UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE GENWORTH FINANCIAL, INC. SECURITIES LITIGATION	Case No. 14-CV-02392 (AKH)

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE SECOND AMENDED CLASS ACTION COMPLAINT

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Defendants Genworth,[1] Michael D. Fraizer, and Martin P. Klein respectfully submit this reply memorandum of law in further support of their motion to dismiss.

PRELIMINARY STATEMENT

Plaintiffs' entire complaint is built on the assertion that Genworth Australia—a mortgage insurance unit of Genworth—experienced massive undisclosed delinquencies (*i.e.*, mortgage defaults by borrowers) and claims (*i.e.*, delinquencies that become valid insurance claims by mortgage lenders) during the November 4, 2011 to April 17, 2012 class period. This assertion about undisclosed delinquencies and claims (which drives Plaintiffs' argument that Defendants made fraudulent statements about subjects as varied as (i) Genworth Australia's financial performance and results, (ii) Genworth Australia's loss reserves, and (iii) Genworth's plan for the IPO) rests on two lone allegations:

(i) Plaintiffs' mischaracterization of a May 2012 post-class period comment by Mr. Upton (CFO of Genworth's global mortgage insurance business) that Genworth Australia had experienced increasing delinquencies "in the second half of 2011," which Plaintiffs—not any CW and certainly not Mr. Upton—characterize as an "admission" of previously concealed information; and

(ii) Alleged assertions from CW1, a former Genworth IT technician (who specialized in software patching and supporting email systems), that, at a meeting in December 2011, Genworth management revealed to 40-50 employees that Genworth Australia had experienced an "increase in claims in Australia equaling around $100-125 million"—an amount far greater than any quarterly claims amount disclosed during or even at the end of the class period.

Plaintiffs do not dispute that, if the Court rejects Plaintiffs' argument that these allegations plead fraud, the complaint must be dismissed.

Defendants' opening brief explained why these two allegations are insufficient to sustain a fraud complaint under the PSLRA:

Nothing in the complaint or Mr. Upton's words supports the claim that Mr. Upton's

[1] Capitalized terms not defined in this brief retain their definitions from Defendants' opening brief.

statement that Genworth Australia had experienced increasing delinquencies was in any way inconsistent with the detailed quarterly delinquency disclosures Genworth made throughout the class period. Plaintiffs continue to label Mr. Upton's comment an "admission" with no factual or legal basis for doing so.

That leaves the assertion of CW1 (a low-level computer technician with no expertise in mortgage insurance, reserves, or the Australian market or economy) that at a regularly scheduled December 2011 meeting Genworth management disclosed to several dozen employees, ranking from senior management down to technicians in the IT department, that Genworth Australia had experienced a "$100-125 million" increase in claims. This number far exceeds what Genworth was reporting to the SEC. It far exceeds even what Genworth reported as the cause of its significant losses at the end of the class period. And, according to Plaintiffs, this number was revealed for no apparent reason to fifty employees, most of whom had nothing to do with the Australian mortgage business. These employees sat silent while Genworth, according to Plaintiffs, concealed this startling information and actively lied about the state of Genworth Australia. In stark contrast, Plaintiffs' CW2—Genworth Australia's COO at the time—has nothing to say about the alleged massive claims increase, the meeting CW1 reports, or anything to substantiate or even suggest any misstatements about claims, Genworth Australia, or the planned IPO. These bases and others, Defendants have argued, render CW1 completely unreliable and support rejecting CW1's illogical story.

Plaintiffs' opposition to these arguments is limited. To the "management spilled the beans to 40-50 employees then committed repeated instances of securities fraud" theory recounted by CW1, Plaintiffs say, "Executives commit securities fraud all the time." To CW1's undisputed lack of expertise, Plaintiffs say, "Who needs expertise to remember one number from

a slide presentation years ago." And to the lack of corroboration of CW1's story by the CW who would have had far greater exposure to any supposed financial fraud, Plaintiffs say, "Corroboration is not required, and there are lots of reasons why a witness might not speak on a topic."

CW1's unsupportable assertions cannot carry Plaintiffs past *Tellabs*'s requirement that a securities fraud plaintiff plead *particularized facts* giving rise to a *strong* inference of scienter. The problems with CW1's account are rendered all the more troubling by Judge Engelmayer's recent decision in *In re Millennial Media, Inc. Securities Litigation*, 2015 WL 3443918 (S.D.N.Y. May, 29, 2015), which involved one half of Plaintiffs' lead counsel here. In *Millennial Media*, plaintiffs' counsel admitted that its standard practice was to "make[] literally no attempt to confirm the quotes of a witness on whom counsel propose[d] to rely in a public filing" (*id.* at *11)—a practice, Judge Engelmayer found, that (i) "create[d] significant potential for inaccuracy" (*id.* at *6) and "significantly undermine[d] the integrity of" plaintiffs' pleading (*id.* at *10) and (ii) perhaps constituted a "'see no evil' approach to pleading"—a "quest for ignorance"—but that in any case "sits at best uneasily alongside" Rule 11 (*id.* at *11). While Defendants cannot on the current record allege that Plaintiffs' counsel here followed their usual CW practice with the same results that Judge Engelmayer identified, there are serious questions raised by CW1's allegations.

For all of these reasons and those below, we urge the Court to grant Defendants' motion and dismiss Plaintiffs' complaint with prejudice.

First, Plaintiffs have failed to follow the Court's instructions to replead their claims "plainly and clearly." Their allegations remain nearly impossible to follow. Their total reliance on the two allegations described above, however, is clear and warrants dismissal. *See* Point I

below.

Second, Plaintiffs still have not articulated a cogent theory of scienter. They posit that (i) Defendants began lying about Genworth Australia's financials after Q3 2011 to preserve an IPO planned for Q2 2012, (ii) by the end of Q4 2011, Defendants realized those financial lies would backfire before the IPO could be executed, but nevertheless began to lie that the IPO was still on track for Q2 2012, and continued to lie about Genworth Australia's financials, and (iii) one quarter later in Q1 2012 Defendants disclosed that Genworth Australia's performance required a postponement of the IPO. There is no logical explanation for why Defendants would proceed with a scheme so certain to fail (certainly none alleged in the complaint) instead of simply disclosing issues about increasing delinquencies and claims one quarter earlier. Plaintiffs try to get around this by offering a half-dozen other scienter theories, none of which has pleaded factual or legal merit. *See* Point II below.

Third, Defendants' statements about the IPO are protected by the PSLRA safe harbor because they are forward-looking statements accompanied by meaningful cautionary language warning investors of reasons why the projections might turn out to be wrong. These statements are independently protected because Plaintiffs have failed to plead that Defendants had actual knowledge of any statement's falsity (a state-of-mind-related inquiry that is separate from the question of whether those statements were accompanied by meaningful cautionary language). *See* Point III below.

Fourth, the individual claims against Mr. Fraizer (Genworth's former CEO), and Mr. Klein (Genworth's CFO) should be dismissed because the complaint is devoid of any particularized allegations demonstrating that either of these individual Defendants made a false statement or acted with scienter. *See* Point IV below.

Finally, Defendants summarize Judge Engelmayer's pertinent findings in *Millennial Media*, which support a rejection or at the very least a heavy discount to Plaintiffs' already insufficient CW allegations here. *See* Point V below.

ARGUMENT

I. PLAINTIFFS FAIL TO PLEAD AN ACTIONABLE FALSE STATEMENT OR OMISSION

Defendants' opening brief established that Plaintiffs' mischaracterizations of Mr. Upton's remark (*see* Def. Br. at 16-19) and the flawed allegations of the confidential computer technician (*see id.* at 19-28) are not sufficient to satisfy Rule 8(a)'s pleading requirements, much less the heightened pleading requirements of Rule 9(b) and the PSLRA. As Defendants explained, neither allegation demonstrates that Defendants falsely stated facts or opinions about Genworth Australia's performance results, loss reserves, or the IPO plan.

Plaintiffs respond by accusing Defendants of "deliberately misconstru[ing] and disregard[ing]" the complaint's operative theory. Pl. Opp. at 7-8. Specifically, Plaintiffs assert that even if Defendants' statements on these subjects were "literally true"—in other words, not false—they nonetheless are actionable because the statements purportedly "Created A Materially Misleading Impression That The Queensland Delinquency Risks Had Been Mitigated, And That No Market Conditions Existed That Would Impede the IPO." *Id.* This represents a notable retreat from the complaint's allegations. The alleged factual support for this fallback "true-but-misleading" argument, however, remains the same: Mr. Upton's comment and CW1.

Plaintiffs' new interpretation of the complaint fails for a number of reasons set forth below. As in their prior pleading and opposition brief, Plaintiffs fail to articulate what exactly Defendants said that was false and why those statements were false (a basic starting point for a fraud claim). *See* Point I.A below. Plaintiffs fail to support their characterization of Mr. Upton's

post-class period comment or their reliance on CW1. *See* Point I.B below. Plaintiffs also fail to offer any meaningful rejoinder to Defendants' arguments that the complaint fails to plead that Genworth Australia's loss reserves were false (*see* Point I.C below) or that Defendants made any false statements about the IPO plan (*see* Point I.D below). Finally, Plaintiffs' new focus on the theory that Defendants made "true-but-misleading" statements is unsupported by any well-pleaded facts and relies on an inapposite line of authority. *See* Point I.E below.

A. Plaintiffs' Opposition Highlights Their Failure to Comply with the Court's Instructions to Replead Their Claims "Plainly and Clearly"

In dismissing Plaintiffs' first amended complaint, the Court found Plaintiffs' pleading "full of … meaningless prolixity and ambiguity" that rendered the reader "unable to understand which of the many allegations are claimed to be false and misleading, or why." ECF No. 41 at 2. The Court ruled that the first amended complaint "fail[ed] to plead a coherent claim for relief, satisfying the command of the PSLRA, 15 U.S.C. §78u-4, and Rules 8(a)(2) and 9(b) of the Federal Rules of Civil Procedure." *Id.* at 3. The Court granted Plaintiffs leave to file a second amended complaint with the instruction that the amended pleading must "'specify each statement alleged to have been misleading,' and 'the reason or reasons why,' but plainly and clearly, and not in an effusive ambiguity as the Amended Complaint does." *Id.* Plaintiffs' opposition brief highlights—even exacerbates—the failure of the second amended complaint to clarify Plaintiffs' basis for accusing Defendants of lying to investors.

Perhaps most confounding are Plaintiffs' vacillating attacks on the loss ratios disclosed for Genworth Australia during the class period. The complaint alleges that Genworth Australia had "grossly understated loss ratios." SAC ¶ 89. But Plaintiffs' opposition leads with the apparent argument that the reported loss ratios, while "literally true," nonetheless were misleading because they "remained stable or decreased" during the class period. Pl. Opp. at 8-9

(emphasis omitted). But as Plaintiffs acknowledge, loss ratios are a math equation: they represent "the ratio of claims on policies and loss reserves to net premiums earned from the insurance." *Id.* at 8 (emphasis omitted). If the loss ratios were "literally true," then Plaintiffs' argument that Genworth falsely reported claims and reserves (components of the loss ratio calculation), yet somehow arrived at "literally true" loss ratios, makes no sense. Further muddling the issue, Plaintiffs' opposition elsewhere argues that the loss ratios were, in fact, "falsely stated." *Id.* at 12.

