UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

THE UNION CENTRAL LIFE INSURANCE COMPANY, AMERITAS LIFE INSURANCE CORP. and ACACIA LIFE INSURANCE COMPANY, Plaintiffs, vs. CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORP., et al., Defendants.	Civil Action No. 11-cv-02890-GBD MEMORANDUM IN SUPPORT OF PLAINTIFFS' MOTION TO COMMENCE LIMITED DISCOVERY FROM DEFENDANT UBS, WASHINGTON MUTUAL AND MORGAN STANLEY CONCERNING STATE LAW CLAIMS

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I. INTRODUCTION

The Union Central Life Insurance Company, Ameritas Life Insurance Corp. and Acacia Life Insurance Company (collectively, "Union Central" or "Plaintiffs") bring this motion seeking to remedy certain defendants' refusal to participate in limited document discovery. Plaintiffs request a ruling that the Private Securities Litigation Reform Act of 1995 ("PSLRA") discovery stay is inapplicable to the requested document discovery, thereby allowing this discovery to proceed with respect to residential mortgage-backed securities ("RMBS") sponsored by defendants UBS, Washington Mutual and Morgan Stanley.[1] These defendants have refused to proceed with discovery by contending that the PSLRA bars "'all discovery"' until "disposition of the motions to dismiss." Declaration of Christopher M. Wood in Support of Plaintiffs' Motion and Memorandum to Commence Limited Discovery from Defendants UBS, Washington Mutual and Morgan Stanley Concerning State Law Claims ("Wood Decl."), Ex. A at 2.[2] Defendants are mistaken because the PSLRA is inapplicable to these defendants and to the claims on which discovery is being sought.

It is axiomatic that discovery should proceed promptly and effectively, even during the pendency of motions to dismiss, absent a protective order or other legitimate reason for delaying discovery. The PSLRA discovery stay does not provide a basis to stay the discovery sought from the defendants at issue in this motion. Plaintiffs only seek to begin discovery with respect to trusts for which no claims under the Securities Exchange Act of 1934 (the "Exchange Act") are alleged, and

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[1] Defendants subject to this motion and from whom plaintiffs seek production of documents are: Washington Mutual Mortgage Corp., WaMu Capital Corp., Washington Mutual, Inc. (collectively referred to as "Washington Mutual"), Morgan Stanley, Morgan Stanley & Co. Incorporated, Morgan Stanley Capital I Inc. (collectively referred to as "Morgan Stanley"), UBS AG, and Mortgage Asset Securitization Transactions, Inc. (collectively referred to as "UBS").

[2] Unless otherwise noted, internal citations are omitted.

with respect to Plaintiffs' state law claims which are grounded in diversity jurisdiction and actionable independently from any alleged federal securities claims. Because the PSLRA discovery stay does not prevent this type of discovery from proceeding, the Court should order defendants to respond to the limited discovery propounded by Plaintiffs and identified herein.

II. PROCEDURAL HISTORY LEADING TO THE INSTANT MOTION

This action was commenced on April 28, 2011, and seeks to recover losses suffered by Union Central in connection with the purchase of 21 separate RMBS purchased between 2005 and 2007. Complaint, Ex. 1.[3] The defendants in this action include the sponsors, depositors and underwriters of these RMBS, as well as certain of their affiliates and current or former officers and/or directors. ¶¶28-66. The 21 RMBS at issue in this action can be further subdivided into seven different groups of RMBS, because each was sponsored by a different group of affiliated defendants. This motion concerns discovery directed at defendants in just three of the seven sponsor groups – UBS, Morgan Stanley and Washington Mutual.

On May 4, 2012, Plaintiffs amended their Complaint pursuant to the schedule endorsed by the Court. Dkt. Nos. 141, 146. The Complaint alleges Plaintiffs purchased the subject RMBS while relying on defendants' false and misleading statements and omissions regarding the quality of the underlying loans and the loan underwriting standards that had been used to screen and select the mortgage loans deposited into the RMBS trusts. *See*, *e.g.*, ¶¶1-20. The Complaint alleges defendants knew or recklessly disregarded the falsity of their material misstatements when selling these RMBS to Plaintiffs. *Id.*

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[3] "Complaint," "¶__" and "§__" refer to the Amended Complaint for Violations of the Federal Securities Laws and New York Common Law Fraud, filed on May 4, 2012. Dkt. No. 146.

