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E-Filed 2/3/2011

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION**

BERTHA ROMERO, et al.,

Plaintiff,

v.

COUNTRY WIDE HOME LOANS, INC., and
DOES 7 through 10 inclusive,

Defendants.

Case Number C 07-4491 JF (PVT)

ORDER¹ DENYING MOTION TO
DISMISS

[re: docket no. 113]

I. BACKGROUND

A. The Loan Documents

Between June 1, 2005 and December 7, 2006 Plaintiffs Bertha Romero, James Ruiz, Margarita Castro, Teresa Aguilera, Gilbert Gomez, Edward Tenorio, and Donna Tenorio applied for residential mortgages through First Magnus.² Fourth Amended Complaint (“FAC”) ¶¶ 3-7. Plaintiffs obtained adjustable rate mortgages (“Option ARMs”) that included a promissory note (“Note”) and a Truth-in-Lending Disclosure Statement (“TILDS”) (collectively, the “Loan

¹ This disposition is not designated for publication in the official reports.

² First Magnus has filed a Chapter 11 petition in the United States Bankruptcy Court for the District of Arizona and no longer is a defendant in this action.

1 Documents”). Each of the loans offered a low “teaser” interest rate ranging from 1% to 3.5% for
2 the first thirty days; the interest rate then adjusted to the sum of an “index” and a “margin.” FAC
3 ¶ 20. Because the margin rate of each loan was higher than the teaser rate, the new rates were
4 guaranteed to be higher than the teaser rate even if the index fell to zero. *Id.* ¶ 23. However, the
5 payment schedule in the TILDS for the first three to five years of the loan was based upon a fully
6 amortizing payment at the lower “teaser” rate. *Id.* ¶ 18. Because of the increase in the ultimate
7 interest rate, the monthly payments described in the Note and TILDS were insufficient to pay all
8 of the interest accruing on the Note after the first month. As a result, negative amortization (the
9 addition of unpaid interest to the loan principal) was certain to occur if Plaintiffs continued to
10 make the disclosed monthly payments. *Id.* ¶ 22. Despite this certainty, the Note disclosed only
11 the possibility of negative amortization, stating that the “Minimum Payment *could be less* than
12 or greater than the amount of the interest portion of the monthly payment.” *Id.* ¶ 28, Ex. 1-5, ¶
13 3(E) (emphasis added).

14 Plaintiffs allege that although First Magnus provided them with the Loan Documents,
15 Defendant Countrywide Home Loans, Inc. (“Countrywide”) “dictated the terms and pre-
16 approved loan and disclosure terms and documents.” *Id.* ¶37(e). After closing, the mortgages
17 were sold to Countrywide. *Id.* ¶ 3-7.

18 **B. Countrywide’s alleged role in the option arm loan origination process**

19 The FAC asserts that “Countrywide is in the business of . . . securitizing home mortgage
20 loans by packaging those loans into trusts or other vehicles in order to sell bonds to investors
21 based on the income to be derived from those loans.” *Id.* ¶ 37(a). Plaintiffs allege that
22 Countrywide and others developed a scheme to have third-party originators such as First Magnus
23 sell loans on their behalf in order to increase the number of loans they could securitize. *Id.* ¶
24 37(b). They claim that because First Magnus funded their Option ARM loans using monies
25 borrowed through warehouse lines of credit (including those offered by Countrywide Warehouse
26 Lending, an affiliate of Countrywide Home Loans), its business depended on its ability promptly
27 to resell the loans it originated to institutions like Countrywide. *Id.* ¶ 37(c)-(d).

28 Plaintiffs allege that Countrywide insisted upon the use of its preapproved loan terms and

1 documents as a condition to its purchase of their loans. FAC ¶ 37(e). Specifically, they assert
2 that Countrywide made the Loan Documents available to First Magnus, which merely filled in
3 the specific details of their respective loan transactions. *Id.* ¶ 37(f). Countrywide then provided
4 First Magnus with access to Countrywide’s secure proprietary website, which identified the
5 specific loan terms Countrywide would accept. *Id.* ¶ 37(g). Under its Loan Purchase Agreement
6 with First Magnus, Countrywide only would purchase loans that were originated using loan and
7 disclosure documents that Countrywide had approved and that complied with underwriting
8 guidelines and rate sheets available on the website. *Id.* ¶ 45, 49.