Plaintiffs also confuse and mischaracterize Defendants' disclosures. Referencing a number of comments by Mr. Upton in his explanation of Genworth Australia's poor Q1 2012 performance (*see id.* at 9-10), Plaintiffs claim that "Upton's admission is consistent with, and further bolstered by, CW1's account that an increase in claims in Australia amounting to $100-125 million was disclosed internally as early as December 2011." *Id.* at 10. But Plaintiffs' list of Mr. Upton's "admissions" (a magical word Plaintiffs seem to think turns any post-class period explanation of bad news into a confession by Defendants that they committed securities fraud) omits what Mr. Upton actually said about claims, on the same investor call where he mentioned increasing delinquencies: "it was—the March loss emergence and the average claims size[] that really gave rise to our deep dive on the delinquency inventory and the extensive review that we undertook to strengthen loss reserves of $82 million." SAC ¶ 117. A "March loss emergence" obviously is not "consistent with" or "bolstered by" CW1's assertion that, in fact, those losses occurred months earlier in December 2011.[2]

[2] Plaintiffs state that "Defendants cannot credibly explain how the Australian MI unit's reported Class Period loss ratios remained stable for an entire year following the January, 2011 Queensland flooding, then spiked unaccountably and suddenly at the end of the Class Period." Pl. Opp. at 15. Plaintiffs try to bolster their conclusory attack by pointing to Mr. Klein's comments at a March 29, 2012 investor conference. *Id.* at 15-16. But there is nothing inconsistent with Mr. Klein's forward-looking opinion that the Australian market would "remain solid" during 2012, made before Q1 2012 results were in, and Genworth Australia's having a bad quarter in Q1 2012. Plaintiffs' further assertion that "a loss emergence of this magnitude, in the span of *less than one* month, is implausible on its face as it would require large amounts of practically *simultaneous* delinquencies" (*id.* at 16) exhibits a gross misconception of the difference between delinquencies (mortgage defaults that may later become

Plaintiffs elsewhere similarly misuse Mr. Upton's comments, describing Mr. Upton as having discussed an "increase in claims throughout 'the second half of 2011.'" Pl. Opp. at 30. But Mr. Upton stated that, "[i]n the second half of 2011, we did see increasing *delinquency* levels." SAC ¶ 16 (emphasis added). Plaintiffs divorce "second half of 2011" from its actual context and splice it with their "increase in claims" allegation, seemingly attempting to legitimize the only source Plaintiffs have for that allegation: the implausible assertions of CW1. But delinquencies are not claims. As Defendants explained in their opening brief (and Plaintiffs do not dispute), delinquencies can be cured for any number of reasons, in which case they do not result in a claim. *See* Def. Br. at 5.

Although Plaintiffs' burden to allege particularized facts supporting a claim of securities fraud is heavy, the burden to identify "what was the lie" is not. Deciphering "what was the lie" from Plaintiffs' papers should not require diagramming sentences or extensive debate. Plaintiffs fail the PSLRA's most basic requirement: "specify each statement alleged to have been misleading" and "the reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4. Plaintiffs' fundamental inability to state simply and specifically why any of Defendants' statements were false (or even consistently identify which statements are alleged to be true and which are alleged to be false) warrants dismissal of the second amended complaint for the same reasons the Court dismissed the first amended complaint.

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insurance claims by lenders) and claims (losses on insurance policies), and how both the number of claims as well as the size of each of those claims contribute to losses. Plaintiffs' argument is simply "one of underestimation in hindsight … rel[ying] on conclusory allegations to mask the legally insufficient contention at its core, which is that defendants could not possibly have believed their own estimates, since plaintiffs interpret those estimates to have proven inadequate." *See Okla. Firefighters Pension & Ret. Sys. v. Student Loan Corp.*, 951 F. Supp. 2d 479, 498 (S.D.N.Y. 2013). It is also inconsistent with Plaintiffs' core claim that far larger losses were reported in the December 2011 meeting that CW1 claims to remember. *See* page 12 & n.4 below (comparing alleged December 2011 increase in claims with claim losses disclosed at end of class period).

B. Plaintiffs' Opposition Confirms the Complaint's Fatal Dependency on Two Meritless Assertions

Plaintiffs' opposition fails to rebut Defendants' arguments as to why the complaint's critical allegations—(i) Plaintiffs' characterization of Mr. Upton's post-class period comment as an admission of undisclosed increasing delinquencies and (ii) the alleged assertion of CW1 that Genworth management disclosed internally a $100-125 million increase in claims—fail to plead falsity of a single alleged misstatement on any subject.

1. Plaintiffs Fail to Refute that Mr. Upton's May 2012 Comment About "Increasing Delinquencies" Does Not Demonstrate Falsity

Defendants' opening brief explained that the complaint fails to supply any particularized facts indicating that Genworth's detailed disclosures of delinquency rates, broken down by geographical region and policy year (including Queensland and 2007 and 2008, respectively), concealed "increasing delinquencies" during the class period, let alone when and by how much Genworth Australia's "true" delinquency rates were higher than disclosed. Def. Br. at 17-18.[3]

Plaintiffs' only response is to double down on their mischaracterization of Mr. Upton's May 2012 statement—that, "[i]n the second half of 2011, we did see increasing delinquency levels and we did observe lender processing delays" (SAC ¶¶ 16, 87, 117)—as a purported "admission" of fraud. Pl. Opp. at 4, 5, 9, 10, 25, 29, 31, 32. But as Defendants' opening brief explained, the complaint pleads no basis for this characterization. Plaintiffs identify no class period statement by Defendants that delinquencies were *not* increasing in the second half of 2011, and, in fact, Defendants discussed increasing delinquencies and the resulting impact on earnings during the class period—entirely consistent with Mr. Upton's post-class period remark.

[3] Plaintiffs' assertion that these disclosures were "isolated" is untrue. Pl. Opp. at 9. Genworth disclosed these figures every quarter and also discussed these figures qualitatively in earnings releases, investor calls, and SEC filings throughout the class period. *See* Def. Br. at 6, 17-18.

See Def. Br. at 17-18 (citing examples). Plaintiffs' opposition also fails to identify any statement by Defendants or any pleaded fact suggesting that Genworth ever misreported delinquencies for Genworth Australia. Plaintiffs have not begun to explain how Mr. Upton's May 2012 comment about increasing delinquency levels was "'meaningfully different from the information the Company provided earlier in the putative class period.'" Def. Br. at 18 (quoting *City of Taylor Gen. Emps. Ret. Sys. v. Magna Int'l Inc.*, 967 F. Supp. 2d 771, 793 (S.D.N.Y. 2013)).

Plaintiffs' opposition brief argues that an additional statement by Mr. Upton in the same May 2012 quarter-end disclosure supports that Mr. Upton "admitted" to undisclosed increases in 2011 delinquencies, namely, Mr. Upton's disclosure that (in Plaintiffs' words): "the Australian MI unit's loss ratio for 1Q '12 was an incredible *154%*—a drastic increase from the reported loss ratio of only 46% in 4Q '11." Pl. Opp. at 10. But a "drastic increase" in a loss ratio quarter-over-quarter says nothing about what any Defendant knew during the class period about delinquencies that was contrary to Defendants' class period statements. On the contrary, the increased loss ratio is consistent with Defendants' explanation of the unexpected losses in Q1 2012. As Plaintiffs acknowledge, the loss ratio equals "the ratio of claims on policies and loss reserves to net premiums earned from the insurance." *Id.* at 2. And for Q1 2012, as Plaintiffs also acknowledge (*see id.* at 10, 32), Genworth disclosed that Genworth Australia paid significantly more in claims and strengthened reserves significantly—the two components of the loss ratio's numerator. Thus, a "drastic increase" in Genworth Australia's loss ratio, as opposed to supporting that Mr. Upton "admitted" to a previously concealed increase in delinquencies, in fact is consistent with Mr. Upton's explanation that "it was—the March loss emergence and the average claims size[] that really gave rise to our deep dive on the delinquency inventory and the extensive review that we undertook to strengthen loss reserves of $82 million." SAC ¶ 117.

Accordingly, Plaintiffs' argument that Mr. Upton's statement about increasing delinquencies was an "admission" that "reported Class Period loss ratios had failed to adequately reflect the true increase in delinquency levels" (Pl. Opp. at 10) attempts to plead fraud on the insufficient basis that Defendants "arguably took a more optimistic view of [the company's] prospects" than Plaintiffs did "viewing the same publicly available information." *Jones v. Perez*, 550 F. App'x 24, 26 (2d Cir. 2013).

2. Plaintiffs Fail to Refute That CW1's Alleged Assertion About an Undisclosed $100-125 Million "Increase in Claims" Does Not Demonstrate Falsity

Without support from Mr. Upton's comments about delinquencies, Plaintiffs are left with one allegation to support their case: Defendants concealed "increasing claims" at Genworth Australia during the class period. That allegation is based solely on the assertion of CW1—a former Genworth computer technician whose job was "remotely downloading patches and supporting email systems"—who purportedly informed Plaintiffs' counsel or investigator that he saw a PowerPoint page in 2012 which said that Genworth Australia experienced a "$100-125 million" increase in claims during the class period. Def. Br. at 20 (quoting SAC ¶ 60). Defendants' opening brief (at 20-28) set forth numerous reasons why CW1's assertions cannot be credited under the PSLRA, Rule 9(b), and well-settled Second Circuit precedent holding that plaintiffs relying on CWs must describe CWs "'with sufficient particularity to support the *probability* that a person in the position occupied by the source would possess the information alleged.'" *Bd. of Trs. of City of Fort Lauderdale Gen. Emps.' Ret. Sys. v. Mechel OAO*, 811 F. Supp. 2d 853, 880 (S.D.N.Y. 2011) (emphasis added) (quoting *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000)), *aff'd sub nom. Frederick v. Mechel OAO*, 475 F. App'x 353 (2d Cir. 2012).

To begin with, Plaintiffs' CW1 asserts that in December of 2011 senior Genworth officials openly told 40-50 employees that Genworth Australia was suffering a catastrophic

increase in claims, put that fact on a PowerPoint slide, and then proceeded to repeatedly lie about that fact publicly for four months. The "increase in claims in Australia equaling around *$100-125 million*" that CWI is reported to have recalled would have been an "increase" in claims far exceeding the *total* amount of paid claims that Genworth was reporting to the SEC each quarter—even at the end of the class period when Genworth announced the claims (losses) that prompted this litigation. Def. Br. at 25 (quoting SAC ¶¶ 62, 65).[4] Even if management had decided to commit fraud, why they would confess that to fifty employees, including members of the IT department, is not explained in the complaint (because it is inexplicable). To no alleged benefit to themselves, the "40-50 MI employees" supposedly kept quiet, until CW1, three years after the fact, recounted to Plaintiffs' investigator a single number from a single slide in a PowerPoint presentation. With the computer technician's 3-year-old recollection of that single number from the PowerPoint presentation, Plaintiffs crafted a 157-paragraph complaint, which relies on that number as the sole factual basis on which it alleges that Defendants concealed "increasing claims" and defrauded investors to the tune of hundreds of millions of dollars.

