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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

COUNTRYWIDE HOME LOANS, INC., and BAC HOME LOANS SERVICING, LP (formerly Countrywide Home Loans Servicing, LP),

Plaintiffs,

v.

MORTGAGE GUARANTY INSURANCE CORPORATION,

Defendant.

Case No. C 10 0233 JSW

DEFENDANT'S NOTICE OF MOTION AND MOTION TO STAY ACTION PENDING RESOLUTION OF ARBITRATION; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

Date: April 2, 2010
Time: 9:00 a.m.
Place: Crtrm. 11, 19th Fl.

Honorable Jeffrey S. White

NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE THAT on April 2, 2010, at 9:00 a.m., or as soon thereafter as the matter may be heard, in the United States District Court, Northern District of California, San Francisco Division, in Courtroom 11, located on the 19th floor at 450 Golden Gate Avenue, San Francisco, California, before the Honorable Jeffrey S. White, the defendant, Mortgage Guaranty Insurance Corporation ("MGIC"), will move to stay this action pending resolution of the arbitration commenced by MGIC against the plaintiffs (collectively, "Countrywide").

MGIC moves to stay the action on the following grounds, which are set forth in detail in the following Memorandum of Points and Authorities:

- Pursuant to Section 3 of the Federal Arbitration Act, 9 U.S.C. § 3, the Court should stay this action based on the arbitration clause in the contract attached to Countrywide's Complaint as Exhibit A.
- In the alternative, the Court should exercise its discretion to stay the action pursuant to the Declaratory Judgment Act, 28 U.S.C. § 2201(a).

The motion will be based on this notice, the memorandum of points and authorities, the arbitration provision of the contract attached to Countrywide's Complaint as Exhibit A, the oral argument of the parties, and the complete files and records for this action.

Dated: February 25, 2010

BARTLIT BECK HERMAN PALENCHAR & SCOTT LLP

By: /s/ Jeffrey A. Hall
Jeffrey A. Hall
Joseph C. Smith
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Attorneys for Defendant
MORTGAGE GUARANTY INSURANCE CORPORATION

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MEMORANDUM OF POINTS AND AUTHORITIES

INTRODUCTION

Countrywide is one of the largest mortgage lenders in the United States. MGIC is an insurance company that insures mortgage lenders against borrower defaults. Countrywide and MGIC are parties to an insurance contract, the Mortgage Guaranty Master Policy or "Flow Policy" (Exhibit A attached). Under the Flow Policy, MGIC insured Countrywide against borrower defaults on a substantial number of Countrywide mortgage loans.

The Flow Policy provides that, under certain circumstances, MGIC may rescind or deny insurance coverage for loans that involve misrepresentations or fraud or are otherwise ineligible for insurance. Ex. A. §§ 2.2, 2.3, 2.4, 4.4, 4.11. In recent years, Countrywide has insured with MGIC a substantial volume of misrepresented, fraudulent, and ineligible loans, many of which have defaulted. As a result, MGIC has rescinded or otherwise denied coverage on an increasing number of Countrywide loans. Countrywide disputes virtually all of MGIC's rescissions or denials, and filed this action in an effort to challenge the bases upon which MGIC has rescinded or denied insurance coverage for numerous Countrywide loans.

By this lawsuit Countrywide seeks judicial resolution of the rescission and denial disputes. But the Flow Policy requires the parties to arbitrate those disputes. MGIC has commenced arbitration under the arbitration provision of the Flow Policy. Pursuant to both the Federal Arbitration Act and the Declaratory Judgment Act, MGIC asks the Court to stay this action pending resolution of the arbitration.[1]

[1] MGIC's motion to stay should be treated as a Rule 12(b) motion for purposes of postponing any answer due date. *See Buckley v. Gallo Sales Co.*, 949 F. Supp. 737, 739-40 (N.D. Cal. 1996); 5C CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1360, pp. 432, 439-41 (2009).

FACTUAL BACKGROUND

The Flow Policy

1. Countrywide and MGIC entered into the Flow Policy. *See generally* Ex. A.[2] Under the Flow Policy, MGIC provides mortgage-default insurance for certain Countrywide mortgage loans.

2. The Flow Policy permits MGIC to rescind or deny coverage for loans involving material misrepresentations or fraud in loan origination or as to loan eligibility. Ex. A, §§ 2.2, 2.3, 2.4, 4.4, 4.11.