9 Plaintiffs also claim that while the Option ARM loan documents it designed and required
10 suggested only a possibility of negative amortization, Countrywide identified the loans as
11 “negative amortization loans” in its prospectus for the sale of mortgage-backed securities. FAC
12 ¶ 51. The “Risk Factors” section of the prospectus explains that

13 after the introductory interest rates expire and until the initial annual adjustment
14 to the scheduled monthly payment made by the borrower . . . *the scheduled*
15 *monthly payment made by the borrower will not be sufficient to pay the amount of*
16 *interest accruing on the mortgage loan. . . .* If borrowers only make their
17 scheduled monthly payments, a portion of the accrued interest on negatively
18 amortizing loans will become deferred interest.

19 FAC ¶ 53 (emphasis added).

20 **C. Procedural History**

21 On August 30, 2007, Plaintiff Romero filed her original class action complaint, asserting
22 claims against First Magnus under the Truth in Lending Act (“TILA”) and California law. First
23 Magnus did not answer or otherwise respond to the complaint. On October 11, 2007, Romero
24 filed a first amended complaint. First Magnus subsequently filed for bankruptcy protection. The
25 Court then granted Plaintiffs’ motion for leave to file a second amended complaint adding Ruiz,
26 Castro, Aguilera, Gomez and the Tenorios as plaintiffs, deleting First Magnus as a defendant,
27 and naming Countrywide Bank, N.A., Countrywide Home Loans (collectively, “the Countrywide
28 Defendants”), and Homecomings Financial LLC, Washington Mutual Bank, Aurora Loan
Services, and Does six through ten as additional defendants.

On July 10, 2009, Plaintiffs moved for leave to file a third amended complaint asserting,
upon information and belief, that First Magnus had sold Plaintiffs’ mortgage loans to the

1 Countrywide Defendants. The Court granted that motion. The third amended complaint was
2 filed on September 14, 2009 against the Countrywide Defendants and Does seven through ten,
3 alleging violations of TILA and California’s Unfair Competition Law (“UCL”), Bus. & Prof.
4 Code § 17200 *et seq.*, as well as a fraudulent omissions claim.

5 The Countrywide Defendants moved to dismiss the third amended complaint for failure
6 to state a claim upon which relief may be granted. The Court granted the motion on the basis
7 that Plaintiffs’ factual allegations lacked sufficient particularity to satisfy the requirements of
8 Fed. R. Civ. Pro. 9(b). Order of July 27, 2010 at 6. In particular, the Court concluded that
9 Plaintiffs had not pled with particularity which Countrywide entity “selected, pre-approved,
10 and/or drafted” the loan disclosure documents at issue. *Id.* The Court also found Plaintiffs
11 allegations with respect to the selection, preapproval, or drafting of loan documents by the
12 Countrywide Defendants to be “vague and conclusory in nature.” *Id.* Plaintiffs were given leave
13 to amend their pleadings to address these deficiencies.

14 II. LEGAL STANDARD

15 “Dismissal under Rule 12(b)(6) is appropriate only where the complaint lacks a
16 cognizable legal theory or sufficient facts to support a cognizable legal theory.” *Mendiondo v.*
17 *Centinela Hosp. Med. Ctr.*, 521 F.3d 1097, 1104 (9th Cir. 2008). For purposes of a motion to
18 dismiss, the plaintiff’s allegations are taken as true, and the court must construe the complaint in
19 the light most favorable to the plaintiff. *Jenkins v. McKeithen*, 395 U.S. 411, 421 (1969). “To
20 survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true,
21 to ‘state a claim to relief that is plausible on its face.’ A claim has facial plausibility when the
22 plaintiff pleads factual content that allows the court to draw the reasonable inference that the
23 defendant is liable for the misconduct alleged.” *Ashcroft v. Iqbal*, --- U.S. ----, 129 S.Ct. 1937,
24 1949., *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556, 570 (2007). Thus, a court need not accept
25 as true conclusory allegations, unreasonable inferences, legal characterizations, or unwarranted
26 deductions of fact contained in the complaint. *Clegg v. Cult Awareness Network*, 18 F.3d 752,
27 754-755 (9th Cir. 1994).

1 **III. DISCUSSION**

2 **A. Countrywide’s liability for fraudulent omissions in the Loan Documents**

3 Under California law, the elements of a common-law claim for fraudulent omission are:
4 (1) the defendant concealed or suppressed a material fact; (2) the defendant was under a duty to
5 disclose the fact to the plaintiff; (3) the defendant intentionally concealed or suppressed the fact
6 with intent to defraud the plaintiff; (4) the plaintiff was unaware of the fact and would have acted
7 differently if she had known of the concealed or suppressed fact; and (5) the plaintiff sustained
8 damage as a result of the concealment or suppression. *See Hahn v. Mirda*, 147 Cal. App. 4th
9 740, 748 (2007).