Perhaps equally stunning, Plaintiffs' second CW, the former COO of Genworth Australia, is dead silent on the wide-ranging fraud supposedly supported by CW1's story. Plaintiffs do not dispute that by the nature of his position, CW2 would have seen whatever information would have supported CW1's assertions that (i) "the Australian MI unit had had a poor quarter due to

[4] For Genworth Australia, Genworth reported *AU$25 million in claims paid in Q3 2011* (Ex. E (Q3 2011 Quarterly Fin. Supp.) at 41), *AU$31 million in Q4 2011* (Ex. F (Q4 2011 Quarterly Fin. Supp.) at 44), and *AU$66 million in Q1 2012*. With respect to the Q1 2012 figure, the complaint does not reference Genworth's Q1 2012 quarterly financial supplement, in which the figure is disclosed explicitly. But the figure can be calculated based on Ex. L (5/2/2012 Presentation) at 9, which the complaint does reference. For January, February, and March 2012 (the months of Q1 2012), Genworth disclosed, respectively, 253, 293, and 306 claims paid. *Id.* For those same months, Genworth disclosed AU$64,000, AU$60,000, and AU$104,000 as the average paid claim for each of those months, respectively. *Id.* Multiplying claims paid and average paid claim for each month yields AU$16,192,000, AU$17,580,000, and AU$31,824,000 total paid in claims for January, February, and March, respectively. Adding those together yields AU$65,596,000 total paid in claims for Q1 2012.

increased claims, leading to miscalculating of reserves, and that claims were exceeding the allotted reserves" (SAC ¶ 64) and that (ii) Genworth Australia had experienced an unprecedented "increase in claims in Australia equaling around *$100-125 million*" (SAC ¶ 65). But CW2 says *not one word* about the alleged concealment of "increasing delinquencies" or "increasing claims" (Def. Br. at 22-23, 42)—allegations without which the complaint does nothing more than impermissibly plead fraud by hindsight.

Plaintiffs' opposition attempts to sidestep these arguments. *First*, Plaintiffs argue that Defendants have offered an "unrealistic portrayal of the December 2011 L&M meeting" because "[i]t hardly is uncommon for executives to present information internally that is at odds with statements made to the public." Pl. Opp. at 19. But saying "executives commit securities fraud all the time" does not satisfy the PSLRA's requirement that Plaintiffs plead particularized facts supporting a "strong" inference of scienter. 15 U.S.C. § 78u-4(b)(2)(A). To show that "executives commit securities fraud all the time," Plaintiffs cite *In re Sturm, Ruger & Co., Inc. Sec. Litig.*, 2011 WL 494753 (D. Conn. Feb. 7, 2011), *cited in* Pl. Opp. at 19, which does not stand for that proposition. The *Sturm* plaintiffs relied on three confidential witnesses—"a former document control manager, a former product engineer at a New Hampshire plant, and the former general manager of the New Hampshire plant"—who all corroborated that "daily meetings were held at the New Hampshire plant in which the failure to meet production goals was discussed." *Id.* at *8. One witness described "internal reports which compared a daily production goal to actual daily production, revealing that the company was not meeting its production targets." *Id.*

Thus, *Sturm* involved corroboration from multiple CWs, as a result of daily meetings discussing production, something the witnesses were familiar with as part of their jobs. But here, the CW who would have the most reliable insight on Genworth Australia's allegedly concealed

losses (CW2, Genworth Australia's then-COO) provides no corroboration, leaving the entire case to turn on the alleged report from a computer technician with no responsibility for or knowledge of claims, delinquencies, reserving, mortgage insurance, or Australia. And while *Sturm* involved a report comparing production goals to actual production—a type of document that plausibly would exist—here, CW1 describes a PowerPoint presentation highlighting $100-125 million in concealed losses. The *Sturm* case does not help Plaintiffs.

Second, regarding CW2's silence on the complaint's critical allegations, Plaintiffs argue that "[n]othing in the *Novak* pleading requirement for CWs *requires* another witness's corroboration." Pl. Opp. at 18. In a footnote, Plaintiffs speculate that CW2 may have had "any number of reasons" for choosing "not to make statements regarding the December 2011 meeting." *Id.* at 18 n.4. But neither their complaint nor their opposition provides any explanation. Speculation does not satisfy the PSLRA, *Tellabs*, or Plaintiffs' pleading obligation. Either Plaintiffs asked CW2 about the December 2011 meeting, or they did not. If Plaintiffs did not, given that CW2 (the COO) was in a better position than CW1 to recall accurately what was or would have been discussed at a December 2011 management presentation, and verify (or not) the computer technician's implausible story, Plaintiffs have not investigated in good faith the most critical allegations in their complaint.

Alternatively, if Plaintiffs did ask, CW2 must have (i) corroborated CW1's account, (ii) not corroborated CW1's account, or (iii) declined to answer. Plaintiffs' complaint and opposition are silent. Given the lack of any such corroborating allegations from CW2 in the complaint, it is reasonable to assume that CW2, if asked, did not corroborate CW1's account. And given that CW1 asserts a $100-125 million fraud proclaimed by management to 40-50 employees, involving financial information over which CW2 had direct reporting responsibility, it is unlikely

that CW2's inability to corroborate CW1's story resulted from a lack of memory. Thus, if Plaintiffs asked CW2 about the December meeting (as one would expect), they have chosen to omit from their complaint the fact that CW2 was unable or unwilling to corroborate CW1's story. Given the lack of corroboration under the circumstances here, these inconsistencies—where Plaintiffs' CWs include a high-level executive with direct responsibility for and knowledge of the key issues in the case and a low-level IT employee, and only the latter asserts facts supporting a massive financial fraud that management supposedly confessed to 40-50 employees involving financials the high-level executive would have had direct knowledge of—are a dispositive and troubling pleading failure.

Even putting aside the logical impediments to crediting CW1, the one paragraph of the complaint featuring the critical CW1 allegations (SAC ¶ 65)—out of a complaint comprising 157 paragraphs—is rife with inconsistency and ambiguity that destroy the reliability of CW1's assertions. CW1 recalls an "increase in claims in Australia equaling around $100-125 million, and that this never had happened before to the Australian unit." SAC ¶ 65 (emphasis omitted). In fact, it still has not happened: at the end of the class period, when announcing the losses that caused the reserve strengthening and IPO postponement at issue in this litigation, Genworth reported $65.6 million in *total* paid claims for that quarter (*see* page 12 & n.4 above)—an amount far below CW1's purported *increase* in claims. The computer technician further fails to provide any specificity regarding the "increase in claims." Was it an increase in the number of submitted claims or an increase in actual payments made on claims? Over what period and compared to what period? If the meeting occurred in "early or mid-December 2011" (SAC ¶ 64), was the $100-125 million from Q3 2011 (which ended September 30)? Or Q4 2011, which would end on December 31? Was the number historical, or did it include a projection? Over

what number was the $100-$125 million an increase?

These ambiguities highlight CW1's undisputed lack of any relevant expertise in the subjects on which he allegedly has spoken. Plaintiffs shrug their shoulders and wonder "what expertise would be necessary to further parse" what CW1 reports. Pl. Opp. at 18-19. As CW1's account makes clear, the answer is: something more than the ability to "remotely download[] patches and support[] email systems" from Genworth's Raleigh office. SAC ¶ 60. The answer is: something more than zero connection to Genworth Australia's operations and zero expertise in the areas of insurance, reserving, finance, accounting, or any other relevant area. The answer is: enough reliability as a witness not to opine, despite one's total lack of expertise, on what Genworth would have considered in "calculating risk and reserves" (SAC ¶ 65)—an opinion Plaintiffs' own allegations acknowledge as incorrect. *See* Def. Br. at 24 n.7 (citing SAC ¶ 5).

Plaintiffs debate none of these factors contributing to CW1's unreliability and instead insist that "CW1's opinion … does not impact his direct observations of what was presented at the December 2011 meeting." Pl. Opp. at 19 n.5. But the Court cannot ignore CW1's baseless opining about Genworth's mortgage insurance business, his demonstrated and conceded lack of expertise, and his conceded lack of connection to Genworth Australia. These considerations render it inconceivable, let alone "probable," that CW1 "would possess the information alleged." *Mechel OAO*, 811 F. Supp. 2d at 880. Plaintiffs cannot, consistent with the PSLRA, Rule 9(b), and their obligations to investigate their claims in good faith, move forward with accusations of fraud against a public company and its executives based on a former computer technician's barely cogent, years-old recollection of a meeting and a number he supposedly saw on a single slide of a PowerPoint presentation regarding a subject on which he claims zero familiarity or expertise.

Considering all of the above, Defendants' opening brief explained that, "even giving CW1 the benefit of the doubt that the meeting he recalls, in fact, occurred, the far more likely explanation is that CW1 is describing a meeting in 2012 where he heard about Genworth Australia's materially increased Q1 2012 losses and the impact on the IPO and is misremembering when that meeting occurred and what the $100-125 million represented." Def. Br. at 27. Plaintiffs call this argument "ludicrous" and "wholesale, self-serving and improper speculation" that "brazenly" "rewrite[s] the Complaint's plain allegations." Pl. Opp. at 20. Plaintiffs ignore *Tellabs*'s clear instruction to courts deciding motions to dismiss securities fraud claims under the PSLRA:

- "*First*, faced with a Rule 12(b)(6) motion to dismiss a § 10(b) action, courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007).

- "*Second*, courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." *Id.*

- "*Third*, in determining whether the pleaded facts give rise to a 'strong' inference of scienter, the court must take into account plausible opposing inferences." *Id.* at 323.

Indeed, with respect to the critical third step, which effectuates as a pleading rule the PSLRA's requirement that an inference of scienter be "strong" (*see id.* at 323-24), the *Tellabs* Court noted that the Seventh Circuit had not "engage[d] in such a comparative inquiry," and the Court rejected an approach in which "[a] complaint could survive … as long as it 'alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent.'" *Id.* at 323 (citation omitted). *Tellabs* clearly interpreted the PSLRA as departing from the ordinary Rule 12(b)(6) standard of review under which a complaint can survive a motion to dismiss simply if it "allows the court to draw the reasonable inference that the defendant is liable

for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). The Second Circuit has recognized this, holding in *ECA & Local 134 IBEW Joint Pension Trust v. JP Morgan Chase Co.*, 553 F.3d 187 (2d Cir. 2009), that, "'[w]hile we normally draw reasonable inferences in the non-movant's favor on a motion to dismiss,' the PSLRA 'establishes a more stringent rule for inferences involving scienter' because the PSLRA requires particular allegations giving rise to a strong inference of scienter." *Id.* at 196 (citation omitted). Plaintiffs' pre-*Tellabs* case law cited for the contrary proposition must be rejected. *See* Pl. Opp. at 20 (citing cases from 2003 and 2004).

Plaintiffs have not alleged that they personally witnessed a December 2011 presentation showing a $100-125 million "increase in claims," or that they possess this presentation or any other document showing such a figure. Plaintiffs are alleging that CW1 recalled to some agent or representative of Plaintiffs' law firm the details of this meeting, specifically, a number on a slide in a PowerPoint presentation given at that meeting. And given Judge Engelmayer's recent finding of significant inaccuracies in CW information retrieved by Plaintiffs' counsel's investigators, there is reason to doubt that an accurate account of CW1's recollection made it to Plaintiffs' counsel. *See* Point V below (discussing *Millennial Media, Inc. Securities Litigation*, 2015 WL 3443918 (S.D.N.Y. May, 29, 2015)).

But even if the investigators heard what the complaint repeats, *Tellabs* asks, what are the competing inferences of fraud versus no fraud? *See Tellabs*, 551 U.S. at 323. For all the reasons set forth in Defendants' opening brief and herein, the inference that CW1 misremembers or misunderstood what he saw is far more compelling than the inference of a startling $100-125 million disclosure to 40-50 Genworth employees, from management right down to the IT department. This non-fraudulent inference supports dismissal of the complaint.

C. Plaintiffs Fail to Plead that Defendants' Reported Loss Reserves Were False

Defendants' opening brief established that the complaint pleads no facts that support when and by how much Genworth's loss reserves were too low, let alone that Defendants believed reserves were too low or even should have believed so. Def. Br. at 28-32.

