate when mental state is an issue, unless *no reasonable inference* supports the adverse party's claim." *Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 739 F.2d 1434, 1436 (9th Cir. 1984) (emphasis added).

A. Trading While In Possession Of Material Nonpublic Information Constitutes Illegal Insider Trading

A corporate insider who obtains material nonpublic information in the course of his duties must either disclose that information or refrain from trading. *United States v. O'Hagan*, 521 U.S. 642, 652 (1997), citing *Chiarella v. United States*, 445 U.S. 222, 228 (1980); *In re Countrywide Financial Corporation Securities Litigation ("Countrywide II")*, 588 F. Supp. 2d 1132, 1202 (C.D. Cal.

2008); 17 C.F.R. § 240.10b5-1.

Mozilo cites *United States v. Smith*, 155 F.3d 1051, 1069 (9th Cir. 1989) and *Freeman v. Decio*, 584 F.2d 186, 199 (7th Cir. 1978) for the proposition that he cannot be found to have illegally traded "on the basis" of his nonpublic information unless the Commission negates the possibility that any other factors influenced his trading decisions. *See* Mozilo MSJ at 12:11-18. But these cases pre-date the adoption of Rule 10b5-1 and thus are inapposite. Rule 10b5-1(b), which became effective in 2001, provides that as a matter of law, a person trades "on the basis of" material nonpublic information "if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale." 17 C.F.R. § 240.10b5-1(b). Even if this were not the rule, Mozilo's acceleration of his stock sales under the 2006-07 trading plans and his own comments would constitute sufficient evidence that he was trading on the basis of his inside information. *See* Section 3, *infra.*

B. Mozilo Possessed Material Nonpublic Information When He Executed His 2006-07 Trading Plans

A fact is material if a reasonable investor would consider it important in making an investment decision. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). In other words, a fact is material if a reasonable investor would likely view it as significantly altering the "total mix of information available". *Id.*, quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

By late 2006, the internal red flags confronting Mozilo were becoming increasingly stark. Mozilo knew that Countrywide's loan quality had decreased markedly – with a corresponding increase in credit risk – due to eroding underwriting standards and the huge volume of loans being issued as "exceptions" to (or simply with callous disregard for) those already relaxed standards. SF 320-29, 394-96, 400-004, 499-501, 502, 504-05, 508-09. He knew that loans he considered to be "poison" and "toxic" were being originated "with disregard for

process [and] compliance with guidelines." *Id;* SF 320-29. He knew that the company's increasing reliance on high-risk products such as 80/20 loans and pay-option ARMS – particularly when coupled with porous underwriting and an inability to effectively manage credit risk – exposed the company to balance sheet risk far beyond what investors were led to believe and threatened to disrupt the secondary market sales that provided Countrywide's financial lifeblood.[2] *Id.*

That a reasonable investor would consider such information important is beyond reasonable dispute. *See, e.g., In re Washington Mutual Sec. Litig.*, 694 F. Supp. 2d 1192, 1211-13 (W.D. Wash. 2009) (dramatic loosening of underwriting standards and loans issued on exceptions basis); *Atlas v. Accredited Home Lenders Holding Co.*, 556 F. Supp. 2d 1142, 1155 (S.D. Cal. 2008) ("[A]s a mortgage lender . . . underwriting practices would be among the most important information looked to by investors."); *Countrywide II* (same). At the very least, it is sufficient to establish a genuine issue for the jury to consider at trial. *See SEC v. Phan*, 500 F.3d 895, 908 (9th Cir. 2007) ("Determining materiality in securities fraud cases should ordinarily be left to the trier of fact.").[3]

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[2] The Commission incorporates by reference its Opposition to Defendants' Joint Motion for Summary Judgment or Summary Adjudication (and evidence cited therein), which further detail the material nonpublic information possessed by Mozilo and the other defendants.