10 **1. Concealment or suppression of a material fact**

11 Rule 9(b) requires that allegations of fraud be “stated with particularity.” The purpose of
12 the rule is to require a plaintiff to be “specific enough to give defendants notice of the particular
13 misconduct which is alleged to constitute the fraud charged so that they can defend against the
14 charge and not just deny that they have done anything wrong.” *Swartz v. KPMG LLP*, 476 F.3d
15 756, 764 (9th Cir. 2007). “In the context of a fraud suit involving multiple defendants, a plaintiff
16 must, at a minimum, identify the role of each defendant in the alleged fraudulent scheme.” *Id.* at
17 765 (internal quotation marks and citation removed).

18 Plaintiffs allege that even though Countrywide knew that negative amortization was
19 certain to occur in Plaintiffs’ Option ARM loans, it suppressed that fact by requiring First
20 Magnus to use loan forms and terms that described negative amortization as a mere possibility.³
21 Plaintiffs’ present pleading specifically identifies the role that Countrywide is alleged to have
22 played in crafting the Loan Documents at issue here. These allegations include the following:
23 “CHL dictated the terms of and pre-approved the loan and disclosure documents, including the
24 Loan Documents at issue in this action, with the intention that First Magnus would provide them
25

26 ³ As the Court noted with respect to Plaintiffs earlier complaint, this Court as well as
27 others have recognized the viability of claims for failure to disclose clearly and conspicuously
28 the certainty of negative amortization. *See Order of July 27, 2010 at 9 (quoting Ralston v. Mortgage Investors Group, Inc., No. C 08-536 JF(PVT), 2010 WL 3211931, at *6 (N.D. Cal. Aug. 12, 2010)).*

1 to Plaintiffs and Class Members in connection with Option ARM loans originated by First
2 Magnus,” FAC ¶ 49; “CHL made the pre-approved loan and disclosure documents available” to
3 First Magnus, *id.* ¶ 37(f), and required the use of “loan and disclosure documents that CHL
4 approved as a condition to CHL’s purchase of those loans,” *id.* ¶ 49; and “First Magnus was
5 required to comply with CHL’s underwriting guidelines and the rate sheets made available to
6 First Magnus on CHL’s proprietary, secure website.” *Id.* ¶ 37(g).

7 Countrywide argues these allegations fail to identify the specific terms in their loan
8 documents that Countrywide purportedly dictated, drafted, or preapproved. Defendant’s Reply
9 at 3. It contends that Plaintiffs must identify exactly what terms it drafted or pre-approved, how
10 it did so, and when it did so. *Id.* However, Plaintiffs’ amended allegations are sufficiently
11 specific to put Countrywide on notice of the particular misconduct that constitutes its alleged
12 fraud.

13 **2. Duty to disclose**

14 Countrywide next contends that Plaintiffs’ fraudulent omissions and UCL claims must be
15 dismissed because it had no duty to disclose information about loans made by another entity.
16 Plaintiffs argue that a duty existed because Countrywide aided and abetted the alleged
17 misconduct of First Magnus.

18 To establish an aiding and abetting claim, Plaintiffs must allege that the Countrywide
19 “[1] *kn[e]w* the other’s conduct constitute[d] a breach of a duty and [2] *g[a]ve* substantial
20 assistance or encouragement to the other to so act.” *In re First Alliance Mortg. Comp.*, 471 F.3d
21 977, 993 (9th Cir. 2006) (quoting *Casey v. U.S. Bank National Assn.*, 127 Cal. App. 4th 1138,
22 1144, 26 Cal. Rptr. 3d 401 (2005)) (emphasis in original). Thus, Plaintiffs must plead facts
23 tending to show that (1) First Magnus breached a duty it owed to Plaintiffs to disclose omitted
24 facts, (2) Countrywide knew in advance that First Magnus’ alleged misconduct constituted a
25 breach of duty, and (3) Countrywide gave substantial assistance or encouragement to First
26 Magnus to engage in the alleged misconduct as to each of their loans.