Plaintiffs argue in their opposition that it is sufficient that the complaint alleges that "'Defendants should have recorded a significant portion (if not the entirety) of the $82 million reserve charge announced at the end of the Class Period in 3Q 11 and 4Q 11.'" Pl. Opp. at 14 (quoting SAC ¶ 82) (emphasis omitted). In other words, Plaintiffs allege that the reserve charge that was taken after the class period should have been taken sometime during the class period. This conclusory argument fails to allege with particularity "at what point in time [the] charge [to reserves] should have been taken and which specific losses known to the Company should have triggered [the] charge" (*City of Sterling Heights Police & Fire Ret. Sys. v. Vodafone Grp. PLC*, 655 F. Supp. 2d 262, 269-70 (S.D.N.Y. 2009); *see also In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 361-62 (S.D.N.Y. 2011) (rejecting allegations as "generalized" where Plaintiffs "fail to specify what caused the Defendants to know that the loan loss reserves were insufficient"))—a requirement that would be meaningless if a plaintiff could satisfy it simply by alleging that "a significant portion (if not the entirety)" of losses recognized post-class period "should have" been recognized during the class period. "[T]he mere fact that … predicted loss reserves turned out to be insufficient some time after they were made does not render those figures false at the time that they were publicly filed with the SEC." *NECA-IBEW Pension Trust Fund v. Bank of Am. Corp.*, 2012 WL 3191860, at *10 (S.D.N.Y. Feb. 9, 2012) (Pitman, Mag. J.), *quoted in Student Loan Corp.*, 951 F. Supp. 2d at 498 and *In re Fannie Mae 2008 Sec. Litig.*, 525 F. App'x 16, 19 (2d Cir. 2013).

Plaintiffs do not dispute that reserves are statements of opinion, "'reflect[ing]

management's opinion or judgment about what, if any, portion of amounts due on loans ultimately might not be collectible.'" Def. Br. at 29 (quoting *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 113 (2d Cir. 2011)). Plaintiffs argue, however, that they satisfy the test in *Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015), for pleading the falsity of Defendants' opinions that loss reserves were adequate. Pl. Opp. at 14.[5] In *Omnicare*, the Supreme Court held that liability does not attach to "a sincere statement of pure opinion," because the securities laws "do[] not allow investors to second-guess inherently subjective and uncertain assessments." *Omnicare*, 135 S. Ct. at 1327. The Court held, however, that statements of opinion can give rise to liability under two limited circumstances. First, liability may attach if the party making the statement of opinion does not believe in the truth of the opinion. *Id.* at 1326. This "subjective falsity" standard is consistent with pre-*Omnicare* Second Circuit law (s*ee Fait*, 655 F.3d at 113), and Plaintiffs fail to plead any facts demonstrating that Defendants did not genuinely believe their stated opinions. *See* Point I.B above; Def. Br. at 29-30.

Second, the Court held that a statement of opinion could be misleading if it "omits material facts about the [speaker's] inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself." *Omnicare*, 135 S. Ct. at 1329. Plaintiffs argue in one paragraph of their opposition that they have satisfied *Omnicare*'s pleading requirements because they have alleged that Defendants "omitted material facts regarding the basis for their reserves" by "fail[ing] to consider" "that claims in Australia had skyrocketed to $100-125 million and had exceeded reserves." Pl. Opp. at 14-15.

[5] *Omnicare* addressed a non-fraud claim under Section 11 of the Securities Act of 1933, for which, as the Supreme Court expressly noted, a plaintiff need not prove that "the defendant acted with any intent to deceive or defraud." 135 S. Ct. at 1323. *Omnicare* thus does not change the rule that a Section 10(b) claim requires an inference of scienter that is "more than merely plausible or reasonable" and "cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Tellabs*, 551 U.S. at 314.

This argument relies on CW1's alleged assertions, which, as explained in Point I.B.2 above, cannot be credited. Plaintiffs also resort to arguing that "Defendants were aware of facts contradicting their false statements that reserves adequately were established, given their awareness of the deteriorating economic conditions in Queensland." Pl. Opp. at 15. But the complaint never links the generalized allegation about deteriorating economic conditions to any specific quantifiable or knowable increase in claims. This allegation is hindsight second-guessing. *See Wachovia*, 753 F. Supp. 2d at 361-62 (rejecting "generalized allegations" that "Wachovia was well aware of, or recklessly indifferent to, the fact that their loan reserves were significantly understated in light of the deteriorating real estate market").

D. Plaintiffs Fail to Plead that Defendants' Statements Concerning the Planned Australia IPO Were False

As demonstrated in Defendants' opening brief and above, Plaintiffs' undisclosed "increasing delinquencies" and "increasing claims" allegations fail to establish the falsity of any of Defendants' statements about the IPO plan. *See* Point I.B above; Def. Br. at 32-35. Defendants also explained that CW2 (the former COO) in fact (i) corroborates that lots of work was being done to execute the IPO on time and (ii) says nothing about an undisclosed change in plans regarding the timing of the IPO. Def. Br. at 33. For CW1's part, the computer technician allegedly recalls that management was asked about the timing of the IPO at a December 2011 meeting, but, like CW2, CW1 does not assert that management said anything, until the end of the class period in April 2012, about delaying or ever intending to delay the IPO. Def. Br. at 33-34. Plaintiffs offer no response to the failure of their CWs to offer any meaningful information on Genworth's supposed scheme to postpone the IPO. *See* Pl. Opp. at 21-22.

Indeed, Plaintiffs' first opposition argument regarding the IPO statements begins by abandoning the allegation that Defendants were not, in fact, as they stated, "working very

actively" and "working really hard" to execute the IPO in Q2 2012. *See id.* at 21 (arguing that "[e]ven if the statement … were literally true, that does not cure the misleading impressions of stability"). But, Plaintiffs say, Defendants made statements like these "only weeks before the Company announced that the IPO would be delayed," and thus Defendants must have known by March that the IPO would be delayed. *Id.* (discussing Mr. Klein's statements at the March 29, 2012 investor conference in response to questions about "whether the IPO might be delayed"). In the first instance, courts have routinely rejected the argument that the mere temporal proximity of defendants' statements to the disclosure of contrary bad news pleads fraud. *See SRM Global Fund L.P. v. Countrywide Fin. Corp.*, 2010 WL 2473595, at *10 (S.D.N.Y. June 17, 2010) (finding plaintiff's asserted inference of scienter "unavailing because the mere disclosure of adverse information shortly after a positive statement does not support a finding that the prior statement was false at the time it was made") (quotation marks omitted), *aff'd*, 448 F. App'x 116 (2d Cir. 2011); *Amida Capital Mgmt. II, LLC v. Cerberus Capital Mgmt.*, L.P., 669 F. Supp. 2d 430, 443 (S.D.N.Y. 2009) ("[T]he inference from the temporal proximity of the roadshow to the November 14 announcement is not 'strong circumstantial evidence' that Cerberus had knowingly misrepresented the state of affairs on November 5."). Moreover, Plaintiffs' opposition ignores Mr. Klein's response, in which he indicated that Genworth sought to execute the IPO "from a position of strength" (in other words, not if Genworth Australia was performing poorly) and that "[w]e're working very actively to put ourselves in a position to execute this in the second quarter [2012], as we've said." SAC ¶ 106 (emphasis omitted). "*That said*," Mr. Klein continued:

> like any IPO there's a number of factors that impact timing and I think we're watching those very closely as we're working through. One is obviously market conditions and the impact that has on valuation considerations. So it's not just looking at the equity markets, it's looking at the impact also in the Australian housing market and things of that nature.

Id. (emphasis added and omitted). The notion that these comments were a misleading

reassurance that "there were no market conditions that would delay the IPO" (SAC ¶ 19) is thus controverted by the full context of the statements Plaintiffs cite. Indeed, from the day the IPO was announced, Genworth warned investors that "there can be no assurance that this transaction can be executed within the targeted timeframe or on the desired terms." Ex. B (Q3 2011 Form 10-Q) at 148 (emphasis added).

Plaintiffs also argue that Mr. Klein "failed to disclose that any market conditions existed that would derail the IPO." Pl. Opp. at 21. But Plaintiffs plead no particularized facts demonstrating what undisclosed market conditions existed or when, nor do Plaintiffs tie any such conditions to Genworth Australia's business or the IPO plan such that any inference could be drawn that Defendants knew the IPO would not proceed. Plaintiffs offer no explanation, other than their unsupported conclusions about increasing delinquencies and claims, as to *why* the IPO was not objectively achievable by Q2 2012, or when Defendants should have known this.

E. Plaintiffs' Argument that Defendants' Statements Created a "Misleading Impression," Even If "Literally True," Makes No Sense

Seemingly lacking confidence in their ability to plead that Defendants' statements were actually false, Plaintiffs in their opposition brief retreat to the argument that Genworth's reported financial results, reserves, and statements about the IPO timing, even if "literally true," created a "misleading impression that Queensland had stabilized and accordingly, that no market conditions warranted delaying the IPO." Pl. Opp. at 8; *see also id.* at 9, 12, 13, 14, 21.

Plaintiffs challenge statements about Genworth Australia's financial performance and about plans for an IPO. But how can stable reported losses be *literally true* yet also create a *false* impression that losses are stable? How can a statement that an IPO is "on track" for execution in Q2 2012 be *literally true* yet also create a *false* impression that the IPO is on track for execution in Q2 2012? They cannot: if Defendants' reporting of Genworth Australia's financial results

were "literally true," and if Defendants' stated plans for the IPO were "literally true," Plaintiffs have no case.

This is most evident in the "misleading impression" Plaintiffs insist was conveyed to investors: stable financial results at Genworth Australia and a resultantly "on track" IPO. By imploring the Court to read Defendants' statements "as a whole" (*id.* at 7, 21), "holistically" (*id.* at 10, 25, 28 n.13), "taken together" (*id.* at 7, 22), and "collectively" (*id.* at 3, 5, 12, 21, 25, 26, 31, 35), Plaintiffs invite the Court to ignore Defendants' actual statements and instead, somehow, determine the truth or falsity of an amorphous "impression" created by Plaintiffs. No precedent or rule supports this invitation.

Indeed, the facts of the cases on which Plaintiffs rely for their "true but misleading" argument illustrate that the cited authority is inapposite. Plaintiffs' lead case is *SEC v. Gabelli*, 653 F.3d 49 (2d Cir. 2011), which held that "so-called 'half-truths'—literally true statements that create a materially misleading impression—will support claims for securities fraud." *Id.* at 57. The "half-truth" at issue in *Gabelli* was a public statement by a fund's adviser that, "for more than two years, scalpers have been identified and restricted or banned from making further trades" but that the fund's adviser "did not completely eliminate all timers." *Id.* The court held that, even if literally true, "a reasonable investor reading the [statement] would conclude that the Adviser had attempted in good faith to reduce or eliminate [fund] market timing across the board," when in fact "the Adviser had expressly agreed to let one major investor … engage in a very large amount of [fund] market timing." *Id.*[6]

In re Fannie Mae 2008 Sec. Litig., 891 F. Supp. 2d 458 (S.D.N.Y. 2012), *aff'd*, 525 F.

[6] Plaintiffs also rely on *Kleinman v. Elan Corp.*, 706 F.3d 145 (2d Cir. 2013), *cited in* Pl. Opp. at 7, which rejected plaintiff's argument that a statement was misleading, if not "literally false," because the statement's full context belied the impression the statement allegedly caused. *Id.* at 153.

App'x 16 (2d Cir. 2013), involved similar "half-truths." While a defendant's non-public emails discussed "serious problems with risk controls" (*id.* at 475-76), the defendant made public statements such as, "from a control and risk underwriting standpoint, we want to continue maintaining prudent underwriting standards." *Id.* at 475 n.10. The court held that, even if the defendant's statements "were literally true (a proposition that may be doubted), he can still be found liable for the overall misleading impression his statements created." *Id.* at 476.

