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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION Plaintiff, vs. ANGELO MOZILO, DAVID SAMBOL, AND ERIC SIERACKI, Defendants.	Case No. CV 09-03994 JFW (MANx) **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF ANGELO MOZILO'S MOTION FOR SUMMARY JUDGMENT REGARDING INSIDER TRADING ALLEGATIONS** Date: August 30, 2010 Time: 1:30 p.m. Ctrm: 16 Judge: Hon. John F. Walter Pre-Trial Conf: October 1, 2010 Trial: October 19, 2010

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Page(s)

Other Authorities

I. INTRODUCTION

The SEC's insider trading claim against Angelo Mozilo fails as a matter of law for three separate reasons. First, the SEC cannot sustain its burden to tie each of Mr. Mozilo's challenged trades, each of which were made pursuant to Rule 10b5-1 trading plans, to a specific material nonpublic event or fact about Countrywide. Discovery has shown that all alleged "inside" information – information about pay option loans and expanded underwriting guidelines – was disclosed to investors through numerous channels and understood by the market. Because the SEC cannot sustain its burden on this fundamental point, summary judgment should be granted.

Second, the SEC has identified no evidence that Mr. Mozilo acted with scienter. The SEC's claim rests on a handful of comments in Mr. Mozilo's communications to senior management. There is no evidence, however, that Mr. Mozilo believed he possessed inside information at the time the challenged plans were executed. This lack of evidence is explained by a simple fact: because the alleged inside information in this case was generally known to the market, no one thought that such information could possibly constitute material nonpublic information.

Further, Mr. Mozilo's actions conclusively negate any possible inference of wrongful intent – that Mr. Mozilo dumped his stock with advance knowledge of market-moving information. Mr. Mozilo's plans were designed to sell Countrywide shares slowly over nearly a year, which is inconsistent with the SEC's allegation that he was trying to sell before bad news impacted the stock price. In addition, Mr. Mozilo personally and repeatedly made negative public statements about market conditions – both before executing the challenged plans, and throughout the time when the sales were actually taking place. Someone trying to benefit from inside information would have painted a rosier outlook during this time period. Mr. Mozilo insisted that a price "floor" be included in the plans so that shares would not be sold below $28 per share and higher. He cleared each of his plans and the

timing of their execution with Countrywide's in-house counsel. Based on this undisputed evidence, no reasonable trier of fact could fairly find that Mr. Mozilo acted with scienter when each of the plans was executed.

Third, the SEC cannot sustain its burden to establish that Mr. Mozilo traded "on the basis of" inside information – *i.e.*, that, even if he possessed material nonpublic information, he *actually used* such information when he executed the challenged plans. The evidence shows, rather, that each trading plan was part of Mr. Mozilo's long-term financial planning and diversification strategy. Accordingly, summary judgment should be granted on this basis as well.[1]

II. FACTUAL BACKGROUND

The SEC challenges four trading plans and one amendment.[2] These plans were part of a long-term financial planning strategy, pursuant to which Mr. Mozilo's financial advisors created ten trading plans and two amendments over six years.

A. Mr. Mozilo's Long-Term Financial Planning Strategy

Mr. Mozilo's financial advisor recommended that Mr. Mozilo diversify his investments, which were heavily concentrated in Countrywide stock and options. UF 88-89. Accordingly, in 2002, Mr. Mozilo entered into the first of a series of Rule 10b5-1 trading plans. UF 75.

Between 2002 and 2004, Mr. Mozilo entered into six separate trading plans, and an additional amendment. UF 75-81. Pursuant to these plans, Mr. Mozilo sold

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[1] This brief does not include all relevant facts that Mr. Mozilo would establish at trial, but only some of the undisputed facts sufficient to warrant summary adjudication.

[2] The challenged trading plans were created on: (1) October 27, 2006 (the "October Plan"); (2) October 27, 2006 in the name of the Mozilo Family Foundation (the "Foundation Plan"); (3) November 13, 2006 in the name of the Mozilo Living Trust (the "Trust Plan"); (4) December 12, 2006 (the "December Plan"); and (5) February 2, 2007, as an amendment to the December Plan (the "February Amendment"). *See* Cmplt. ¶¶ 117, 119-21, 123.

over 12 million shares of Countrywide stock from 2002 through 2006. *Id.* The SEC challenges none of these trading plans.