[3] Mozilo cites obliquely to *SRM Global Fund Ltd. P'ship v. Countrywide Fin. Corp.*, 2010 WL 2473595, at *9 (S.D.N.Y. June 16, 2010) in support of his materiality argument. *See* Mozilo MSJ at p.4, n.4. Mozilo overstates what *SRM Global* says in that respect – it noted that a single fact (Countrywide's lack of historical experience with pay-option loans) had been disclosed in a public filing prior to the beginning of the class period. In any event, the *SRM Global* decision considered whether private class-action Plaintiffs had adequately pleaded materiality under a "fraud on the market" theory under the PSLRA's heightened pleading standards. As such, the analysis employed by the court in this action is inapposite here. *See SEC v. Reys*, No. C09-1262RSM, 2010 WL 1734843 at *4(W.D. Wash. April 28, 2010) (fraud on the market and truth on the market doctrines are inapposite in an SEC enforcement action). A more thorough

1. Mozilo Had The Requisite Scienter

In insider trading cases, scienter is established by proof that the defendant was aware of his fiduciary duty not to trade on inside information and had actual knowledge of the undisclosed information. *SEC v. Musella*, 748 F. Supp. 1028, 1038-40 (S.D.N.Y. 1989).[4] It is undisputed that Mozilo was aware of his duty not to trade while in possession of material nonpublic information. SF 495.

Mozilo complains that the Commission has not adduced direct evidence that he knew the nonpublic information, if disclosed, would cause the price of Countrywide's stock to drop. Mozilo MSJ at 6. But there is no requirement that the defendant know that the information was "market-moving". "Scienter requires that the insider . . . possess material nonpublic information at the time of the trade." *SEC v. Ginsburg*, 362 F.3d 1292, 1297 (11th Cir. 2004) (citations omitted); *see also Miller v. Thane International, Inc.*, 2010 WL 3081488 at *3 (9th Cir. August 9, 2010). Mozilo's own statements and conduct demonstrate that he ascribed great importance to the nonpublic information. That alone is sufficient to establish scienter in this context. *See SEC v. MacDonald*, 699 F.2d 47, 51 (1st Cir. 1983) (if defendant himself considers information important, he necessarily understands it would be material to a reasonable investor); *SEC v. Ingram*, 649 F. Supp. 1437, 1441 (C.D. Cal. 1998) (perceived materiality of information probative of scienter). Mozilo's increasingly strident internal emails amply demonstrate his

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consideration of the materiality of the defendants' misrepresentations and omissions may be found in *In re Countrywide Financial Corp. Derivative Litigation ("Countrywide I")*, 554 F. Supp. 2d 1044 (C.D. Cal. 2008) and *Countrywide II* – and of course, this Court's November 3, 2009 Order denying defendants' motions to dismiss the Complaint in this action.

[4] In Rule 10b-5 cases generally, scienter can be established shown either through evidence of a direct intent to deceive or through a showing of extreme recklessness. *SEC v. Rubera*, 350 F.3d 1084, 1093-94 (9th Cir. 2003). "Scienter can be inferred from circumstantial evidence." *MacLean v. Huddleston*, 459 U.S. 375, 390-91 n. 30 (1983).

appreciation of the significance of the deterioration of Countrywide's credit profile and the resulting threat to its financial health.

Mozilo gave final approval to create his October 2006 10b5-1 trading plan on September 25, 2006, a mere one day before he sent the e-mail stating that Countrywide was "flying blind" regarding the performance of Pay-Option loans. SF 514. Contemporaneous with entering into the December 2006 plan he acknowledged to Countrywide's board of directors that Countrywide had lowered underwriting guidelines in every conceivable area, thereby increasing the company's credit risk exposure. SF 85, 514-15. And in February, he amended the December plan to double the volume of stock sales, thereby directing the liquidation of an additional 1.4 million shares under that plan alone. SF 86.

Because Mozilo was in possession of material non-public information – information that clearly caused him grave concern – when he made these trading plans, the Commission has more than established a genuine issue regarding his scienter. *Ginsburg*, *supra*; *see also In re Apple Computer Securities Litigation*, 886 F.2d 1109, 1117 (9th Cir. 1989) ("Insider trading in suspicious amounts or at suspicious times is probative of bad faith and scienter.")[5]

2. Mozilo's Dramatic Change In His Trading Patterns Does Not Negate, But Rather Evidences Scienter

Mozilo argues that his stock sales during the relevant period were part of a "long-term financial planning strategy", citing advice that he diversify his fortune by selling off a greater portion of his Countrywide holdings. Mozilo MSJ at 2:14 –