3. In the Flow Policy, Countrywide and MGIC agreed to arbitrate virtually all Policy disputes:

> [A]ll controversies, disputes or other assertions of liability or rights arising out of or relating to this Policy, including the breach, interpretation or construction thereof shall be settled by arbitration.

Id. at § 7.6(a). The arbitration provision provides a narrow exception, permitting the parties to seek a declaratory judgment from a court only "on matters of interpretation of the Policy." *Id.*

The Rampant Increase in Misrepresented, Fraudulent, and Ineligible Countrywide Loans

4. For well over a year, MGIC has observed that a substantially increasing volume of Countrywide loss claims under the Flow Policy have involved materially misrepresented, fraudulent, or otherwise ineligible Countrywide loans. MGIC's investigations and other information have revealed that Countrywide engaged in reckless and negligent mortgage underwriting and lending practices, which facilitated widespread fraud and misrepresentation in mortgage loans.

5. For example, as Judge Pfaelzer reported in *In re Countrywide Financial Corp. Derivative Litigation*, 554 F. Supp. 2d 1044, 1058 (C.D. Cal. 2008) (attached as Exhibit B), Countrywide faces allegations from "numerous confidential witnesses" that "support a strong

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[2] MGIC entered into separate Mortgage Guaranty Master Policies with many Countrywide branch locations. As a result, there are hundreds of separate Mortgage Guaranty Master Policies between the parties. Because, with the exception of certain state-specific endorsements not germane to this motion, these Mortgage Guaranty Master Policies are identical, MGIC collectively refers to the policies as the "Flow Policy."

inference of a Company-wide culture that, at every level, emphasized increasing loan origination volume in derogation of underwriting standards" – "simply pushing through loans without adherence to underwriting standards," exhibiting "a rampant disregard for underwriting standards," and having "virtually abandoned its own loan underwriting practices." *Id.* at 1051, 1057, 1058.

6. As a result of Countrywide's failure to follow reasonable loan underwriting practices, it experienced massive loan defaults and has submitted to MGIC a substantial volume of loss claims for misrepresented, fraudulent, or otherwise ineligible loans. MGIC has therefore exercised its right of rescission or denial on a higher volume of loans than in the past. Countrywide disputes the bases underlying MGIC's rescissions or denials of coverage for numerous Countrywide loans under the Flow Policy.

Countrywide's Complaint

7. On December 17, 2009, Countrywide filed this declaratory judgment action in California Superior Court. On January 19, 2010, MGIC timely removed the action to this Court under 28 U.S.C. § 1441.

8. Countrywide purports to seek a declaratory judgment on matters of interpretation of the Flow Policy. Compl. ¶ 1 ("Countrywide seeks declaratory relief in this case so that the policy language can be properly interpreted.").

9. But Countrywide's Complaint does not describe a dispute about Flow Policy interpretation. It instead describes numerous disputes over (1) the relevance, authenticity, admissibility, credibility, and weight of evidence on which MGIC has relied in making its rescission or denial decisions, (2) purported evidence that Countrywide claims contradicts MGIC's rescission or denial decisions in certain cases, and (3) which party should bear the burden of proof concerning Countrywide knowledge or involvement in loan misrepresentations or fraud.

10. For example, in the heart of Countrywide's Complaint, which it calls "MGIC's Improper Interpretations of the Flow Policy," Countrywide alleges that:

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- the parties have a "dispute regarding the burden of proof," *id.* ¶ 47;
- MGIC has based rescission decisions on "untrustworthy, unsubstantiated" evidence or "hearsay that would not be admissible," *id.* ¶¶ 50-51;
- Countrywide's purported evidence is "entitled to greater weight" than MGIC's evidence, *id.* ¶ 52;
- MGIC has relied on "unauthenticated documents of questionable veracity, such as tax and bankruptcy-related documents," or evidence "based on sources the accuracy and completeness of which cannot be verified," or evidence that "does not negate" purportedly contrary evidence, or evidence that is "weak or undercut," *id.* ¶¶ 53-56;
- MGIC has relied on evidence that "lack[s] credibility" or violates appraisal standards, *id.* ¶ 64; and
- MGIC's evidence "does not come close to what MGIC must put forth to establish that there were material misrepresentations entitling it to avoid coverage," *id.* ¶ 50.