In the fall of 2006 and early 2007, Mr. Mozilo entered into the challenged plans. UF 82-86. These plans were part of the same financial planning strategy recommended by Mr. Mozilo's independent financial advisor, who urged Mr. Mozilo to sell shares and balance his portfolio. UF 88-89. One of Countrywide's board members, Robert Donato, a former investment advisor, similarly recommended that Mr. Mozilo sell more shares as Mr. Mozilo approached the age of 70. UF 90.

After the sales under the challenged plans, Mr. Mozilo still owned more than 6 million Countrywide shares and options when he retired in 2008. UF 91.

B. Countrywide's Insider Trading Policy and Legal Preclearance

All of Mr. Mozilo's trading plans were precleared by counsel as to both terms and timing. Mr. Mozilo signed each trading plan during an open trading window, after receiving approval from Countrywide's General Counsel, Susan Bow. UF 92-93. Significantly, Ms. Bow was the senior-most lawyer in Countrywide's disclosure process. UF 95. In addition, Ms. Bow had the ability to consult with outside counsel with respect to Mr. Mozilo's trading plans, and she did so at least with respect to the December Plan. UF 96.

III. ARGUMENT

In order to prove insider trading, the SEC must establish several elements, three that are relevant here. First, the SEC must identify "inside" – *i.e.*, material, nonpublic – information Mr. Mozilo possessed at the time he signed each of the challenged trading plans. *See SEC v. Clark*, 915 F.2d 439, 443 (9th Cir. 1990). Second, the SEC must prove that Mr. Mozilo acted with scienter – that he engaged in "intentional or willful conduct designed to deceive or defraud investors." *See Dirks v. SEC*, 463 U.S. 646, 664 n.23 (1983) (quotations omitted); *see also SEC v. MacDonald*, 699 F.2d 47, 50 (1st Cir. 1983) (SEC must prove that insider "had

actual knowledge of undisclosed material information; knew it was undisclosed, and knew it was material"). Third, the SEC must also prove that Mr. Mozilo traded "on the basis of" inside information – that he *actually used* material, nonpublic information when deciding to trade. *See United States v. Smith*, 155 F.3d 1051, 1069 (9th Cir. 1998) ("Rule 10b-5 requires . . . the SEC . . . [to] demonstrate that the suspected inside trader actually used material nonpublic information in consummating his transaction." (footnote omitted)). The SEC cannot sustain its burden to raise a triable issue for the jury on any of these three prongs, and therefore summary judgment should be granted.

A. No Evidence of Material Nonpublic Information

The SEC bears the burden of tying each of Mr. Mozilo's trading plans to specific material nonpublic information about Countrywide. The SEC has identified two general types of information that it alleges constitute inside information: (1) increased credit risk associated with pay option loans, and (2) Countrywide's "expanded underwriting guidelines." Cmplt. ¶¶ 114-15. As explained in detail in the Joint Defense Brief,[3] however, the company disclosed all material facts about pay option loans and expanded underwriting guidelines to investors through a variety of channels. In light of Countrywide's exhaustive disclosures, and the market's knowledge, the SEC cannot establish that Mr. Mozilo had material, nonpublic information at the time he signed each challenged trading plan.[4]

In addition, any opinions contained in Mr. Mozilo's communications to senior management do not constitute inside information. Insider trading requires proof of

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[3] Mr. Mozilo hereby incorporates the Joint Defense Brief by reference.

[4] In fact, in an unrelated case, the court recently held that the concerns Mr. Mozilo expressed in a September 26, 2006 email identified in the Complaint (¶ 118) were adequately disclosed to investors: "Countrywide's lack of significant historical experience with pay-option ARMs was clearly disclosed in a document filed with the SEC." *SRM Global Fund Ltd. P'ship v. Countrywide Fin. Corp.*, 2010 WL 2473595, at *9 (S.D.N.Y. June 16, 2010).

material, nonpublic, *factual* information. *See United States v. Mylett*, 97 F.3d 663, 666 (2d Cir. 1996) (identifying specific "non-public facts"). As a matter of law, inferences drawn from publicly known facts do not constitute inside information. *See In re Cady, Roberts & Co.*, 40 S.E.C. 907, 915 (Nov. 8, 1961) (inside information does not include "perceptive analysis of generally known facts"). Insiders are not "obligated to confer upon outside investors the benefit of [their] superior financial or other expert analysis by disclosing [their] educated guesses or predictions." *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848-49 (2d Cir. 1968). Full disclosure "requires nothing more than the disclosure of basic facts so that outsiders may draw upon their own evaluative expertise in reaching their own investment decisions with knowledge equal to that of the insiders." *Id.*