Plaintiffs also spend three pages arguing that September 2011 pre-class period statements Defendants made regarding loss mitigation efforts, including efforts to reduce lender processing delays and accelerate old delinquencies to claim, created the misleading impression that "the Queensland risks had been mitigated." Pl. Opp. at 11-13. Plaintiffs cite market reactions to Genworth's disclosure of bad news in Q1 2012 in support of their point that "the very risk factors Defendants had claimed to mitigate" had contributed to higher losses. *Id.* at 12. But the complaint alleges nothing about the falsity of these pre-class period statements. Cover-to-cover, there is no contradictory information alleged as of September 2011 or any other facts suggesting what precisely was false or misleading about these statements at the time they were made. Plaintiffs cannot rely on CW1, who says nothing about Genworth Australia's performance before December 2011. And as explained in Point I.B.1 above, Plaintiffs have alleged no facts showing that Mr. Upton's comments regarding increasing delinquencies were inconsistent with Genworth's disclosures in the "second half of 2011." The market's "surprise" at Genworth Australia's poor results establishes, at most, that investors were surprised that Defendants had underestimated a risk of loss, not that Defendants "knew" their loss mitigation efforts would be less than fully effective. *See In re CIT Grp., Inc. Sec. Litig.*, 349 F. Supp. 2d 685, 689-91 (S.D.N.Y. 2004) (dismissing complaint because "plaintiffs' claim that loan loss reserves were

inadequate is nothing more than an assertion that CIT was incorrect or unskillful in determining exactly what amount of reserves would be adequate").[7]

II. PLAINTIFFS FAIL TO PLEAD SCIENTER

While the complaint fails to set forth any specific theory of scienter, Plaintiffs' opposition asserts no less than six theories of scienter. None of these is "cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Tellabs*, 551 U.S. at 314.

Most importantly, Plaintiffs' opposition fails to resolve the inherent contradiction of the complaint's story of fraud. This contradiction is easily illustrated using Plaintiffs' case, *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702 (7th Cir. 2008), *cited in* Pl. Opp. at 25, which posits a hypothetical fraud that the Seventh Circuit calls "a considered, though because of the risk a reckless, gamble." *Id.* at 710. In the hypothetical scenario, the fraudster "embezzl[es] in the hope that winning at the track will enable the embezzled funds to be replaced before they are discovered to be missing." *Id.* But this theory does not fit here. In *Makor*'s gambling hypothetical the fraudster always has the hope of covering up the fraud by winning at the track.

But here Plaintiffs allege no "gamble" that made the alleged scheme "reckless" but possibly successful. Rather, Plaintiffs allege an impossible fraud in which Defendants continued to lie in the face of certain failure. Plaintiffs' theory posits that Defendants (i) began lying about Genworth Australia's financials after Q3 2011 to preserve an IPO planned for Q2 2012, (ii) by

[7] Plaintiffs rely on *City of Providence v. Aeropostale, Inc.*, 2013 WL 1197755, at *13 (S.D.N.Y. Mar. 25, 2013), to support their argument that Defendants' statements about mitigating Queensland losses, "'while technically true, [were] materially misleading'" because losses were not prevented. Pl. Opp. at 13. But in *Aeropostale*, the court did not simply hold that Aeropostale's failure to "aggressively clear through spring inventories" and to "rectify [its] [mistakes] and to get this brand back on course" showed that these statements were fraudulent when made. 2013 WL 1197755 at *11. That would be fraud by hindsight. The court instead found the statements misleading in light of plaintiff's allegations that, when the statements were made, Aeropostale's "spring and summer lines were selling poorly and would continue to sell poorly; that markdowns and promotions were not helping to sell the merchandise; that Aeropostale would therefore not be able to clear through all of the inventory by the end of the second quarter; and that the markdowns and promotions would adversely affect the company's margins and earnings more substantially than Defendants advised." *Id.* at *6. No such contradictory facts are adequately pleaded here.

end-of Q4 2011, realized those financial lies would backfire before the IPO could be executed, but nevertheless began to lie that the IPO was still on track for Q2 2012, and continued to lie about Genworth Australia's financials, and (iii) one quarter later after Q1 2012 disclosed that Genworth Australia's performance required a postponement of the IPO. To accept Plaintiffs' theory, one must also believe that, after Defendants realized their scheme was doomed to failure in Q4 2011, they not only continued to falsify financial results, but casually informed 40-50 employees that they were doing so and began to lie about the IPO—all instead of simply adjusting reserves as soon as these supposed trends emerged, as Genworth ultimately did anyway in Q1 2012. Plaintiffs do not allege a fraudulent scheme that depended recklessly on winning at the racetrack, but rather one in which (not to beat a dead metaphor) Defendants no longer had a horse in the race.[8]

Plaintiffs' opposition fails to rebut the far more compelling inference that, in March 2012, Genworth experienced unexpected losses that caused the postponement of the IPO and a strengthening of reserves. Def. Br. at 37. Plaintiffs argue that this inference "is fatally undermined by Upton's admission that the Australian MI unit had seen '[i]n the second half of 2011 … increasing delinquency levels and … lender processing delays.'" Pl. Opp. at 25. But nothing about increasing delinquency levels and lender processing delays in the second half of 2011 is inconsistent with more of those delinquencies becoming claims than expected, and in higher dollar amounts than expected, in the beginning of 2012. And as for CW1's recollection of these losses occurring in Q4 2011 instead of Q1 2012, the far more compelling inference, as explained in Point I.B.2 above, is that CW1 misremembers or misunderstood or misreported

[8] Plaintiffs' opposition does not dispute that courts reject illogical theories of fraud; instead, Plaintiffs try to distinguish the cases Defendants cite for this proposition on the basis that they actually involved illogical theories of fraud. *See* Pl. Opp. at 26 n.9. Because Plaintiffs do in fact plead an illogical fraud here, those factual distinctions are unavailing.

what he saw.

Plaintiffs' opposition also fails to identify well-pleaded facts showing (i) "that defendants had the motive and opportunity to commit fraud" or (ii) "strong circumstantial evidence of conscious misbehavior or recklessness." *ECA*, 553 F.3d at 198.

A. Plaintiffs Fail to Plead Any Discernible Motive for the Alleged Fraud

Defendants' brief also explained that the complaint sets forth no discernible motive that Defendants would have had to commit the alleged fraud or any personal benefit they derived. Def. Br. at 38. Plaintiffs respond that "Defendants disregard their motive to conceal the Australia MI unit's problems to ensure a successful and timely IPO." Pl. Opp. at 26-27.

Second Circuit law is clear, however: generalized allegations of motives shared by all companies (*e.g.*, a motive to "raise capital" (*id.* at 27)) do not demonstrate scienter. Addressing a similar allegation in *In re PXRE Group, Ltd. Securities Litigation*, 600 F. Supp. 2d 510 (S.D.N.Y. 2009), *aff'd sub nom. Condra v. PXRE Group Ltd.*, 357 F. App'x 393 (2d Cir. 2009), Judge Sullivan thus held: "[R]aising capital as part of an amorphous scheme to stave off a company's collapse, as in this case, does not suffice. Such a motive is too generalized, and if scienter could be pleaded on that basis alone, virtually any company that attempted to raise capital, especially in a woeful economic climate, would face specious securities fraud allegations." *Id.* at 533.

In any event, even accepting *arguendo* that the IPO did motivate Defendants to misstate Genworth Australia's financial performance, it does not explain why, once Defendants supposedly learned that the IPO was not achievable by Q2 2012, Defendants began and continued lying about the achievability of the IPO. The cases Plaintiffs cite for the proposition that the IPO motivated Defendants to lie about Genworth Australia's financial performance involved, unsurprisingly, offerings that actually occurred, rather than an IPO that Defendants

allegedly knew would not occur.[9]

B. Plaintiffs Fail to Plead Conscious Misbehavior or Recklessness

Defendants' opening brief explained (at 39) that Plaintiffs attempt to plead scienter by alleging that Defendants "'knew facts or had access to information suggesting that their public statements were not accurate,'" but that the allegations of their two CWs fall well short of "'specifically identify[ing] the reports or statements containing this information'" that were available to Defendants when the statements were made. *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 196 (2d Cir. 2008) (quoting *Novak*, 216 F.3d at 309, 311).

CW1's assertion about an increase in claims is unreliable for the reasons set forth in Section I.B.2 above. Further, CW1's allegation that Messrs. Fraizer and Schneider traveled frequently to Australia (SAC ¶ 61) says nothing about what information, much less contradictory information, they learned on these trips. Def. Br. at 39. Judge Gardephe rejected such allegations as indicative of scienter in *City of Brockton Retirement System v. Avon Products, Inc.*, 2014 WL 4832321 (S.D.N.Y. Sept. 29, 2014), holding that simply alleging that a defendant "traveled to China several times for meetings" did not constitute "facts demonstrating that these meetings would have made [the defendant] aware" of contradictory information. *Id.* at *20. Plaintiffs argue *City of Brockton* is inapposite by touting their allegation that "increasing delinquencies were admittedly pervasive." Pl. Opp. at 34 n.15. Plaintiffs still have not explained how traveling to Australia made any Defendant aware of contradictory nonpublic information. *City of Brockton*

[9] *See In re Silvercorp Metal, Inc. Sec. Litig.*, 26 F. Supp. 3d 266, 275 (S.D.N.Y. 2014) (finding that "the $117 million stock offering in December 2010" provided motive); *Van Dongen v. CNinsure Inc.*, 951 F. Supp. 2d 457, 474 (S.D.N.Y. 2013) (plaintiffs alleged that "Defendants were able to raise $109.6 million in the offering that they otherwise would not have been able to if they presented a more complete and accurate financial snapshot"); *In re MicroStrategy, Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 648 (E.D. Va. 2000) ("Defendants raised approximately $48 million").

is thus dispositive here.

CW2, as Defendants explained, simply provides a lengthy recitation of Genworth's internal reporting procedures; none of CW2's alleged assertions contradict any of Defendants' public statements. Def. Br. at 40-41. Plaintiffs do not dispute this point, which is dispositive. *See Jones*, 550 F. App'x at 28 (allegation that "defendants had access to reports showing that consumer inkjet sales were missing internal forecasts … absent any pleading indicating a divergence from publicly disclosed information … fails the specificity requirements of the PSLRA and Rule 9(b)"). There is no allegation linking Messrs. Fraizer and Klein to information that would make any of their statements knowingly false.

Plaintiffs' opposition also asserts a grab bag of scienter theories, each meritless.

Company "Admissions." Plaintiffs argue without basis that Defendants made "[a]dmissions showing that Defendants contemporaneously were aware of facts contradicting their Class Period statements." Pl. Opp. at 28. These "admissions" are simply Plaintiffs' characterizations of Mr. Upton's statements after the class period regarding increasing delinquencies "in the second half of 2011" and efforts to mitigate lender processing delays. *See id.* at 28-29. As explained in Section I.B.1 above, Plaintiffs have failed to allege that Mr. Upton said anything inconsistent with Defendants' statements during the class period. Plaintiffs merely quote these statements and then list conclusory assertions regarding the importance of the IPO, the risk level of Genworth's portfolio, and a "sharp increase of claims" (presumably based on the unreliable assertion of CW1). *See* Pl. Opp. at 29. These conclusory rehashes of Plaintiffs' other allegations do not turn Mr. Upton's comments into admissions of fraud. In addition, nothing in the complaint links Messrs. Fraizer and Klein to knowledge of Mr. Upton's alleged admission.