11. The Complaint's cause of action confirms that Countrywide seeks judicial declarations on various matters, including:

- "the burden of proof regarding 'first party' involvement or knowledge in a misrepresentation," *id.* ¶ 69;
- "how the provisions of the Flow Policy should be interpreted *and applied with regard to individual loans*," *id.* ¶ 68 (emphasis added);
- "how Sections 2.2, 2.3 and 4.4 [of the Flow Policy] should be interpreted *and applied regarding allegations by MGIC that coverage can be denied or rescinded…*," *id.* ¶ 69 (emphasis added); and
- "how the Flow Policy should be interpreted *and applied with regard to other issues raised by MGIC…*," *id.* (emphasis added).

MGIC's Arbitration Complaint

12. On February 24, 2010, pursuant to the Flow Policy's arbitration provision, MGIC filed a demand for arbitration with the American Arbitration Association seeking to resolve the parties' disputes. (Arbitration Demand attached as Exhibit C.)

13. The Arbitration Demand presents in detail specific examples of Countrywide's

reckless underwriting practices, which facilitated fraud and caused soaring loan default levels. As described in the demand, Countrywide has submitted to MGIC a substantial volume of loss claims for ineligible or fraudulent loans, or loans that are otherwise subject to rescission of coverage. The demand seeks the resolution of Countrywide and MGIC's disputes concerning rescissions or denials of coverage for approximately 1,400 listed claims in dispute between the parties. The demand addresses all loans in dispute related to the Flow Policy.

SUMMARY OF ARGUMENT

The Court should stay this action under the Federal Arbitration Act ("FAA"). The FAA announces a liberal federal policy favoring agreements to arbitrate. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). If a suit is brought "in any of the courts of the United States upon any issue referable to arbitration" under a written arbitration clause, the court "shall . . . stay the trial of the action." 9 U.S.C. § 3.

The Flow Policy contains a broad arbitration clause requiring the parties to submit all disputes "arising out of or relating to this Policy, including the breach, interpretation or construction thereof" to arbitration. Ex. A. § 7.6(a). Declaratory relief may only be requested as to "matters of interpretation of the Policy." Ex. A. § 7.6(a). But Countrywide's various requests for declarations, including on the admissibility and weight of evidence and which party bears the burden of proof concerning Countrywide's knowledge of or participation in borrower fraud, do not seek the Court's interpretation of the Flow Policy. Instead, Countrywide's Complaint demands that the Court answer various questions of law and apply the law to the parties' disputes. The parties have agreed that those issues must be resolved by arbitration.

Even if Countrywide could demonstrate a dispute between the parties that is not subject to mandatory arbitration, the Declaratory Judgment Act ("DJA") provides an additional ground for staying this case. The DJA provides that "any court of the United States . . . *may* declare the rights and other legal relations of any interested party seeking such declaration." 28 U.S.C. § 2201(a) (emphasis added). In accord with the DJA's non-mandatory text, a district court has discretion "to stay or to dismiss an action seeking a declaratory judgment." *Wilton v. Seven Falls*

1 *Co.*, 515 U.S. 277, 288 (1995). Declaratory relief should be denied when it will neither serve a
2 useful purpose nor conclude the proceedings between the parties. *United States v. Washington*,
3 759 F.2d 1353, 1357 (9th Cir. 1985).
4 Countrywide's lawsuit duplicates matters before the arbitrator, who will resolve the
5 parties' specific loan disputes. Because Countrywide may only seek "interpretation" of the Flow
6 Policy in this Court, declaratory relief here will not resolve the controversy between the parties
7 with respect to any of the numerous loans in dispute. Remand to the California Superior Court is
8 not appropriate under these circumstances. Returning the case to the Superior Court will simply
9 require that court to answer questions already before the arbitrator and, as with judicial resolution
10 by this Court, will not conclude the arbitral proceedings between the parties. A stay pending
11 arbitration permits the parties to resolve their disputes by the agreed-upon procedure and achieves
12 the aim of judicial economy.
13 **ARGUMENT**
14 **I. Pursuant to the Federal Arbitration Act, the Court Should Stay This Action**
15 **A. The Federal Arbitration Act Requires a Stay of Judicial Proceedings Where**
16 **an Action Raises Issues Subject to Arbitration**
17 The FAA has long decreed that a written agreement to arbitrate "in any . . . contract
18 evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable,
19 save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C.
20 § 2. The primary purpose of the FAA is "to place an arbitration agreement 'upon the same
21 footing as other contracts, where it belongs.'" *Dean Witter Reynolds, Inc v. Byrd*, 470 U.S. 213,
22 219–20 (1985) (quoting H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924)).
23 Section 2 of the FAA declares "a liberal federal policy favoring arbitration agreements."
24 *Moses H. Cone*, 460 U.S. at 24. To advance this policy favoring arbitration, "as a matter of
25 federal law . . . any doubts concerning the scope of arbitrable issues should be resolved in favor of
26 arbitration." *Id.* at 24–25. The admonition to err on the side of arbitration is especially
27 pronounced where the parties have "agreed to a broad arbitration clause" that evidences the
28 parties' intent to submit a wide range of issues to the arbitrator. *Prima Paint Corp. v. Flood &*