As explained in the Joint Defense Brief, Countrywide disclosed the material facts about its product mix and the details of its loans. Any predictions or opinions that Mr. Mozilo expressed in emails to other senior executives as part of his ongoing management of the business do not constitute inside information. As the SEC cannot sustain its burden to identify specific material, nonpublic information at the time Mr. Mozilo signed each of the challenged plans, Mr. Mozilo's motion for summary judgment should be granted.[5]

B. No Evidence That Mr. Mozilo Acted With Scienter

Separately, summary judgment must be granted because the SEC cannot sustain its burden to prove that Mr. Mozilo acted with scienter. Scienter exists in an insider trading case "only where there is intentional or willful conduct designed to deceive or defraud investors." *Dirks*, 463 U.S. at 664 n.23 (quotations omitted).

[5] Even if opinions from Mr. Mozilo's internal emails could somehow constitute material, nonpublic information, Mr. Mozilo regularly voiced the same opinions and concerns in public. *See* Joint Defense Brief, Part III.B; *infra* Part III.B.2.b.

1. No Evidence Mr. Mozilo Believed He Had "Inside" Information

The SEC must prove that Mr. Mozilo "had actual knowledge of undisclosed material information; knew it was undisclosed, and knew it was material." *See MacDonald*, 699 F.2d at 50. The SEC has no evidence that Mr. Mozilo held such a belief at the time each trading plan was executed.

The SEC's case rests on a handful of comments from Mr. Mozilo's internal management communications. The SEC has developed no evidence, however, that Mr. Mozilo believed that the information contained in those communications (the factual basis for which had been disclosed) constituted market-moving information. There is certainly no evidence that Mr. Mozilo said at the time that he believed the information was market-moving. *See United States v. Nacchio*, 519 F.3d 1140, 1166 (10th Cir. 2008) (defendant discussed the "impact of the disclosure" on the market). There is no evidence that Mr. Mozilo was concerned about the impact to his personal wealth if certain information was made public. *See SEC v. Brethen*, 1992 WL 420867, at *21 (S.D. Ohio Oct. 15, 1992) (defendant "expressed worry about the consequences to his personal wealth if the merger were not consummated"). There is also no evidence that Mr. Mozilo believed any information he had was nonpublic and should be kept secret. *See SEC v. Ingram*, 694 F. Supp. 1437, 1441 (C.D. Cal. 1988) (defendant said "I really shouldn't be telling you this"); *SEC v. Rorech*, 2010 WL 2595111, at *49 (S.D.N.Y. June 25, 2010) (no scienter where defendant "did not act as though the information was possibly prohibited" and "[t]here was no effort to hide the transaction"). There is no evidence that anyone from Countrywide's legal department, who approved each of the trading plans, ever advised Mr. Mozilo that he potentially had inside information. *See Brethen*, 1992 WL 420867, at *21 (in-house counsel "warned [defendant] that he had inside information"). In short, there is no evidence that Mr. Mozilo thought he had inside information.

This case lies far beyond the bounds of typical insider trading cases, and lacks all the traditional hallmarks of insider trading. Mr. Mozilo did not keep his trades secret. He did not dump a large amount of shares just before publicly commenting on negative news affecting the industry. Mr. Mozilo instead communicated his concerns openly to the public and to individuals throughout Countrywide. His emails cascaded throughout the Countrywide as they were forwarded from senior officers to other employees in the organization.[6] Despite their wide dissemination, however, there is no evidence that anyone believed that the information in these communications constituted "inside" information. This lack of evidence is explained by a simple fact: in light of the extensive disclosures about pay option loans and expanded underwriting guidelines, and the market's widespread understanding, no one thought such information could possibly constitute material, nonpublic information. *See Ingram*, 694 F. Supp. at 1441 ("[T]he degree of materiality of the information possessed by the alleged insider could affect the analysis of scienter; the more significant the information the more likely the insider was aware that he was conferring a benefit or breaching a duty."). In light of the SEC's failure of proof on this essential element of its claim, summary judgment should be granted.

2. The Undisputed Evidence Negates Any Inference of Scienter

Not only does the SEC have no evidence to support its allegation of scienter, but the undisputed evidence of Mr. Mozilo's conduct conclusively rebuts that allegation. *See In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1118 (9th Cir.