Plaintiffs' "admissions" cases do not support Plaintiffs' argument. *In re Scholastic Corp.*

Securities Litigation, 252 F.3d 63 (2d Cir. 2001), and *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72 (1st Cir. 2002), *cited in* Pl. Opp. at 28, did not involve admissions.[10] With respect to Plaintiffs' cases that actually involved admissions, the admissions were unmistakable. In *Hall v. Children's Place Retail Stores, Inc.*, 580 F. Supp. 2d 212 (S.D.N.Y. 2008), the defendant company "admitted that it had material weaknesses in its internal controls." *Id.* at 233. In *Lormand v. US Unwired, Inc.*, 565 F.3d 228 (5th Cir. 2009), "contemporaneous documents and post-period admissions" both showed that "defendants privately knew, at the time of the representations," that ceding control of billing and customer service operations "would be disastrous for the company but continued to tout their benefits publicly." *Id.* at 254. The court held that these "admissions … directly and cogently tend[ed] to prove [defendants'] state-of-mind at the time of their misleading statements and omissions." *Id.* None of Defendants' statements come close to an "admission" of a misrepresentation.

"Core Operations." Plaintiffs next rely on the so-called "core operations" doctrine, arguing that, because Genworth Australia paid "regular dividends" to Genworth and because the IPO was important, the Court can infer that Defendants knew what Plaintiffs allege about Genworth Australia's performance and the IPO. Pl. Opp. at 29-31. Plaintiffs do not argue that "core operations" allegations can independently support an inference of scienter. And as numerous courts in this District have observed, "there is considerable doubt whether the core operations doctrine survived enactment of the PSLRA." *In re Turquoise Hill Res. Ltd. Sec. Litig.*, 2014 WL 7176187, at *8 (S.D.N.Y. Dec. 16, 2014) (collecting cases). Indeed, "the plain language of the PSLRA, which requires facts supporting the scienter inference to be 'state[d]

[10] *Scholastic* just makes the uncontroversial point that "post-class period data may be relevant to determining what a defendant knew or should have known during the class period." 252 F.3d at 73. And in *Aldridge*, the court merely found it "entirely reasonable to think that price protection for the stores selling the product was also discussed and agreed on" from the introduction of a new product in 1998, when company officials stated post class period that price cuts had also been planned "from the get go" in 1998. 284 F.3d at 79-80.

with particularity,' would seem to limit the force of general allegations about core company operations." *Wachovia*, 753 F. Supp. 2d at 353.

Regardless, "the majority approach has been to consider [core operations] allegations as a 'supplementary but not independently sufficient means to plead scienter.'" *In re Molycorp, Inc. Sec. Litig.*, 2015 WL 1097355, at *12 (S.D.N.Y. Mar. 12, 2015) (citations omitted). Thus, under the PSLRA, Plaintiffs "must provide more facts to support a strong inference that any misstatements by defendants … must have been made with scienter" where plaintiffs seek to rely on the "'core operations' method of pleading conscious misbehavior or recklessness." *In re eSpeed, Inc. Sec. Litig.*, 457 F. Supp. 2d 266, 294 (S.D.N.Y. 2006). For all the reasons stated in this Section II, Plaintiffs fail to do so.

Further, Plaintiffs have not pleaded that the "core operations" doctrine applies in this instance. Courts applying the doctrine have generally "'required that the operation in question constitute nearly all of a company's business before finding scienter.'" *Hensley v. IEC Elecs. Corp.*, 2014 WL 4473373, at *5 (S.D.N.Y. Sept. 11, 2014) (quoting *Tyler v. Liz Claiborne, Inc.*, 814 F. Supp. 2d 323, 343 (S.D.N.Y. 2011)). Plaintiffs plead no facts demonstrating that Genworth Australia constitutes "nearly all" of Genworth's business.

Magnitude of the Reserve Increase. Plaintiffs also resort to arguing that the "magnitude of the purported fraud here supports a strong inference of scienter." Pl. Opp. at 32. However, "it is well established that 'the size of the fraud alone does not create an inference of scienter.'" *PXRE*, 600 F. Supp. 2d at 545 (citation omitted); *see also In re China N.E. Petroleum Holdings Ltd. Sec. Litig.*, 2014 WL 7243149, at *3 (S.D.N.Y. Dec. 11, 2014) (rejecting "highly generalized" allegation that the "sheer size of [China North's later] restatement bespeaks of Defendants' scienter"); *In re ShengdaTech, Inc. Sec. Litig.*, 2014 WL 3928606, at *9 (S.D.N.Y.

Aug. 12, 2014) (rejecting "allegations regarding the magnitude of the fraud" as insufficient to support a strong inference of recklessness), *mot. to vacate denied*, 2015 WL 3422096 (S.D.N.Y. May 28, 2015).

Plaintiffs' reliance on *Scholastic* and *Freudenberg* (Pl. Opp. at 32) highlights the inadequacy of Plaintiffs' complaint. Both cases held that plaintiffs established a strong inference of scienter where there were significant, detailed allegations that defendants knew of contradictory information. The complaint in *Scholastic* contained "detailed allegations as to what defendants knew on a daily, weekly and monthly basis about the retail trade of Goosebumps books, while at the same time making public statements that painted a different picture," which the court considered *together with* Plaintiffs' allegations regarding the magnitude of special charges. *Scholastic*, 252 F.3d at 76. Similarly, the *Freudenberg* complaint included allegations by a confidential witness who was a "due diligence analyst and senior underwriter" (not a computer technician) and who "report[ed] to management of huge numbers of loans with negative discrepancies" and posed "questions to management as to why it was keeping bad loans" and received "responses from management that E*TRADE wanted to maintain strong relationships with originators," which demonstrated "the type of back and forth that could establish top management's involvement and knowledge, particularly when combined with all the other reports of Defendants' direct involvement." *Freudenberg v. E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 188, 197 (S.D.N.Y. 2010).

Plaintiffs' allegations here are nothing like those in *Scholastic* and *Freudenberg*.[11]

[11] Plaintiffs cite two additional inapposite cases. *See* Pl. Opp. at 32. *Maine State Retirement System v. Countrywide Financial Corp.*, 2011 WL 4389689 (C.D. Cal. May 5, 2011), is an out-of-circuit case brought under Sections 11, 12(a)(2) and 15 of the Securities Act, which "do not require allegations of scienter" (*id.* at *3) and are therefore irrelevant to Plaintiffs' argument that the magnitude of Genworth's losses supports an inference of scienter. In *Rothman v. Gregor*, 220 F.3d 81 (2d Cir. 2000), the court considered the magnitude of royalty advances a company had to write off "[t]aken together" with the allegations that, after the company began experiencing poor sales, the company continued to account for the royalty advances as assets, despite simultaneously filing lawsuits to recover

Defendants' Access to Data. Under this heading Plaintiffs collect several pages of allegations regarding the sorts of monitoring, stress-testing, and upward-reporting processes Genworth had in place. *See* Pl. Opp. at 33-36. As Defendants' opening brief explained, these allegations are meaningless without particularized allegations showing what specific *contradictory* information Defendants possessed—that Defendants simply possessed information about "delinquencies, claims, trends, and loss reserves" (Pl. Opp. at 33) says nothing about whether this information "diverge[d] from publicly disclosed information," and thus these allegations "fail[] the specificity requirements of the PSLRA and Rule 9(b)." *See Jones*, 550 F. App'x at 28.

Here, Plaintiffs' confidential witnesses do nothing to "show that individual defendants actually possessed the knowledge highlighting the *falsity* of public statements." *Glaser v. The9, Ltd.*, 772 F. Supp. 2d 573, 591 (S.D.N.Y. 2011) (emphasis added). CW2, as explained in Section I.B.2 above, merely details a reporting scheme and nowhere asserts "what specific contradictory information the Individual Defendants received or when they received it." *Local No. 38 IBEW Pension Fund v. Am. Express Co.*, 724 F. Supp. 2d 447, 461 (S.D.N.Y. 2010), *aff'd*, 430 F. App'x 63 (2d Cir. 2011). And the sole contradictory information asserted by CW1—a "$100-125 million" increase in claims—is beyond reliability for the reasons stated above in Section I.B.2 and in any event does not link to Messrs. Fraizer and Klein.

III. THE PSLRA'S SAFE HARBOR PROTECTS GENWORTH'S FORWARD-LOOKING STATEMENTS CONCERNING THE IPO

Defendants' opening brief established that Genworth's statements about the IPO are protected under the "meaningful cautionary language" prong of the PSLRA and, independently,

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royalty payments, indicating its view that "it could not recover its royalty advances through *sales* of the related product." *Id.* at 91-92.

the "no actual knowledge" prong of the PSLRA. Def. Br. at 43-47. Plaintiffs argue that neither prong applies because Defendants allegedly had actual knowledge that their statements were false, and that Defendants' cautionary language was not "meaningful" because the warned-of risks had already materialized. Pl. Opp. at 22-24. None of Plaintiffs' arguments have merit.

A. Defendants' IPO Statements Were Accompanied by Meaningful Cautionary Language

Plaintiffs' opposition first errs by conflating the "actual knowledge" prong of the PSLRA safe harbor (15 U.S.C. § 78u-5(c)(1)(B)) with the "meaningful cautionary statements" prong (*id.* § 78u-5(c)(1)(A)(i)). As explained in Defendants' opening brief (Def. Br. at 43 (citing *Slayton v. Am. Express Co.*, 604 F.3d 758, 766 (2d Cir. 2010))) and not rebutted by Plaintiffs, the safe harbor "is written in the disjunctive, [and] statements are protected by the safe harbor if they satisfy any one of the[] three categories." *In re Sanofi Sec. Litig.*, 2015 WL 365702, at *14, 21 (S.D.N.Y. Jan. 28, 2015) (dismissing under the "independent" cautionary language prong); *see also In re WEBMD Health Corp. Sec. Litig.*, 2013 WL 64511, at *7 (S.D.N.Y. Jan. 2, 2013) (noting that the "safe harbor is written in the disjunctive" and that "the Complaint [was] alternatively subject to dismissal on the grounds that Defendants are protected by their cautionary language").

Indeed, in enacting the PSLRA, Congress sought "to encourage issuers to disseminate relevant information to the market without fear of open-ended liability" by, among other things, offering "certainty that forward-looking statements …. will have safe harbor protection if they are accompanied by a meaningful cautionary statement." H.R. Conf. Rep. 104-369, at 32, 44 (1995). The statute reflects this policy decision, precluding liability under the securities laws "with respect to any forward-looking statement" if that statement is "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ

materially from those in the forward-looking statement." 15 U.S.C. § 78u-5(c)(1)(A)(i). As Congress stated regarding this prong:

> The use of the words "meaningful" and "important factors" are intended to provide a standard for the types of cautionary statements upon which a court may, where appropriate, decide a motion to dismiss, *without examining the state of mind of the defendant*. The first prong of the safe harbor requires courts to examine only the cautionary statement accompanying the forward-looking statement. *Courts should not examine the state of mind of the person making the statement*.