Conklin Mfg. Co., 388 U.S. 395, 398 (1967).

To effect the policy favoring arbitration, the FAA requires federal courts to stay lawsuits involving matters subject to arbitration agreements. Section 3 provides that if a suit is brought "in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement." 9 U.S.C. § 3.

The Supreme Court has emphasized that the language of Section 3 authorizing a stay of judicial proceedings is not advisory. Where a party identifies *any* issues subject to arbitration under a valid arbitration agreement, Section 3 "mandates that district courts *shall*" stay the action as to those issues until they are arbitrated pursuant to the arbitration agreement. *Dean Witter*, 470 U.S. at 218 (citing 9 U.S.C. § 3) (emphasis in original); s*ee also Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d 1126, 1130 (9th Cir. 2000) (same).

Where some but not all of the issues in a case are arbitrable, a trial court's "inherent power to control its own docket and calendar" enables it to stay both the arbitrable and nonarbitrable claims alike. *Mediterranean Enter., Inc. v. Ssangyong Corp.*, 708 F.2d 1458, 1465 (9th Cir. 1983); *see also Genesco, Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840, 844 (2nd Cir. 1987) ("[I]f the court concludes that some, but not all, of the claims in the case are arbitrable, it must . . . determine whether to stay the balance of the proceedings pending arbitration."). A stay of the entire action is "particularly appropriate if the arbitrable claims predominate the lawsuit and the nonarbitrable claims are of questionable merit." *Id.* at 856.

B. Countrywide Asks the Court to Allocate the Burden of Proof, to Rule on the Sufficiency and Credibility of Evidence, to Apply the Flow Policy, and to Decide Other Matters that Do Not Involve "Interpretation of the Policy"

The Flow Policy contains a broad arbitration clause that requires "all controversies, disputes or other assertions of liability or rights arising out of or relating to this Policy, including the breach, interpretation or construction thereof" to be resolved by arbitration. Ex. A. § 7.6(a).

1 The parties may "seek a declaratory judgment from a court of competent jurisdiction" only as to
2 "matters of interpretation of the Policy." *Id.* By these provisions the parties agreed that an
3 arbitrator would have exclusive jurisdiction over all disputes related to the Flow Policy with a
4 narrow exception for questions of policy "interpretation."

5 Under the broad arbitration clause, arbitration is the proper forum to resolve issues of
6 burden of proof allocation; the sufficiency, credibility, and admissibility of evidence supporting
7 coverage denials or rescissions; and other issues related to the application of the Flow Policy.
8 These issues – which form the core of Countrywide's Complaint – are not "matters of
9 interpretation of the Policy." These issues are within the broad category of disputes the parties
10 agreed to resolve exclusively through arbitration. Countrywide should not be permitted to
11 circumvent arbitration.

12 **1. Determining Which Party Bears the Burden of Proving Countrywide**
13 **Involvement in or Knowledge of Borrower Misrepresentations or Fraud Does Not Involve Interpretation of the Flow Policy**

14 Central to Countrywide's Complaint is its request that the Court decide who should bear
15 the burden of proof concerning Countrywide's involvement in or knowledge of borrower fraud or
16 misrepresentations related to the loans under dispute: "Countrywide seeks declaratory relief as
17 to, among other things, how Section 2.4 should be interpreted concerning the burden of proof
18 regarding 'first party' involvement or knowledge in a misrepresentation." Compl. ¶ 69.