[5] Mozilo cites several cases with different fact patterns and argues that the facts evidencing scienter in those cases are not present here. *See* Mozilo MSJ at 6, citing *United States v. Nacchio*, 519 F.3d 1140 (10th Cir. 2008); *SEC v. Brethren*, 1992 WL 420867 (S.D. Ohio October 15, 1992); and *SEC v. Ingram*, 694 F. Supp. 1437 (C.D. Cal. 1988). Well and good. But the fact that certain types of evidence were deemed probative of scienter in those cases does not mean that other types of evidence are not probative here. *SEC v. Rorech*, 2010 WL 2595111 (S.D.N.Y. June 25, 2010) is a "tipping" case decided on the merits after a full bench trial. As such, its facts and analysis are wholly inapposite.

3:9. But Mozilo had been receiving that advice for years – and had been consistently *rejecting* it for years, telling his financial advisor that he would not sell any Countrywide securities other than expiring options. SF 490-92.

Only after becoming increasingly alarmed in late 2006 about Countrywide's increasingly risky credit profile, and the company's inability to effectively manage and mitigate those risks, did Mozilo decide that "diversifying" much of his wealth into non-Countrywide holdings was an appealing strategy.

Shortly after warning Sambol and Sieracki that Countrywide was "flying blind" with respect to the ultimate risk of its Pay-Option strategy, Mozilo suddenly reversed field and *changed* his long-standing investment strategy by implementing the first of four trading plans (and one amendment) that in the aggregate triggered the sale of nearly five million shares of stock for proceeds of approximately $188,881,861, and gross profits (net of the strike price) of more than $140,000,000. SF 496-97.

Mozilo's decision to change his long-established financial strategy by diversifying away from Countrywide securities at the very time he was becoming increasingly concerned about the undisclosed, increasing riskiness of Countrywide's business is powerful evidence of scienter. *See Countrywide I*, 588 F. Supp. 2d at 1188 ("Mozilo's increased sales – as disclosures snowballed – contributes independently to an inference of scienter."); *SEC v. Lipson*, 278 F.3d 565, 659 (7th Cir. 2002) (existence of an ostensibly legitimate purpose for stock sales "would not sanitize the illegitimate one.") At the very least, it clearly establishes the existence of a genuine issue of material fact that can only be resolved at trial. *Id.; see also Goldman v. Belden*, 754 F.2d 1059, 1071 (2d Cir. 1985) (whether to credit defendant's claim that accelerated stock sales were motivated by his imminent retirement not susceptible of resolution on summary judgment); *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 507 (9th Cir. 1991) (defendant corporation's continued investment of millions of dollars in its product

and corporate officers' failure to sell their stock during class period did not negate scienter and thus genuine issue of material fact precluded summary judgment); *Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1191 (10th Cir. 2003) (scienter not negated by defendants' failure to sell stock).

As Judge Pfaelzer found in *Countrywide II*: "Mozilo's actions appear to defeat the very purpose of 10b5-1 plans, which were created to allow corporate insiders to 'passively' sell based on triggers, such as specified dates and prices, without direct involvement. Accordingly, his amendments of 10b5-1 plans at the height of the market does not support the inference 'that the sales were pre-scheduled and not suspicious' . . ." 554 F. Supp. 2d at 1068-69.

Nor does the fact that the newly aggressive sales plans would stagger Mozilo's sale of nearly 7 million shares of stock over roughly one year "negate" scienter. *See* Mozilo MSJ at 8: 3-17. The Commission does not contend that Mozilo tried to immediately unload *all* of his shares in advance of a discrete, cataclysmic event expected to occur within days or weeks. Rather, the Commission contends that Mozilo's decision to hedge his bets by selling off a substantial portion of his Countrywide holdings was motivated by the material, nonpublic information he possessed about the dire risks facing Countrywide. Mozilo's implementation of that new trading strategy on the basis of his insider knowledge of those substantial undisclosed risks constituted insider trading in violation of Rule 10b-5. *See Countrywide II*, 554 F. Supp. 2d at 1069 (given the magnitude of Mozilo's sales, "[i]t is irrelevant that Mozilo held on to over 7 million shares of Countrywide Stock through the end of 2007 . . ."), citing *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1232 (9th Cir. 1994) ("where, as here, stock sales result in a truly astronomical figure, less weight should be given to the fact that they may represent a small portion of the defendant's holdings.")