27 Countrywide argues first that Plaintiffs have not alleged adequately that First Magnus
28 had a duty to disclose the omitted facts. It contends that under California law a lender owes no

1 fiduciary duty to a borrower because the parties are engaged in an arms length transaction.
2 *Pension Trust Fund of Operating Eng'rs v. Fed. Ins. Co.*, 307 F.3d 944, 954 (9th Cir. 2002).
3 However, Plaintiffs observe correctly that affirmative representations made in loan documents
4 may give rise to a duty to disclose relevant information. *See Warner Constr. Corp. v. L.A.*, 2
5 Cal. 3d 285, 294 (1970) (“In transactions which do not involve fiduciary or confidential
6 relations, a cause of action for non-disclosure of material facts may arise . . . [where] the
7 defendant makes representations but does not disclose facts which materially qualify the facts
8 disclosed, or render his disclosure likely to mislead.”); *see also LiMandri v. Judkins*, 52 Cal.
9 App. 4th 326, 336-37 (1997). Plaintiffs allege that “the Loan Documents’ partial representations
10 that omitted material facts created a duty to disclose all material facts concerning Plaintiffs’ and
11 Class Members’ Option ARM loans.” FAC ¶ 67. They also assert that First Magnus provided
12 the Loan Documents to them when it originated the loan. *See id.* ¶ 3-7. These factual
13 allegations are sufficient to support a claim that First Magnus owed Plaintiffs a duty to disclose
14 relevant material facts during the loan transaction.

15 Next, Countrywide contends that Plaintiffs do not plead sufficient facts to support the
16 conclusion that Countrywide had advance knowledge of First Magnus’s omissions or partial
17 representations. It argues that because First Magnus inserted the specific terms of each loan into
18 the loan documents, it is implausible that Countrywide would have known of First Magnus’s
19 alleged misconduct. However, Plaintiffs allege that Countrywide *required* that First Magnus use
20 particular loan forms and loan terms on all loans First Magnus intended to resell to Countrywide.
21 FAC ¶ 45. They also allege that through its proprietary website, Countrywide identified “all of
22 the possible loan options offered by Countrywide available to a particular borrower, *including*
23 *different pricing, documentation requirements, and terms.*” FAC ¶ 41 (emphasis added).
24 Plaintiffs thus allege adequately that the statements and omissions at issue were dictated by
25 Countrywide before Plaintiffs’ transactions with First Magnus occurred.

26 Finally, Countrywide contends that Plaintiffs have not sufficiently alleged that
27 Countrywide provided “substantial assistance” to First Magnus. However, Plaintiffs assert
28 specifically that the Loan Purchasing Agreement, under which Countrywide agreed to buy loans

1 from First Magnus that conformed to its specifications (including loan terms), allowed First
2 Magnus to obtain the warehouse lines of credit it needed to originate Plaintiffs' loans. FAC ¶
3 37(i). Countrywide argues that the mere fact that it purchased loans from First Magnus does not
4 rise to the level of substantial assistance, especially where Plaintiffs have not alleged that its was
5 the *only* purchaser of loans made by First Magnus. Countrywide relies upon *In re Software*
6 *Toolworks, Inc. Securities Litig.*, No. C-90-2906 FMS, 1991 WL 319033, at *3 (N.D. Cal. June
7 17, 1991), in which the court found that "providing routine investment banking services" in
8 connection with an initial public offering was insufficient to state a claim for aiding and abetting.
9 Here, in contrast, Plaintiffs allege that Countrywide *required* First Magnus use conforming loan
10 terms and disclosures as a condition of the Loan Purchase Agreement. They also allege that it
11 was this particular arrangement that allowed First Magnus to obtain funding for their loans. This
12 Court has found has found similar allegations sufficient to allege aiding and abetting liability.
13 *See, e.g., Ralston*, 2010 WL 3211931, at *8 (concluding that allegations that "Countrywide
14 provided . . . loan originators with substantial assistance in pushing the fraudulent loans by
15 providing lines of credit and guarantees that Countrywide would purchase the Option ARM
16 loans when made" sufficient to state a claim under aiding and abetting).