19 Though Countrywide labels this burden-of-proof question a matter of "interpretation,"
20 Countrywide neglects to mention that the Flow Policy is silent on the issue. In the absence of any
21 contractual language addressing the subject, the allocation of the burdens of proof does not
22 constitute a "matter of interpretation of the Policy."

23 The Flow Policy's silence on burdens of proof comes as no surprise. Virtually every
24 contract is silent as to burdens of proof in the event of an alleged breach. Contracting parties
25 rarely engage in *ex ante* negotiations to allocate such rules of evidence. Burdens of proof are
26 matters of law, often allocated based on public-policy considerations. *See Aydin Corp. v First*
27 *State Ins. Co.*, 18 Cal. 4th 1183, 1193 (1998) (allocating the burden of proof to the insured based
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on public-policy considerations); *Modern Dev. Co. v. Navigators Ins. Co.*, 4 Cal. Rptr. 3d 528, 534 (Ct. App. 2003) (holding, without looking to policy language, that the "policyholder bears the initial burden of proving the potential for coverage"); *Paese v. Hartford Life and Accident Ins. Co.*, 449 F.3d 435, 441 (2d Cir. 2006) ("The placement of the burden of proof is a question of law . . . . "); 23 RICHARD A. LORD, WILLISTON ON CONTRACTS § 63:14 (May 2009) ("The plaintiff or party alleging the breach has the burden of proof on all of its breach of contract claims.").

Countrywide does not seek an interpretation of the Flow Policy when it asks the Court to allocate the burden of proof. Countrywide instead is attempting to enlist the Court in interpreting how *applicable law* allocates the burden of proof. The parties have agreed to resolve that question of law exclusively through arbitration.

2. Countrywide Seeks the Court's Rulings on the Sufficiency and Credibility of the Evidence, and Other Matters Not Involving Interpretation of the Flow Policy

Countrywide's many challenges to the authenticity, credibility, reliability, admissibility, and sufficiency of MGIC's evidence related to borrower misrepresentations also do not involve "matters of interpretation of the Policy." *See* Compl. ¶¶ 50-64. The Flow Policy is silent as to the nature and sufficiency of the evidence necessary to establish material misrepresentations and Countrywide's knowledge or involvement in them. That silence leaves no policy language for the Court to interpret.

As with the burden-of-proof issue, the Policy's silence on these evidentiary issues comes as no surprise. Matters of evidentiary authenticity, credibility, admissibility, reliability, and weight are not questions of Policy interpretation. They are matters of law. *See*, *e.g.*, Fed. R. Evid. 802 ("Hearsay is not admissible except as provided by these rules or by other rules prescribed by the Supreme Court pursuant to statutory authority or by Act of Congress"); *United States v. Alvarez*, 358 F.3d 1194, 1214 (9th Cir. 2004) ("Whether the district court correctly construed a hearsay rule is a question of law reviewed *de novo"*).

Countrywide relies on the narrow declaratory-relief exception to arbitration for matters of policy interpretation to press evidentiary objections to breach-of-contract allegations that are not

before the Court and that are now a subject of arbitration between the parties. Countrywide must assert its challenges to the evidentiary bases for MGIC's rescission and coverage denial decisions in arbitration.

3. Application of the Flow Policy Does Not Involve Interpretation of the Policy

The essence of Countrywide's Complaint is that MGIC has "wrongfully denied and/or rescinded coverage" for certain loans. Compl. ¶ 60. To redress that asserted breach of contract, Countrywide asks the Court to *apply* the Flow Policy. *See id.* at ¶¶ 68, 69. Countrywide contends that proper application of the Flow Policy requires MGIC to reinstate coverage of unidentified disputed loans.