There is complete diversity between Plaintiffs and defendants. ¶23. As a result, the Court has both federal question and diversity jurisdiction over the subject matter of the action. §II. The Complaint asserts claims for common law fraud against all defendants (¶¶815-836), and alleges claims for violation of the federal securities laws (specifically Sections 10(b), 20(a) and 20(b) of the Exchange Act) against some, but not all, defendants. ¶¶837-860. As noted above, Plaintiffs are currently seeking to commence limited document discovery against just Washington Mutual, UBS and Morgan Stanley, because Plaintiffs assert no Exchange Act claims relating to the RMBS that these defendants sponsored.

On February 8, 2012, the Court held a conference to discuss the parties' then-pending motions to consolidate and sever. Plaintiffs had filed a motion to consolidate this action with their earlier filed and related RMBS action entitled *The Union Central Life Insurance Co. v. Credit Suisse Securities (USA), LLC*, No. 11 CIV 2327 (S.D.N.Y.). After Plaintiffs moved to consolidate the two actions, certain defendants filed cross-motions seeking to sever claims against them in an effort to split this action into separate cases – arguing that claims against the groups who sponsored and underwrote RMBS were distinct and should be adjudicated separately. The Court denied both motions to sever and consolidate without prejudice to their being renewed after the case was further advanced and the proper case structure would be more readily ascertainable. Dkt. Nos. 127, 129.

During the February 8 conference, Judge Daniels further instructed the parties to contact the Magistrate Judge to schedule a conference to discuss the case. Wood Decl., Ex. B at 4:1-21; 6:2-11. The Court stated that the parties should meet and confer regarding the possibility of commencing immediate discovery as to some claims or as to some parties. *Id.* at 4:1-21; 6:2-11, 7:21-8:8. Pursuant to the Court's invitation to consider the possibility of certain limited discovery at this juncture, on March 14, 2012, Plaintiffs' counsel wrote to counsel for certain defendants, including

defendants UBS, Washington Mutual and Morgan Stanley, enclosing a proposed request for production of documents. Wood Decl., Ex. C. In their letter, Plaintiffs asserted it would be appropriate for certain limited document discovery to begin immediately with respect to RMBS that were not subject to any Exchange Act claims. *Id.* On March 19, 2012, defendants jointly responded that they would not agree to commence discovery because, according to them, the PSLRA prevented all discovery from proceeding until after defendants' motions to dismiss had been resolved and the Complaint had been upheld. Wood Decl., Ex. A.

After the Complaint was filed on May 4, 2012, and the factual allegations had been set, Plaintiffs' counsel continued meeting and conferring with defendants over this issue, and the parties agreed to have the Court resolve the dispute. Plaintiffs' counsel then wrote to this Court on May 11, 2012, proposing a briefing schedule for resolution of the parties' disagreements over whether limited discovery from some defendants is appropriate. Dkt. No. 147. The Court approved the proposed briefing schedule on May 14, 2012. *Id.* Plaintiffs filed this motion pursuant to that schedule.

III. ARGUMENT

A. The PSLRA Discovery Stay Should Not Apply to State Law Claims Where No Parallel Exchange Act Claim Is Asserted

Plaintiffs have asserted no Exchange Act claims against defendants UBS, Washington Mutual and Morgan Stanley relating to the RMBS they sponsored and sold to Plaintiffs. Rather, Plaintiffs assert only state law claims relating to these RMBS transactions. As a result, defendants should be precluded from invoking the PSLRA discovery stay with respect to these claims, because that statute is simply inapplicable.[4]

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[4] Plaintiffs are limiting the discovery they currently seek to only the following proposed document requests: Requests Nos. 1, 7-18, 22, 24, 27-29, 31-39, 42-47, 49-50, 52-53, 55-58, all of

Plaintiffs are not seeking deposition discovery of any type, and they seek no document discovery beyond what is sought by these limited document requests. Because this particularized discovery is directed at only state law claims in a situation where there are no overlapping or corresponding Exchange Act claims, defendants have no valid basis for objecting on grounds of a discovery stay that applies to Exchange Act claims.

The Court also has diversity jurisdiction over these state law claims, which are in no way dependent on the Exchange Act claims. Defendants therefore have no basis for attempting to invoke a discovery stay that is entirely premised on inapplicable federal law. Courts routinely allow discovery to proceed where, as here, there is no basis for staying discovery pending the outcome of a motion to dismiss. *See Hachette Distribution, Inc. v. Hudson Cnty. News Co.*, 136 F.R.D. 356, 358 (E.D.N.Y. 1991) (discovery should only be stayed "when there are no factual issues in need of further immediate exploration, and the issues before the Court are purely questions of law that are potentially dispositive"). In order to seek to stay discovery, defendants should be required to obtain a protective order pursuant to Fed. R. Civ. P. 26 where they would bear the burden of demonstrating good cause for such a stay. *Richards v. North Shore Long Island Jewish Health Sys.*, No. CV 10-4544 (LDW) (ETB), 2011 U.S. Dist. LEXIS 106319, at *2-*4 (E.D.N.Y. Sept. 21, 2011). Here, there is no good cause for staying the requested discovery.