H.R. Conf. Rep. 104-369, at 44 (1995) (emphasis added). Congress's policy decision is unmistakable: encourage forward-looking disclosures by limiting the instances in which the speaker's state of mind is at issue in lawsuits alleging that those disclosures were false.[12]

Thus, Plaintiffs' allegations that Defendants had "actual knowledge" that their statements were false (Pl. Opp. at 23) or "knew" that the warned-of risks had already materialized (*id.* at 23-24) jumps the gun and questions Defendants' state of mind before addressing, as Congress clearly intended, whether Defendants' cautionary language "identif[ied] important factors that could cause actual results to differ materially from those in the forward-looking statement" (15

[12] Although Plaintiffs do not affirmatively argue that the safe harbor prongs are *not* disjunctive, they quote two different sections of *In re ITT Educational Services, Securities Litigation*, 34 F. Supp. 3d 298 (S.D.N.Y. 2014), in a manner that suggests (incorrectly, in Defendants' view) that *ITT* made such a ruling. Plaintiffs begin by quoting *ITT*'s statement that the safe harbor "is dependent on what the defendant knows at the time of the statement; cautionary language is meaningful only when it discloses the *known* risks of the statement's falsity and statements are forward-looking only if they are not false when made." *See* Pl. Opp. at 22 (quoting *ITT*, 34 F. Supp. 3d at 305). This appears simply to be a paraphrasing of (i) the PSLRA's requirement that "meaningful cautionary statements identify[] important factors that could cause actual results to differ materially from those in the forward-looking statement" (15 U.S.C. § 78u–5(c)) and (ii) the "general rule" that forward-looking statements are "statements whose truth cannot be ascertained until some time after the time they are made" (*In re Aegon N.V. Sec. Litig.*, 2004 WL 1415973, at *12 (S.D.N.Y. June 23, 2004) (citation omitted)). To the extent *ITT* suggests that a court reviewing a speaker's risk disclosures must also consider the speaker's state of mind, that proposition is, Defendants respectfully submit, inconsistent with Congress's intent as indicated above in H.R. Conf. Rep. 104-369, at 44 (1995). Plaintiffs follow their first quote from *ITT* with the statement: "Accordingly, 'the safe harbor does not cover claims that were 'made or approved by an executive officer with actual knowledge by that officer that the statement was false or misleading.'" Pl. Opp. at 22 (quoting *ITT*, 34 F. Supp. 3d at 306). Plaintiffs' use of the word "Accordingly" suggests a connection between the two quoted statements from *ITT*, and thus suggests that *ITT* held that "actual knowledge" of falsity trumps meaningful cautionary language, rendering the safe harbor *not* disjunctive (a ruling that would be inconsistent with Second Circuit precedent). But the "actual knowledge" quote from *ITT* appears a full page after the first quote Plaintiffs use, in a separate section of the opinion. Thus, nothing in *ITT* is inconsistent with Second Circuit law that the safe harbor is "disjunctive." *Slayton*, 604 F.3d at 766.

U.S.C. § 78u-5(c)(1)(A)(i)), and was not simply boilerplate.[13] As Defendants' opening brief set forth (at 44-46) and Plaintiffs' opposition does not dispute, Genworth's cautionary language was meaningful; indeed, the company's losses at the end of the class period resulted from the materialization of identified risks. *See Sanofi*, 2015 WL 365702, at *21 ("meaningful[ly] cautionary" where "statements conveyed substantive information about the risk that ultimately materialized"). The safe harbor analysis ends there. *See Gissin v. Endres*, 739 F. Supp. 2d 488, 511 n.144 (S.D.N.Y. 2010) (the court "need not consider whether [defendants] had 'actual knowledge' that their statements were false" because defendants "prevail on the 'meaningful cautionary language' prong of the safe harbor").[14]

Even if the disjunctive nature of the safe harbor is ignored, as explained below, Plaintiffs have no basis for arguing that Defendants knew the disclosed risks had materialized or had actual knowledge of their statements' falsity.[15]

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[13] Further, in *Strougo v. Barclays PLC*, 2015 WL 1883201, at *5 (S.D.N.Y. 2015), the case Plaintiffs cite for the proposition that "statements are not protected where defendants had no basis for their optimistic statements and already knew … that certain risks had become reality" (*see* Pl. Opp. at 24), it is unclear whether the court is analyzing the cautionary language under the PSLRA safe harbor or the "bespeaks caution" doctrine. *Strougo* relies on *Gabriel Capital, L.P. v. NatWest Finance, Inc.*, 122 F. Supp. 2d 407, 419 (S.D.N.Y. 2000), which "observ[es] that the bespeaks caution doctrine 'does not apply where a defendant knew that its statement was false when made.'" 2015 WL 1883201, at *5 n.58. In this regard, the bespeaks caution doctrines departs from the PSLRA's clear disjunctive test, described above.

[14] Plaintiffs' contention that "Defendants cannot convincingly rely on cautionary language regarding 'natural disasters,' when they specifically addressed the Queensland risks; outlined their mitigation of those risks, and reported misleading Class Period loss ratios that validated the purported mitigation" (Pl. Opp. at 24 n.7) ignores Genworth's extensive, detailed disclosures about the impact of the Queensland flooding on Genworth Australia's performance each quarter and the fact that Genworth reported increased reserves to account for these losses. *See* Def. Br. at 6-10. In any event, to qualify for safe harbor protection, a risk disclosure "need not mention 'the particular factor that ultimately causes the forward-looking statement not to come true.'" *In re Avon Prods. Inc. Sec. Litig.*, 2009 WL 848017, at *17 (S.D.N.Y. Feb. 23, 2009) (quoting *Ehlert v. Singer*, 245 F.3d 1313, 1319-20 (11th Cir. 2001), and H.R. Rep. No. 104-369, at 44 (1995)), *report and rec. adopted*, Case No. 05-CV-06803 (LAK), ECF No. 129 (Mar. 18, 2009).

[15] Plaintiffs' argument that Defendants' statements of present fact regarding Genworth Australia's performance and the Australian economy "effectively nullified their cautionary language" about their forwarding-looking statements makes no sense, and Plaintiffs provide no authority in support. *See* Pl. Opp. at 24.

B. Plaintiffs Fail to Plead that Defendants' Forward-Looking Statements Were Made with Actual Knowledge of Falsity

As set forth above, because the three prongs of the PSLRA safe harbor operate independently, even if the Court determines that Defendants' forward-looking statements were not accompanied by cautionary language, Plaintiffs do not state a Section 10(b) claim because Plaintiffs fail to plead that these statements were "made with actual knowledge that [they] w[ere] false or misleading." *Slayton*, 604 F.3d at 766. "Actual knowledge" of falsity is "stricter than for statements of current fact" and requires "proof of knowing falsity." *Id.* at 773 (citation omitted). Plaintiffs' repetition of their allegation that "existing conditions had already caused a loss in the Australian unit" and that at the December 2011 L&M meeting "it was disclosed that the Australian unit had had a bad quarter and that the increase in the claims for Australia equaled around $100-125 million" (Pl. Opp. at 23) fails to respond to Defendants' argument that nowhere in the complaint do Plaintiffs plead particularized facts showing that Defendants did not actually "expect[]" or "anticipate" a Q2 2012 execution for the IPO if market and other conditions permitted. *See Sanofi*, 2015 WL 365702, at *22 (allegation that "defendants were aware of the FDA's concerns and therefore 'knew *or* were severely reckless in disregarding' the misleading nature of their statements" does not constitute "concrete factual particulars that support an inference that the statements were 'made with actual knowledge that [they were] false or misleading'") (citations omitted). Thus, Plaintiffs' claims must be dismissed under the "actual knowledge" prong of the safe harbor.

IV. PLAINTIFFS FAIL TO STATE A CLAIM AGAINST THE INDIVIDUAL DEFENDANTS

Defendants' opening brief argued that, despite the Court's instruction that Plaintiffs plead a "strong" inference of scienter specific to "each of the two individual defendants" (ECF No. 41 at 3-4), the second amended complaint fails to plead any facts specifically supporting that Mr.

Fraizer or Mr. Klein made a false statement, let alone did so with scienter. Def. Br. at 47-49. Plaintiffs' opposition does not identify any such allegations.

First, Plaintiffs fail to plead that Mr. Fraizer or Mr. Klein made any false statements. For the reasons stated in Section I.B above, Plaintiffs have failed to support with factual allegations the complaint's conclusions that Genworth's Q3 2011 Form 10-Q or 2011 Form 10-K contained any false financial information (SAC ¶ 89) or false statements regarding delinquency trends (SAC ¶ 99) or lender processing (SAC ¶ 102); therefore, Plaintiffs have failed to plead that Messrs. Fraizer's and Klein's certifications of those filings were false. SAC ¶ 90.

With respect to other statements made by Mr. Fraizer, the complaint challenges:

- His statement on Genworth's Q3 2011 earnings call on November 4, 2011, that "Australia is transitioning as expected, absorbing the loss pressures coming from the early 2011 Queensland flood events," which Plaintiffs allege "is false and misleading because Fraizer failed to disclose that the coastal Queensland region was experiencing an economic downturn that particularly affected small business owners, driving an increase in claims of $100-125 million." SAC ¶¶ 91-92 (emphasis omitted). This allegation fails because Plaintiffs have not adequately pleaded any undisclosed increase in claims. *See* Point I.B.2 above.

- His statement on the same call that Genworth Australia's Q3 loss ratio "remained flat at 48% sequentially," which Plaintiffs allege was "false and misleading because Klein failed to disclose that the significant increase in claims was exceeding the allotted reserves, and the reported loss ratio figure was, accordingly, materially understated." SAC ¶¶ 91-92 (emphasis omitted). This allegation fails because Plaintiffs have not adequately pleaded any undisclosed increase in claims. *See* Point I.B.2 above.

- His statements on Genworth's Q4 2011 earnings call on February 3, 2012, that the IPO was on track for execution in Q2 2012, which Plaintiffs allege "were false and misleading because Fraizer failed to disclose that deteriorating economic conditions in Queensland had led to a significant increase in claims and delinquencies during the Class Period, including on low documentation loans issued to small business and self-employed borrowers in 2007 and 2008, that exceeded allotted reserves—information that would, if disclosed, delay the IPO." SAC ¶¶ 96-97. This allegation fails because Plaintiffs have not adequately pleaded any undisclosed increase in delinquencies (*see* Point I.B.1 above) or claims (*see* Point I.B.2 above) or that Defendants made any false statements about their plans for the IPO (*see* Point I.D above).

Accordingly, Plaintiffs have failed to plead that Mr. Fraizer made any false statements.

With respect to other statements made by Mr. Klein, the complaint challenges:

- His statement on the Q3 2011 earnings call that "[t]he loss ratio remained flat at 48%," which Plaintiffs allege was "false and misleading because Klein failed to disclose that the significant increase in claims was exceeding the allotted reserves, and the reported loss ratio figure was, accordingly, materially understated." SAC ¶¶ 91-92 (emphasis omitted). This allegation fails because Plaintiffs have not adequately pleaded any undisclosed increase in claims. *See* Point I.B.2 above.

- His statement that the Australian housing market was "performing as expected," which Plaintiffs allege "was false and misleading because [Klein] failed to disclose that the Queensland coastal region's economic decline was leading to significantly increasing delinquencies and claims from severe housing price declines." SAC ¶¶ 96-97 (emphasis omitted).[16] This allegation fails because Plaintiffs have not adequately pleaded any undisclosed increase in delinquencies (*see* Point I.B.1 above) or claims (*see* Point I.B.2 above).

- His statements on a February 3, 2012, investor call that "we expect stable home prices" in Australia and that the IPO remained "on track" for Q2 2012 execution, which Plaintiffs allege were "false and misleading because of Klein's failure to disclose that the Queensland region was impacted by an economic downturn, with skyrocketing delinquencies and claims (including on low documentation loans issued to small business and self-employed borrowers in 2007 and 2008) that exceeded allotted reserves, and that those market conditions and resulting financials would force a delay in the IPO." SAC ¶¶ 104-05 (emphasis omitted). This allegation fails because Plaintiffs have not adequately pleaded any undisclosed increase in delinquencies (*see* Point I.B.1 above) or claims (*see* Point I.B.2 above) or that Defendants made any false statements about their plans for the IPO (*see* Point I.D above).