Whatever the ultimate merits of Countrywide's breach-of-contract theory, Countrywide's Complaint before this Court conflates policy interpretation and policy application. The concepts are not one and the same. Interpretation tasks a court with either explaining what clear words of a contract mean or clarifying ambiguous contractual language. *E.g.*, *Black's Law Dictionary* (8th ed. 2004). Application, on the other hand, entails implementing and enforcing contractual language based on the particular facts of a specific dispute. *Compare* RESTATEMENT (SECOND) OF CONTRACTS § 200(c) (1981) ("Interpretation is not a determination of the legal effect of words or other conduct."); 5 MARGARET N. KNIFFIN, CORBIN ON CONTRACTS § 24.3 (rev. ed. 1998) ("[T]he process of interpretation stops wholly short of a determination of the legal relations of the parties."); 11 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 30:1 (4th ed. 1999) ("[I]nterpretation involves ascertaining the meaning of the contractual words, while construction involves deciding their legal effect."). *See also Fausel v. JRJ Enters., Inc.*, 603 N.W.2d 612, 618 (Iowa 1999) ("Interpretation is a process for determining the meaning of words in a contract. Construction, on the other hand, is a process of determining the legal effect of such words.") (internal citations omitted).

Countrywide's requests that the Court apply the Flow Policy are not "matters of interpretation of the Policy." They amount to requests for abstract rulings on the merits of unidentified contract disputes and are not within the narrow exception to the arbitration

agreement. The proper application of the Flow Policy to the loans in dispute can only be resolved in arbitration. Ex. A. § 7.6(a).

C. The Court Should Stay the Entire Action

Because Countrywide's Complaint seeks rulings on numerous matters that do not involve "interpretation of the Policy" – including allocating the burden of proof; determining the sufficiency, credibility, and admissibility of evidence; and applying the Flow Policy – the Complaint is subject to arbitration. This Court should stay the entire action. *Chiron,* 207 F.3d at 1130. Even if the Court concludes that Countrywide has asserted some issues that may involve Policy interpretation, it should nevertheless exercise its discretion to "stay the balance of the proceedings pending arbitration." *Genesco,* 815 F.2d at 844. Any questions of Flow Policy interpretation arguably sought by Countrywide's Complaint pale in comparison to the substantial non-interpretive matters it raises that are the subject of arbitration. Because "arbitrable claims predominate the lawsuit," a stay of the entire action is justified. *Id.* at 856.

D. The Court Should Determine Arbitrability Under the FAA Before Considering Countrywide's Motion to Remand Under the DJA

The FAA is a body of federal substantive law that compels federal courts to enforce agreements to arbitrate. *Dean Witter*, 470 U.S. at 218. Unlike the DJA, the FAA does not provide federal courts with discretion to deny relief. Where a case raises "issue[s] referable to arbitration," the federal court "*shall* . . . stay the trial of the action." 9 U.S.C. § 3 (emphasis added). This case, therefore, is not marked by the "absence of any federal interest or non-discretionary federal claims," as asserted by Countrywide in its recently filed motion to remand. (Pl.'s Mot. to Remand 10.) To the contrary, Countrywide's Complaint implicates the important federal policy favoring arbitration and MGIC's non-discretionary entitlement to enforce the Flow Policy's broad arbitration clause. Before this Court can consider its discretion under the DJA, therefore, it should first resolve MGIC's request for a stay under the FAA.[3]

[3] MGIC will file its response to the motion to remand on or before March 4, 2010.

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II. Pursuant to the Declaratory Judgment Act, the Court Should Stay this Action

The DJA provides an additional basis to stay any aspect of this lawsuit not subject to arbitration.

A. The Court Has Broad Statutory Discretion to Stay Countrywide's Request for Declaratory Relief

Under the DJA, the Court has discretion as to whether to permit a declaratory judgment action to proceed. The DJA provides that "any court of the United States . . . *may* declare the rights and other legal relations of any interested party seeking such declaration." 28 U.S.C. § 2201(a) (emphasis added). The statute's "textual commitment to discretion" is not accidental. *Wilton*, 515 U.S. at 286. In accord with the DJA's nonobligatory text, "a district court is authorized, in the sound exercise of its discretion, to stay or to dismiss an action seeking a declaratory judgment before trial or after all arguments have drawn to a close." *Id.* at 288.

"Declaratory relief should be denied when it will neither serve a useful purpose in clarifying and settling the legal relations in issue nor terminate the proceedings and afford relief from the uncertainty and controversy faced by the parties." *Washington*, 759 F.2d at 1357. Additional factors that counsel in favor of a discretionary stay include: (1) avoiding needless determination of state law issues; (2) preventing duplicative litigation; and (3) the presence of pending parallel state proceedings involving the same issues and parties. *Gov't Employees Ins. Co. v. Dizol*, 133 F.3d 1220, 1225 (9th Cir. 1998) (en banc) (citations omitted).