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3. Mozilo's Statements About The General State Of The Housing Market Do Not Negate Scienter

Mozilo argues that a series of public comments he made about the housing market "negate" his scienter. Mozilo MSJ at 8:18 – 10:2. They do not.

The "negative comments" Mozilo references concern the broader economy and the housing and mortgage market *generally*. *None* of them disclose the specific material, nonpublic information about Countrywide-specific risks that were fueling his growing concerns and motivating his accelerating stock sales. *See United States v. Mylett*, 97 F.3d 663, 666 (2d Cir. 1996) (criminal insider trading conviction affirmed where defendant possessed information "that was substantially more specific than that in the newspaper."); cf. *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1098 (1991) ("[N]ot every mixture with the true will neutralize the deceptive.")

Indeed, the so-called "negative" comments are even less meaningful when viewed in light of the fact that Mozilo's insistence in other public statements that Countrywide's supposedly more prudent underwriting and conservative practices would enable it to reap substantial benefits from generally challenging market conditions. SF 498. (*e.g.*, Mozilo insisting in January 2007 that market disruption would be "great for Countrywide at the end of the day because of all of the irrational competitors will be gone".)

Mozilo's willingness to predict challenging economic times for the housing market generally while falsely reassuring investors that Countrywide had largely insulated itself from the effects of such economic contingencies – does not negate, but rather supports a finding of scienter. *See Jones v. Corus Bancshares*, 2010 WL 1338070 (N.D. Ill. April 6, 2010) ("the fact that Corus disclosed certain of its difficulties during the class period does not necessarily negate an inference of scienter, for Corus's statements may still have been intended to conceal the fact that its condition was substantially worse than its statements suggested.")

4. Mozilo Has Not Established Any Foundation For An Advice Of Counsel Defense

In order to establish a good faith reliance on counsel, a party must show that he "(1) made a complete disclosure to counsel; (2) requested counsel's advice as to the legality of the contemplated action; (3) received advice that it was legal; and (4) relied in good faith on that advice." *SEC v. Goldfield Deep Mines Co. of Nevada*, 758 F.2d 459, 467 (9th Cir. 1985). Here, there is no evidence that Mozilo made a complete disclosure – indeed *any* disclosure – to counsel of the nonpublic information he possessed in order to allow counsel to evaluate whether he could legally trade. *See* SF 516-17.

Mozilo cites *Howard v. SEC*, 376 F.3d 1136, 1148 (D.C. Cir. 2004) for the proposition that his consultation with Bow "precludes any inference of scienter". Mozilo MSJ at 10:20-21. But *Howard* does not support the conclusion Mozilo urges here. In *Howard*, the court considered – on a full evidentiary record after a hearing on the merits – whether the defendant had aided and abetted violations of Rule 10b-9 with respect to how the structuring of certain transactions was disclosed. *Id.* at 1138-41. The finder of fact determined that the defendant had relied on his understanding that higher management and both inside and outside counsel had specifically approved the disclosures after fully reviewing the underlying transactions and analyzing their treatment under applicable law. *Id.* at 1146-47.

Even then, the court noted that the defendant's reliance upon counsel's advice was not a complete defense, but merely one "relevant consideration in evaluating a defendant's scienter." *Id.* at 1147. Here, Mozilo adduces no evidence that he disclosed the nonpublic information at issue to Bow so as to obtain her advice regarding whether it would bar his attempt to change his trading plans to divest himself of more than $180 million worth of in Countrywide securities. As such, his consultation with her regarding other aspects of his plan documentation is

irrelevant. *Goldfield Deep Mines*, *supra*. But even if relevant to the issues at hand, such evidence would only be one relevant consideration to be weighed by the jury against all of the other evidence of Mozilo's scienter. *Id.*; *Howard*, *supra*.

III. CONCLUSION

For all the foregoing reasons, Mozilo's motion for summary judgment should be denied.

Dated: August 16, 2010

Respectfully submitted,

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