[6] For example, on July 10, 2006, Mr. Mozilo sent an email to Dave Sambol, Stan Kurland, Steve Bailey, and Jack Schakett asking for their input on delinquency rates associated with pay option loans. This email was subsequently forwarded throughout the organization to at least Svetlana Keslin, Bill Endicott, Karl Horne, Kevin Meyers, Brian White, Carlos Garcia, Mike Muir, Cliff Rossi, Dave Walker, Richard Silva, Tim Wennes, and Jim Furash. *See* Lefler Decl. ¶¶ 196-98, Exs. 193-95.

1989) (scienter "completely dispelled by the defendants' overall pattern of conduct").

a. Mr. Mozilo Planned to Sell Shares Over Nearly One Year

Mozilo's trading plans themselves are inconsistent with the SEC's theory of insider trading. The SEC contends that Mr. Mozilo believed Countrywide's business model was fundamentally "unsustainable." *See* Cmplt. ¶ 5. The October Plan, however, was designed to sell 3.99 million shares in staggered transactions *over eleven months*, the December Plan was designed to sell 1.39 million shares in staggered transactions *over eleven months*, and the February Amendment added 1.39 million shares to be sold in staggered transactions *over ten months*. UF 82, 85-86. Someone who believed that the company was headed for financial peril, and intended to trade ahead of a decrease in the stock price (as the SEC alleges), would not have planned to sell stock so gradually during the same time he expected the stock price to decline, and would not have set minimum sales prices well above the exercise price for the underlying options. *See In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1424-25 (9th Cir. 1994) (no scienter where insider "incurred the same large losses as did the Plaintiffs").

b. Mr. Mozilo's Pessimistic Statements Negate Scienter

Mr. Mozilo was a frequent public commenter who personally made negative comments about the state of Countrywide's markets, further negating any inference of scienter. UF 97. Mr. Mozilo's negative public comments were ubiquitous and, as a result, Mr. Mozilo was regarded as one of the most open and frank CEO's in the industry. For the purposes of this Motion, Mr. Mozilo focuses on those statements that were most connected in time to the decisions to execute the challenged trading plans and the period under which sales were planned to occur.

Significantly, Mr. Mozilo personally made numerous negative statements about the housing market just before he entered into the challenged trading plans. For example, during a July 25, 2006 earnings call, Mr. Mozilo commented on his

negative outlook: "I've never seen a soft landing in 53 years, so we have a ways to go before this levels out." UF 98. Just two days before the October Plan was created, on October 25, 2006, Mr. Mozilo commented that "the housing cycle has entered a downward phase." UF 99. Similarly, just three days before the February Amendment was created, on January 30, 2007, Mr. Mozilo stated: "We're also preparing for increased borrower delinquencies and continued credit deterioration." UF 100. As of January 30, 2007, Mr. Mozilo had yet to sell 78 percent of the shares planned to be sold under the October and December plans. UF 101.

During the period in which stock sales were going to occur pursuant to the plans, Mr. Mozilo continued to speak candidly about his concerns. On March 26, 2007, Mr. Mozilo stated that "I think there's more to come out in terms of delinquencies and foreclosures. . . . I thought that the housing downturn would have an impact on the economy and could be the start of a recession." UF 102. On July 20, 2007, Mr. Mozilo stated: "I think we're going to go through an enormous correction period, and we have a long way to go . . . this is just the beginning of the process." UF 103. During a July 24, 2007 earnings call, Mr. Mozilo made the dramatic statement that: "We are experiencing home price depreciation almost like never before, with the exception of the Great Depression." UF 104. This statement was made while 33 percent of Mr. Mozilo's shares still had yet to be sold under the October and December trading plans. UF 105.[7]

Mr. Mozilo spoke his mind notwithstanding the fact that his negative comments could adversely impact Countrywide's stock price during the time he was selling stock. This is entirely inconsistent with a notion that Mr. Mozilo was somehow attempting to conceal information from investors or profit from an

[7] For a visual illustration of some of Mr. Mozilo's negative statements over the relevant period, see the Declaration of Daniel P. Lefler ¶ 194, Ex. 191 (Lehn Report, Ex. V).

inflated stock price. *See In re Segue Software, Inc. Sec. Litig.*, 106 F. Supp. 2d 161, 170 (D. Mass. 2000) ("candid" disclosure "negates . . . any inference of scienter").

c. Mr. Mozilo's Plans Were Approved By Countrywide Lawyers

Each of Mr. Mozilo's trading plans was approved by Countrywide's in-house legal department and each was executed during an open trading window. *UF* 92-93. These facts alone strongly negate scienter. *See* WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING § 4:4.6 (2010) ("Preclearance of the transaction in accordance with the employer's compliance procedure also is an important factor tending to negate scienter.").

