

## BofA, Goldman Sachs Find State Mortgage Cases Hard to Shake

By Karen Gullo - Jul 29, 2011

Investors suing [Bank of America Corp. \(BAC\)](#) and more than a dozen other underwriters to force the buyback of \$6.7 billion in downgraded mortgage securities have defeated efforts by the banks in pretrial skirmishes to throw out the cases or move them from state courts.

A Washington state judge in [Seattle](#) said in rulings over the past two months that Bank of America, [Goldman Sachs Group Inc. \(GS\)](#) and other underwriters can't cite faulty data from appraisers or expired statutes of limitation to avoid Federal Home Loan Bank of Seattle's claims that there was false information in offering documents for at least \$3.9 billion in securities it bought.

Bank of America tried unsuccessfully today to persuade a [California](#) state court judge that the statute of limitations had expired on claims in a lawsuit seeking to make underwriters repurchase \$19 billion in mortgage-backed securities.

If the judge's tentative ruling becomes final, it may open the door for investors to access internal bank files and e-mails about the loans in the pre-trial exchange of evidence, strengthening their bargaining position in any settlement talks.

"At each milestone it puts additional pressure on the defendant to settle," said Isaac Gradman, an attorney and managing member of IMG Enterprises LLC, a mortgage-backed securities consulting firm in Petaluma, California, that advises clients on legal and contractual matters.

### 'Public Awareness'

The nine securities dealers sued by the Federal Home Loan Bank of [San Francisco](#) asked Judge Richard Kramer today to dismiss the case. They said the home loan bank waited too long to sue, should have heeded "public awareness" of the risks of mortgage-backed securities and was warned in the offering documents about potential problems with loan performance, according to court filings.

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The statute of limitations for seeking buybacks is two years from when the bank knew or should have known about the alleged false statements, Kramer said. The securities at issue in the case date back to 2006. The lawsuit was filed last year.

The home loan bank, a sophisticated and central player in the mortgage business, would “have had to be more than deaf, dumb and blind” not to have known back in 2007 about the problems with residential loans, said Stephen Hibbard, an attorney for Bank of America, at today’s hearing in San Francisco. “The information was out there in the world, and this sophisticated plaintiff should have known.”

## Statute of Limitations

Kramer, in his tentative ruling, rejected arguments by Bank of America and other underwriters that the statute of limitations under California law had passed. The Federal Home Loan Bank will drop its federal securities-law claims if Kramer adopts his tentative ruling that the bank waited too long to sue under federal law, said David Grais, the bank’s attorney, at today’s hearing.

Kramer hasn’t ruled on the underwriters’ requests for dismissal on other grounds.

The Federal Home Loan Banks of Seattle, San Francisco, Pittsburgh, [Chicago](#) and Indianapolis, as well as companies including [Charles Schwab Corp. \(SCHW\)](#) and Allstate Insurance Co., are pursuing lawsuits in state courts across the country under each state’s so-called blue sky investor protection laws.

The term blue sky came from the words of a judge in the early 1900s who referred to speculative schemes backed by nothing more than so many feet of “blue sky,” according to the North American Securities Administrators Association [website](#).

## Blue Sky

Under the blue-sky laws, plaintiffs don’t have to prove that there was a fraud committed, only that the defendants made untrue statements, unlike in federal securities cases where it must be shown that defendants knew their actions were fraudulent, said Grais, a lawyer at Grais & Ellsworth in [New York](#) who represents some of the home loan banks.

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“The burden of proof is less in the state cases,” said William Black, law and economics professor at [University of Missouri](#) and former litigation director at the Federal Home Loan Bank Board, explaining why investors favor the venue over federal courts.

Black said state court plaintiffs stand a better chance of getting a judge who isn’t “hostile to the notion that someone in a nice suit made a false representation selling securities.”

[Bill Halldin](#), a spokesman for [Charlotte](#), North Carolina- based Bank of America, declined to comment on today’s tentative rulings.

The cases take aim at investment banks that played a central role in securitizing pools of home loans that were sold to investors during the housing bubble.

## Credit Quality

In securitizations, a large number of loans are grouped into a pool and sold to a trust which raises money for the purchase by selling bonds, or certificates.

The underwriters purchase certificates from the trust and sell them to investors. They gather statistics and data about the loans’ credit quality to include in documents filed with regulators when the securities are offered for sale.

The [cash flow](#) from the loans in the pool is the source of funds to pay the holders of the certificates. Loans backing these certificates that went into default were a key part of the financial crisis in 2008 that helped send the U.S. into the biggest recession since the 1930s.

In more than a dozen cases filed in state courts since 2009, investors have alleged that the offering documents prepared by the underwriters contained false or misleading information about the loans, such as how much equity borrowers had in their homes, the appraised value of the home and the criteria used by lenders to decide whether borrowers should get loans.

## Countrywide, IndyMac

The loans were originated or acquired by Countrywide Financial Corp., IndyMac Bank, GreenPoint Mortgage Funding Inc., National City Mortgage and others, according to the complaints.

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Countrywide, based in Calabasas, California, was once the biggest U.S. residential home lender, originating or purchasing about \$1.4 trillion in mortgages from 2005 to 2007. The bulk of them were sold to investors as mortgage-backed securities. Bank of America acquired Countrywide in 2008.

The lawsuits are separate from group, or class-action, cases pending in federal courts where some institutional investors may have to settle for less than 1 percent of what they initially sought because judges have scaled back or dismissed claims.

The state cases also aren't covered by an \$8.5 billion settlement announced June 29 between Bank of America and 22 institutional investors in Countrywide mortgage-backed securities. That accord, if approved, will resolve investors' claims that Countrywide was required under contract to repurchase loans that didn't meet its underwriting guidelines.

## Cases Continue

The state court cases would continue under the terms of the proposed settlement, Grais said.

A group of [Federal Home Loan Banks](#), including some that are suing in state court, have said that Countrywide investors may be owed more than three times what is offered in the \$8.5 billion settlement, according to a court filing.

Underwriters moved the state cases to federal court, claiming that the lawsuits shouldn't be heard in state courts because some of the loans involved were made by companies in bankruptcy, according to court filings. Federal judges rejected the argument and sent almost all the cases back to state courts, according to court filings.

Judges in Seattle and Pittsburgh have refused to throw out two of more than a dozen cases pending around the country seeking buybacks of as much as \$32 billion in securities. The amount at stake in the Pittsburgh case is \$2.8 billion. Motions to dismiss in other cases are pending or haven't yet been filed.

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## Credit Ratings

The Federal Home Loan Bank of Seattle, in one of 11 lawsuits it filed in [Washington's](#) King County Superior Court against underwriters, claimed that New York-based Goldman Sachs's offering documents made false representations about more than half of the loans in a 2,793-loan pool that it bought in 2007 for \$105 million.

The security, originally given the highest credit ratings by Moody's Investors Service and [Standard & Poor's](#), has been downgraded to junk status, according to the complaint.

Goldman Sachs claimed that the lawsuit should be dismissed because it can't be sued over statements in the offering documents that came from other parties.

Washington's investor protection law holds underwriters strictly liable for materially untrue or misleading statements, "regardless of the ultimate source of those statements," Judge Laura Inveen said in a July 19 order.

[Michael DuVally](#), a Goldman Sachs spokesman, declined to comment.

Grais said the next phase of the case would be to seek internal documents from the underwriters to learn what they knew about the loans involved in the securities.

The San Francisco case is Federal Home Loan Bank of San Francisco v. Credit Suisse, CGC-10-497840, California Superior Court, San Francisco County.

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