- His statements on a March 29, 2012, investor call "regarding Genworth's risk management procedures, specifically stress testing 'in terms of home price depreciation … and unemployment,' and that the Company 'look[s] at the impact on delinquencies and on cure rates,'" which Plaintiffs allege "were false and misleading because of Klein's failure to disclose that deteriorating economic conditions in Queensland had already caused delinquencies to rise significantly (including from a $12 billion portfolio of low documentation loans issued in 2007 and 2008) and an increase in claims that exceeded allotted reserves." SAC ¶¶ 107. This allegation fails because Plaintiffs have not adequately pleaded any undisclosed increase in delinquencies (*see* Point I.B.1 above) or claims (*see* Point I.B.2 above).

- His statements on the same March 29, 2012, investor call "that he expected the Australian market to 'remain solid,' [that the] Company would do the IPO 'from a position of strength,' and that 'we're working really hard … to do the transaction in the second

[16] The quoted language comes from paragraph 97 of the complaint, which incorrectly identifies Mr. Fraizer as the speaker. Paragraph 96 of the complaint correctly identifies Mr. Klein as the speaker.

> quarter,'" which Plaintiffs allege "were false and misleading because of Klein's failure to disclose that deteriorating—and extant—economic conditions in Queensland and a concomitant spike in delinquencies and claims in excess of reserves would force the IPO to be delayed." SAC ¶ 108. This allegation fails because Plaintiffs have not adequately pleaded any undisclosed increase in delinquencies (*see* Point I.B.1 above) or claims (*see* Point I.B.2 above) or that Defendants made any false statements about their plans for the IPO or their efforts to execute the IPO in Q2 2012 (*see* Point I.D above).

Accordingly, Plaintiffs have failed to plead that Mr. Klein made any false statements.

Second, Plaintiffs identify no pleaded facts showing that Mr. Fraizer or Mr. Klein "benefitted in some concrete and personal way from the purported fraud." *ECA*, 553 F.3d at 198 (citation omitted); *see Shemian v. Research In Motion Ltd.*, 2013 WL 1285779, at *14 (S.D.N.Y. Mar. 29, 2013) (no motive where plaintiff "failed to identify any 'concrete and personal' benefit that would have motivated the Individual Defendants to engage in securities fraud") (citing *ECA*, 553 F.3d at 198), *aff'd*, 570 F. App'x 32 (2d Cir. 2014). Plaintiffs attempt to distinguish *Shemian* on an irrelevant ground: the court's finding that the alleged scheme to "inflate[] [the company's] stock value to enable the purchase of two technology companies" was implausible given the timing of the acquisitions. *See Shemian*, 2013 WL 1285779, at *13), *cited in* Pl. Opp. at 27 n.12.

Plaintiffs say their allegations are different here because "completing the IPO … can be viewed as a necessary condition to Fraizer's continued position at Genworth, given that Fraizer resigned just two weeks following the disclosure that the IPO would be delayed." Pl. Opp. at 27 n.12 (citing SAC ¶¶ 24, 33). But the complaint makes no such allegation: paragraphs 24 and 33 simply note Mr. Fraizer's resignation "shortly after the truth about the Australian MI unit's financials was disclosed." SAC ¶ 33. Putting aside Plaintiffs' improper attempt to amend their complaint in their opposition brief, the Second Circuit has expressly rejected this argument, holding that, "[i]f motive could be pleaded by alleging the defendant's desire for continued employment … the required showing of motive and opportunity would be no realistic check on aspersions of fraud, and mere misguided optimism would become actionable under the securities

laws." *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994), *quoted in Shemian*, 2013 WL 1285779, at *13 n.7.

Third, because Plaintiffs appear to base their fraud claims against Messrs. Fraizer and Klein on those individuals' alleged knowledge (or reckless disregard) of increasing delinquencies and claims, and Plaintiffs "fail[] to demonstrate that defendants had a motive to defraud … [they] must produce a *stronger* inference" of conscious misbehavior or recklessness. *Kalnit v. Eichler*, 264 F.3d 131, 143 (2d Cir. 2001) (emphasis added); *see also ECA*, 553 F.3d at 199 ("the strength of the circumstantial allegations must be correspondingly greater if there is no motive") (citations omitted).

But Plaintiffs fail to identify "what specific contradictory information the Individual Defendants received or when they received it." *Local No. 38*, 724 F. Supp. 2d at 461. Even if Plaintiffs' meritless allegations about increasing delinquencies and claims were true, the complaint fails to plead that this information was available to Mr. Fraizer or Mr. Klein. As Plaintiffs' opposition does not dispute, CW1 is not alleged to have had any contact with either Mr. Fraizer or Mr. Klein or to have provided information to them, and CW2 does not assert that he provided any information to either individual contradicting that individual's public statements. *See* Def. Br. at 49. Plaintiffs thus fail to state a claim against Mr. Fraizer or Mr. Klein under well-established case law requiring allegations about specific contradictory information that was provided to an individual defendant. *See* Def. Br. at 49 (collecting cases).[17]

[17] Plaintiffs respond to this case law simply by stating, "Plaintiffs have described both confidential witnesses with sufficient particularity to support the probability that someone in their position would know the information attributed to them." Pl. Opp. at 31 n.14. Whether Plaintiffs' CWs' assertions can be credited has nothing to do with the issue above: the failure of these CWs even to assert (credibility issues aside) that Mr. Fraizer or Mr. Klein received information contradicting his public statements.

V. RECENT DECISION INVOLVING PLAINTIFFS' COUNSEL CASTS FURTHER DOUBT ON THE COMPLAINT'S CW ALLEGATIONS

For the numerous reasons identified in Section I.B.2 above, Plaintiffs' CW allegations are unreliable on the face of the complaint and cannot support Plaintiffs' claim of fraud. But Judge Engelmayer's recent decision in *In re Millennial Media, Inc. Securities Litigation*, 2015 WL 3443918 (S.D.N.Y. May 29, 2015), which addressed CW practices by one of two of Plaintiffs' lead counsel in this action, is cause for additional concern.

Judge Engelmayer made a number of findings pertinent to the CW allegations here:

First, plaintiffs' counsel conceded that, per its standard practice, it "did not attempt to confirm with any of the 11 CWs the quotes attributed to them." *Id.* at *6. "Instead, the quotes used in the FAC were drawn from an investigator's memo summarizing an earlier phone interview of the CW. The CWs were not given an opportunity to verify, or refute, that these quotes were accurate or presented in fair context." *Id.* (footnote omitted). These practices, Judge Engelmayer found, "create significant potential for inaccuracy." *Id.*

Indeed, Judge Engelmayer found numerous inaccuracies (*see id.* at *6-10) that, "[v]iewed in combination … significantly undermine[d] the integrity of the FAC, such that, had plaintiffs not voluntarily dismissed the case, [the CWs'] recantations would have left a materially thinner Complaint for the Court to review on a motion to dismiss." *Id.* at *10. "This [was] not a case of merely isolated or immaterial differences between a Complaint and the declarations of a recanting witness, deficiencies which, although regrettable, do not fundamentally affect the integrity of a Complaint," Judge Engelmayer found. *Id.* Rather, "[t]he deficiencies reported by the CWs … [were] pervasive" and "r[a]n a gamut." *Id.* "They infect[ed] statements of major as well as minor importance; and they involve[d] statements that witnesses denied making, statements that were made but which the FAC presented out of context, and statements of

knowledge or opinion for which the witness lacked a factual basis." *Id.*

Second, Judge Engelmayer found that the above deficiencies "could have been avoided had counsel sought to confirm with these witnesses the facts and quotations that counsel proposed to attribute to them," and that "[t]he necessary refinements could have been made to ensure that quotes were used accurately; that information was presented in proper context; and that opinions, assumptions, hearsay, and speculation were not commingled and confused with representations of facts acquired firsthand by a percipient witness." *Id.* at *11. Addressing this investigative failure, Judge Engelmayer stated:

> It is difficult to come up with a good reason why counsel would *not* attempt to confirm with a witness, let alone any of 11 CWs, the accuracy of the statements that counsel intended to attribute to them in a Complaint. Perhaps counsel feared that, confronted with such statements, the witness might repudiate, or unhelpfully modify or contextualize, the investigator's account of his earlier statements. Perhaps counsel were pleased with the pungent sound-bites that the investigator reported from CW-4 in particular. Perhaps counsel feared that a follow-up call to CW-4 to confirm his quotes and determine whether there was a factual basis for them might have led CW-4 to back away, resulting in adjustments that might weaken the draft Complaint. But those are not good reasons to refrain from checking factual accuracy. And the Federal Rules of Civil Procedure do not countenance a "see no evil" approach to pleading. A quest for ignorance when preparing a federal-court Complaint diminishes counsel and ill behooves the litigation process.

Id.

Judge Engelmayer concluded that "[t]he practice revealed by this case, in which plaintiffs' counsel makes literally no attempt to confirm the quotes of a witness on whom counsel proposes to rely in a public filing, sits at best uneasily alongside Federal Rule of Civil Procedure 11." *Id.* The court further noted that, "[i]f the unreasonableness of failing to undertake rudimentary fact-checking with a witness were not intuitively obvious, the growing body of cases chronicling the repudiation by CWs of statements attributed to them in securities class-action complaints would cinch the need to insist upon such care. Numerous reported decisions

have recounted claims by CWs that such complaints inaccurately attributed facts and statements to them." *Id.* at *12 (collecting cases).

Without discovery, Defendants cannot with certainty determine whether Plaintiffs' counsel followed their standard CW practice here with the same results that Judge Engelmayer identified. But what is clear is that one half of Plaintiffs' lead counsel admitted to a practice found by Judge Engelmayer to (i) "create significant potential for inaccuracy" (*id.* at *6) and "significantly undermine the integrity of" plaintiffs' pleading (*id.* at *10) and (ii) constitute perhaps a "'see no evil' approach to pleading"—a "quest for ignorance"—(*id.* at *11) that in any case "sits at best uneasily alongside" Rule 11 (*id.*). And the other half of Plaintiffs' lead counsel has faced similar charges. *See generally City of Livonia Emps. Ret. Sys. v. Boeing Co.*, 711 F.3d 754, 762 (7th Cir. 2013) (Posner, J.) (Plaintiffs' lawyers' "failure to inquire further puts one in mind of ostrich tactics—of failing to inquire for fear that the inquiry might reveal stronger evidence of *their* scienter regarding the authenticity of the confidential source than the flimsy evidence of scienter they were able to marshal …."). In light of these apparently standard practices, CW1's allegation about increasing claims, and the absence of corroboration of any facts supporting the alleged fraud from CW2 or any explanation as to what CW2 said or refused to say concerning CW1's claims, there is significant concern that the problems identified in *Millennial Media* and *Boeing* plague the CW allegations in this action.

In light of the above and the significant uncertainties with the assertions attributed to CW1, Defendants respectfully reiterate their request that, should the Court deny Defendants' motion to dismiss based on the CW1 allegations, the denial be without prejudice and with leave to file an amended motion to dismiss after having the opportunity to promptly depose Plaintiffs' CWs to "determin[e] whether the confidential witnesses acknowledge[] the statements attributed

to them in the complaint." *Campo v. Sears Holdings Corp.*, 371 F. App'x 212, 216 n.4 (2d Cir. 2010). *See* Def. Br. at 27 n.8. Plaintiffs have stated no opposition to this request.

CONCLUSION

Plaintiffs' second amended complaint should be dismissed with prejudice. The consistency of pleading deficiencies and legal flaws through Plaintiffs' three complaints and two opposition briefs negates the possibility that yet another pleading attempt is warranted.

Dated: June 5, 2015
New York, New York

Respectfully submitted,

/s/ Greg A. Danilow

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