Ms. Bow, the company's General Counsel, specifically approved each of the challenged trading plans. Before approving each plan, Ms. Bow spoke to other executives within Countrywide, including the Chief Legal Officer and CFO, in order to determine whether anyone was aware of material nonpublic information that would prevent Mr. Mozilo from implementing the trading plans. UF 94. Ms. Bow was also the chief lawyer in charge of Countrywide's SEC disclosure process. UF 95. With this knowledge, Mr. Bow specifically approved each trading plan. UF 93. In addition, Ms. Bow had the ability to consult outside counsel with respect to Mr. Mozilo's trading plans, and recalls doing so at least with respect to the December Plan. UF 96. Mr. Mozilo's consultation with counsel further precludes any inference of scienter. *See, e.g., Howard v. SEC*, 376 F.3d 1136, 1148 (D.C. Cir. 2004) ("[R]eliance on the advice of counsel" is "evidence of good faith, a relevant consideration in evaluating a defendant's scienter.").

d. The Evidence Refutes the Allegation that Mr. Mozilo Believed Countrywide's Business Was Unsustainable

Mr. Mozilo's numerous other actions are entirely inconsistent with the SEC's allegation that Mr. Mozilo believed Countrywide was headed for financial peril. For example, each trading plan include a price floor to prevent shares from being sold

below $28 per share, even though Mr. Mozilo could have earned profits at sale prices well below the price floor. UF 106-07. Mr. Mozilo's financial advisor urged him to eliminate the price floor, but Mr. Mozilo refused, explaining that he "didn't want to give the stock away." UF 108.

In February 2007, within one week of executing the February Amendment, Mr. Mozilo transferred $1 million in Countrywide stock to a grantor retained annuity trust ("GRAT") that he established for the benefit of his children. UF 109. Putting an asset into a GRAT only provides tax benefits for assets that *appreciate* in value over time. UF 110.

In July 2007, the company distributed 18,000 shares of common stock to Mr. Mozilo pursuant to a restricted stock agreement. UF 111. Mr. Mozilo paid more than $300,000 in taxes and held the shares. UF 112. He could have, but did not, sell the shares during an open window period to recoup the taxes and realize a profit. UF 113.

Also in July 2007, Mr. Mozilo became aware that a substantial number of shares remained unsold under the October Plan because of the $28 price floor, and that all remaining shares would be sold pursuant to the "catch-all" provision included in the plan. UF 114. When Mr. Mozilo learned of this, he attempted to prevent any sales under $28 per share. UF 115. When advised that changing the plan to avoid that result might jeopardize the Rule 10b5-1 status, Mr. Mozilo insisted that the company issue a press release calling attention to his impending sales to explain why they were occurring. UF 116.

Furthermore, Mr. Mozilo has testified that, consistent with these actions, he believed Countrywide would continue to prosper and the company's stock price would increase over time. UF 117. *See Worlds of Wonder*, 35 F.3d at 1425 (summary judgment granted where insiders had "good faith belief in WOW's prospects for success"). Mr. Mozilo also remained heavily invested in Countrywide

stock, owning more than 6 million options and shares when he retired in 2008. UF 91.

Finally, consistent with Mr. Mozilo's actions and his sworn testimony, Countrywide's contemporaneous internal forecasts show that the company expected Countrywide's average stock price to improve in 2007 and beyond. UF 118-19. Summary judgment should therefore be granted. *See Freeman v. Decio*, 584 F.2d 186, 199 (7th Cir. 1978) (summary judgment granted where insider's positive expectations were "consistent with contemporaneous internal documents predicting record sales and earnings").

C. No Evidence That Mr. Mozilo Used Inside Information

Finally, the SEC cannot sustain its burden of establishing that Mr. Mozilo traded "on the basis of" inside information. The SEC has no evidence that Mr. Mozilo actually used material nonpublic information when deciding to trade. *See Smith*, 155 F.3d at 1069 ("actual[] use[]" required). To the contrary, each of Mr. Mozilo's challenged trading plan was part of his long-term financial planning strategy. *See Freeman*, 584 F.2d at 197 n.44 (inference trades were "on the basis of" inside information "nullified by a showing . . . other circumstances might reasonably account for their occurrence").

IV. CONCLUSION

For all the foregoing reasons, Mr. Mozilo's motion for summary judgment with respect to the insider trading allegations should be granted.

Dated: August 2, 2010

Respectfully submitted,

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