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which are targeted to the specific RMBS for which there are no Exchange Act claims. *E.g.*, Wood Decl., Ex. D (proposed document requests propounded on defendant UBS). Plaintiffs' proposed requests for production of documents to defendants UBS, Washington Mutual and Morgan Stanley were identical except with respect to the trusts and parties at issue.

B. The Mere Presence of Exchange Act Claims Asserted Against Other Parties in the Action Is Not a Valid Basis for Extending the PSLRA Discovery Stay

Defendants take the position that because Exchange Act claims are asserted against some parties in this litigation, all defendants are entitled to a discovery stay – even those defendants against whom there are only state law claims and where there would otherwise be no automatic stay of discovery. Defendants can find no support for this position in the language of the PSLRA, which provides:

> In any private action arising under this title, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

15 U.S.C. §78u-4(b)(3)(B). To begin with, this provision should not apply to claims that are based on facts for which there is no Exchange Act claim asserted against defendants sponsoring these RMBS. As discussed below, many courts have recognized that this statutory provision does not stay all discovery against all parties who are joined together in a single action.

1. The PSLRA Discovery Stay Should Be Evaluated Separately for Each Defendant

In enacting the PSLRA, Congress did not specifically consider "the scenario of multiple defendants with multiple motions to dismiss," such as this action. *In re Lernout & Hauspie Sec. Litig.*, 214 F. Supp. 2d 100, 106 (D. Mass. 2002); *accord Latham v. Stein*, No. 6:08-2995-RBH, 2010 U.S. Dist. LEXIS 86181 (D.S.C. Aug. 20, 2010). In situations such as this, courts have held that despite pending motions to dismiss by certain parties, the PSLRA does not prevent discovery from proceeding against other defendants who have no independent basis for invoking the stay provisions. *See Lernout*, 214 F. Supp. 2d at 107 (allowing discovery to proceed with respect to

certain defendants whose motions to dismiss had been denied notwithstanding pendency of other motions to dismiss); *Latham*, 2010 U.S. Dist. LEXIS 86181, at *11-*12 (same).

Thus, federal courts have recognized that not "all discovery" in "any private action" is automatically stayed simply because some party to the action may have a valid basis for invoking the PSLRA discovery stay. Instead, courts examine the factual allegations and nature of the claims relating to each individual defendant to determine whether the automatic discovery stay applies to them. With respect to claims alleged against defendants UBS, Washington Mutual and Morgan Stanley there is no basis for staying discovery directed at them.

Staying discovery with respect to Plaintiffs' claims against defendants UBS, Washington Mutual and Morgan Stanley would simply be "[penalizing plaintiffs] for bringing both its federal securities claims and related state common law claims in one federal action. To prohibit discovery on the state claims would encourage a duplication of effort and serve as a disincentive for efficiency." *Tobias Holdings, Inc. v. Bank United Corp.*, 177 F. Supp. 2d 162, 168 (S.D.N.Y. 2001).[5]

In short, the PSLRA should not bar discovery with respect to defendants who will not be moving to dismiss an Exchange Act claim.

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[5] In order to promote efficiency and a coordinated discovery schedule, deposition discovery should wait until all parties can participate in such discovery. In contrast, there is no inefficiency in defendants subject to this motion producing the limited documents relating to their RMBS. Other document discovery directed at common factual issues, which are the same for all defendants, should be deferred until the lifting of the discovery stay for all parties.

2. The PSLRA Does Not Address the Application of the Discovery Stay in Actions Involving State Law Claims

While it is undisputed that the '"PSLRA has no application to actions in which only state law claims are alleged,'" (*Koock v. Sugar & Felsenthal, LLP*, No. 8:09-CV-609-T-17EAJ, 2009 U.S. Dist. LEXIS 81153, at *3-*4 (M.D. Fla. Aug. 19, 2009)), the PSLRA does not address a case in which a plaintiff alleges separate state law claims where jurisdiction is based on diversity of citizenship. *See Tobias*, 177 F. Supp. 2d at 167 ("the fact that Congress is silent with respect to a case invoking both federal question and diversity jurisdiction cannot be taken as evidence that Congress considered plaintiff's argument but rejected it. Indeed, Congressional silence more likely means that the issue was not considered"). Courts have held that where both Exchange Act claims and state law claims are pled in an action, a plaintiff alleging diversity jurisdiction may be able to proceed with discovery with respect to such state law claims notwithstanding the PSLRA.