17 **3. Remaining Elements**

18 Plaintiffs allege that Countrywide concealed or suppressed the certainty of negative
19 amortization deliberately, with intent to defraud them and those similarly situated. FAC ¶¶ 51-
20 59; *see* Fed. R. Civ. P. 9(b) ("Malice, intent, knowledge, and other conditions of a person's mind
21 may be alleged generally."). Plaintiffs also allege that the omitted information was material as to
22 both the interest rate and the amount of payments and that they would not have entered into the
23 loans if the certainty of negative amortization had been disclosed. FAC ¶ 77; *see Mirkin v.*
24 *Wasserman*, 5 Cal.4th 1082, 1092 (1993) (holding that plaintiffs can demonstrate reliance by
25 showing that "had the omitted information been disclosed, [they] would have been aware of it
26 and behaved differently"). Finally, Plaintiffs allege adequately that they suffered damages,
27 including the loss of equity in their homes. FAC ¶ 78,

28 **B. UCL Claim**

1 California’s UCL prohibits “any unlawful, unfair or fraudulent business act or practice
2 and unfair, deceptive, untrue or misleading advertising.” Cal. Bus. & Prof. Code § 17200.
3 Accordingly, “[a]n act can be alleged to violate any or all of the three prongs of the
4 UCL—unlawful, unfair, or fraudulent.” *Berryman v. Merit Prop. Mgmt., Inc.*, 152 Cal. App. 4th
5 1544, 1554 (2007). Plaintiffs claim that Countrywide’s conduct violated all three prongs.

6 Countrywide contends that to the extent that Plaintiffs’ UCL claim is based on fraudulent
7 conduct, it fails to meet the heightened pleading standard of Rule 9(b). However, as discussed
8 above, the Court concludes Plaintiffs have stated a claim for fraudulent omission.

9 **C. Tenorios’ Fraudulent Omissions Claim**

10 Countrywide argues that the Tenorios’ fraudulent omissions claim should be dismissed as
11 time-barred. It argues that because their claim challenges conduct that occurred at or prior to the
12 inception of their loan, a reasonable person in the Tenorios’ position would have discovered the
13 basis of the claim. The Tenorios’ loan closed in June 2005, FAC ¶ 7, but they did not file their
14 claim until November 17, 2008. The applicable limitations period is three years. *See* Cal. Code
15 Civ. Pro. § 338(d) (providing that the statute of limitations for common law fraud runs three
16 years from the discovery of the facts constituting fraud).

17 In its order dated July 27, 2010, the Court discussed whether Romero’s initial complaint
18 tolled the statute of limitations for the Tenorios’ rescission claim. The Court noted that in
19 *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 554 (1974), the Supreme Court held
20 that “commencement of a class action suspends the applicable statute of limitations as to all
21 asserted members of [the] class who would have been members had the suit been permitted to
22 proceed as a class action.” However, this Court also observed that the “the rescission remedy
23 prescribed by TILA is procedurally and substantively incompatible with the class-action device”
24 and “may not be pursued on a class basis.” Order of July 27, 2010 at 19 (citing *Amparan v.*
25 *Plaza Home Mortg., Inc.*, 678 F. Supp.2d 961, 979 (N.D. Cal. 2008)).

26 The Tenorios’ state law claims do not suffer from the same infirmity as their rescission
27 claim. Romero’s initial class action complaint was filed August 30, 2007. On November 17,
28 2008, the complaint was amended to add additional class representatives, including the Tenorios.

1 “An amendment adding a party plaintiff relates back to the date of the original pleading only
2 when: 1) the original complaint gave adequate notice of the claims of the newly proposed
3 plaintiff; 2) the relation back does not unfairly prejudice the defendant; and 3) there is an identity
4 of interests between the original and newly proposed plaintiff.” *Immigrant Assistance Project of*
5 *the L.A. County Fed’n of Labor v. INS*, 306 F. 3d 842, 857 (9th Cir. 2001). Here, the Tenorios’
6 fraud claim relates back to Romero’s initial complaint. The loan documents used in the
7 Tenorios’ transaction are identical in all relevant respects to the documents used in the Romero
8 transaction. Accordingly, the original complaint provided adequate notice of the Tenorios’
9 claims, and there is an identity of interests between Romero and the Tenorios. As a practical
10 matter, because Countrywide was first named as a defendant in the same pleading that added the
11 Tenorios as plaintiffs, Countrywide could not have been prejudiced by the addition of the
12 Tenorios as class representatives in November 2008 rather than August of 2007.

13 **IV. ORDER**

14 Good cause therefor appearing, the motion to dismiss is DENIED.⁴ Countrywide shall
15 file its answer within thirty (30) days of the date this order is filed.

16 **IT IS SO ORDERED.**

17
18 Dated: February 3, 2011

19 
20 JEREMY FOGEL
21 United States District Judge

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⁴ The Court previously dismissed the Tenorios’ rescission claim.