Courts have also recognized arbitration proceedings as a ground for staying a declaratory judgment action. *See Gemini Ins. Co. v. Clever Const. Inc.*, Cv. No. 09-00290 DAE-BMK, 2009 WL 3378593 at *10 (D. Haw. Oct. 21, 2009); *St. Paul Fire & Marine Ins. Co. v. La Firenza, LLC*, No. 8:06-CV-1855-JDW-TGW, 2007 WL 2010759 at *2 (M.D. Fla. July 6, 2007); *see also Dizol,* 133 F.3d at 1225, n.5 (the "availability and relative convenience of other remedies" is an additional factor justifying a stay); *Smith v. Metro. Property and Liability Ins. Co.*, 629 F.2d 757, 759 (2d Cir. 1980) (affirming district court's abstention given the availability of a "fully adequate" arbitral remedy that would be "substantially duplicative of any proceeding[s]" in court). Just as the interest in judicial efficiency cuts against forcing the same parties to adjudicate

the same issues before two separate judicial tribunals, so too does efficiency discourage compelling the same parties to make their case before both a court and an arbitrator.

B. The Relevant Factors Support a Stay of Countrywide's Declaratory Judgment Action

1. Granting Declaratory Relief Would Serve No Useful Purpose

MGIC has initiated arbitration to resolve its disputes with Countrywide concerning MGIC's election to rescind or deny coverage of over 1,400 Countrywide loss claims under the Flow Policy. Adjudication of that dispute will necessarily require the arbitrator to resolve the manner in which to apply the Flow Policy, Compl. ¶¶ 68, 69, who bears the burden of proving Countrywide's knowledge or involvement in borrower fraud, *id.* at ¶ 69, and the sufficiency, credibility, and reliability of the evidence, *id.* ¶¶ 50, 51. Because Countrywide's declaratory-judgment action is duplicative of the claims before the arbitrator, issuing declaratory relief would not "serve a useful purpose in clarifying and settling the legal relations in issue." *Washington*, 759 F.2d at 1357; *B & O Mfg., Inc. v. Home Depot U.S.A., Inc.*, No. C 07-02864 JSW, 2007 WL 3232276 (N.D. Cal. Nov. 1, 2007) (dismissing declaratory-relief claim because it was duplicative of a breach-of-contract claim); *Strawflower Elec., Inc. v. Radioshack Corp.*, No. C-05-0747 MMC, 2005 WL 2290314, *11 (N.D. Cal. Sept. 20, 2005) (same).

To the contrary, resolution of Countrywide's questions in the abstract, divorced from the concrete facts surrounding particular disputed loans, risks muddying rather than clarifying the legal relations between the parties. And granting declaratory relief to address those abstract questions will not "terminate" the ongoing arbitration. *Washington*, 759 F.2d at 1357. The arbitrator will address concrete disputes with access to the factual record necessary to make a full and informed adjudication that resolves the parties' disputes. To permit the arbitrator to do so, a stay here is warranted.

2. A Stay Avoids Resolving State-Law Questions and Serves the Interest in Judicial Economy

Adjudicating Countrywide's request for declaratory relief would require the court: (1) needlessly to resolve difficult questions of state insurance law while (2) making legal and

factual determinations on matters that are the subject of arbitration, which is (3) the agreed-upon forum for resolving disputes between the parties. Any one of these factors alone could support an order to stay this case. *Dizol*, 133 F.3d at 1225. Together, they amply justify a decision to step back and to permit arbitration to run its course.

Countrywide's recent motion to remand correctly identifies this Court's discretion to deny declaratory relief, *see* Pl.'s Mot. Remand, but provides no basis for preferring a remand to a stay. The very factors Countrywide relies on in its motion confirm that a stay is the preferable discretionary remedy. And just as resolution of Countrywide's dispute in this Court would not dispose of the controversy between the parties, *id.* at 11, resolution in California Superior Court would not achieve that aim either. Regardless of which court were to hear Countrywide's Complaint, the parties would still need to proceed in arbitration to resolve their disputes. To avoid the "risk of duplicative litigation," *id.,* and to serve the interest in "judicial economy," *id.* at 9, a stay pending arbitration is the only appropriate form of discretionary relief.

CONCLUSION

The Court should stay this action pending resolution of the parties' arbitration.

Dated: February 25, 2010

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