In *Tobias*, 177 F. Supp. 2d at 164-65, the court addressed the question "whether the PSLRA stays discovery with respect to plaintiff's non-fraud state law claims where jurisdiction over such claims is based on diversity of citizenship," notwithstanding the presence of federal securities claims alleged against the same defendants in the same action. The court concluded that the PSLRA stay did not apply to plaintiffs' state law claims. In reaching its determination, the court found that although plaintiffs' state law claims "arise from the same set of facts as the federal securities claims, they are separate and distinct claims that cannot be summarily dismissed." *Id*. at 166. Because "plaintiff's state law claims do not mirror the federal securities claims but represent legally cognizable, substantive causes of action," the court found the PSLRA stay inapplicable to the state law claims, stating that to "hold otherwise would give the PSLRA too broad a brush, sweeping into its purview all related but distinct state law claims brought under diversity jurisdiction." *Id.* at 168-69.

Other courts have agreed with the *Tobias* court's holding and reasoning. *Angell Invs., L.L.C. v. Purizer Corp.*, No. 01 C 6359, 2001 U.S. Dist. LEXIS 17782, at *5 (N.D. Ill. Oct. 31, 2001) (*Tobias* "stands for the proposition that state law claims that are distinct from the federal securities claims – such as would be expected to be found where the basis of jurisdiction over the state law claims relies solely on diversity of citizenship – are not subject to the discovery stay."); *Fazio v. Lehman Bros.*, No. 1:02CV370, 2002 U.S. Dist. LEXIS 15157, at *12 (N.D. Ohio May 16, 2002) ("if diversity jurisdiction exists, and additionally, the Congressional policies behind the [PSLRA] would not be furthered by maintaining the stay, relief from the stay is warranted").

Here, in addition to federal question jurisdiction with respect to Plaintiffs' Exchange Act claims, the Complaint pleads diversity jurisdiction with respect to all defendants. ¶23. Furthermore, Plaintiffs' state law claims against defendants UBS, Washington Mutual and Morgan Stanley are far more distinct from the Exchange Act securities claims than was the case in *Tobias*. In *Tobias*, the plaintiffs' state law claims were against the same defendants and arose "from the same set of facts as the federal securities claims." 177 F. Supp. 2d at 166. Here, Plaintiffs only seek discovery from defendants against whom no Exchange Act claims are pending, and there is, therefore, even more justification for allowing this requested discovery than there was for the discovery that was permitted in *Tobias*.

C. The Discovery Stay Was Not Enacted to Address Any Perceived Issues Related to Non-Class Action Securities Claims

In considering whether the PSLRA applies to a given case, courts consider whether a case was brought as a class action or an individual action. *In re Transcrypt Int'l Sec. Litig.*, 57 F. Supp. 2d 836, 842 (D. Neb. 1999). The PSLRA was enacted to address perceived issues related to class actions, and in an individual action such as this there is far less justification, if any, for imposing a discovery stay. *See id.* ("Noticeably absent from [the legislative history] is any reference to the ills

of ***individual*** lawsuits in state – or federal – court, either of which could also be used as a means to circumvent the Reform Act's stay provision. A plain reading of this section yields the conclusion that Congress was at least principally, if not exclusively, concerned with private ***class action*** lawsuits, rather than private ***individual*** lawsuits" (emphasis in original).); *Tobias*, 177 F. Supp. 2d at 166 ("None of the perceived abuses addressed by Congress are present in this case. Plaintiff is not attempting to use discovery as a 'fishing expedition' to find a sustainable claim not alleged in its Complaint which has already been amended. Furthermore, as this is not a class action, there is little, if any, coercive aspect to plaintiff's discovery demands.").

This matter is the very opposite of the type of purportedly coercive class action that the PSLRA was enacted to address. This case does not seek to bring claims on behalf of thousands or millions of absent class members against one or two defendants; Plaintiffs have brought this individual action to recover for defective RMBS sold to them by some of the largest and most sophisticated financial institutions in the country. Plaintiffs' discovery demands are specifically targeted to elicit production of responsive documents pertaining to their specific RMBS transactions. There is no "coercive aspect to Plaintiff's discovery demands," and the presence of Exchange Act claims should not prevent Plaintiffs from commencing discovery to which they are otherwise entitled.

IV. CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request the Court allow the limited discovery identified above and directed at defendants UBS, Washington Mutual and Morgan Stanley to proceed.

DATED: June 1, 2012

Respectfully submitted,

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