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LOS ANGELES

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UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

20 IN RE FREMONT GENERAL
21 CORPORATION LITIGATION

CASE No. CV07-02693 FMC (FMMx)

22 CONSOLIDATED COMPLAINT
23 FOR BREACHES OF FIDUCIARY
24 DUTY UNDER ERISA

25 CLASS ACTION

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I. INTRODUCTION

1. Interim Lead Plaintiffs Marcy Johannesson, Wendy Horvat, Robert Anderson, Linda Sullivan, Armando Salas and James K. Hopkins (hereafter the “Interim Lead Plaintiffs” or “Plaintiffs”) allege the following based upon the investigation of Plaintiffs’ counsel, which included a review of United States Securities and Exchange Commission (“SEC”) filings by Fremont General Corporation (“Fremont” or the “Company”), including the Company’s proxy statements (Form 14A), annual reports (Form 10-K), quarterly reports (Form 10-Q), current periodic reports (Form 8-K), and the annual reports (Form 11-K) filed on behalf of (a) the Fremont General Corporation and Affiliated Companies Investment Incentive Plan, as amended through Mar. 19, 2007 (Exhibit A) (hereafter the “401(k) Plan”); and (b) the Fremont General Corporation Employee Stock Ownership Plan, effective Jan. 1, 2000 (Exhibit B) (hereafter the “ESOP” or “ESOP Plan” and with the 401(k) Plan, the “Plans”), a review of the Forms 5500 filed by the Plans with the Department of Labor, interviews with participants of the Plans, and a review of available documents governing the operations of the Plans. Plaintiffs believe that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

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II. NATURE OF THE ACTION

2. This is a class action brought on behalf of the Plans pursuant to §§ 502(a)(2) and (a)(3) of the Employee Retirement Income Security Act (“ERISA”), 29 U.S.C. §§1132(a)(2) and (a)(3), against the fiduciaries of the Plans for violations of ERISA.

3. The Plans are retirement plans sponsored by Fremont.

4. Plaintiffs’ claims arise from the failure of Defendants, who are fiduciaries of the Plans, to act solely in the interest of the participants and beneficiaries of the Plans, and to exercise the required skill, care, prudence, and

1 diligence in administering the Plans and the Plans' assets during the period January
2 1, 2005 through the present (the "Class Period").

3 5. Plaintiffs allege that Defendants allowed the imprudent investment of
4 the Plans' assets in Fremont equity throughout the Class Period despite the fact that
5 they knew or should have known that such investment was unduly risky and
6 imprudent due to the Company's serious mismanagement and improper business
7 practices, including, among other practices: (a) aggressively marketing
8 exceedingly risky loan products to borrowers without adequate consideration of the
9 borrower's ability to repay and with high risk of borrower default in order to
10 produce huge volumes of loans for quick resale to third party investors
11 securitization; (b) producing huge volumes of loans for quick resale to third party
12 investors for securitization without regard to whether a borrower could afford the
13 loan by instituting improperly lax underwriting guidelines; (c) providing financial
14 incentives to third party mortgage brokers to sell high cost products, but failing to
15 meaningfully monitor or control the unfair and deceptive conduct used by brokers
16 to sell Fremont loans or to disclose the inherent conflicts of interest created by
17 such practices; (d) misleading borrowers about loan terms and their ability to
18 refinance to lower cost products by providing incomplete, confusing and often,
19 intentionally inaccurate information to borrowers; (e) engaging in unfair or
20 deceptive loan servicing conduct, which led to unnecessary foreclosures for
21 borrowers; (f) operating with ineffective risk management policies and procedures,
22 including inadequate underwriting criteria; (g) operating with inadequate liquidity
23 in relation to the volatility of Fremont's business lines and assets; and (h) operating
24 with a large volume of poor quality loans and in such a manner as to produce low
25 and unsustainable earnings; (i) using highly subjective "gain on sale" accounting
26 practices in an aggressive and ill-founded manner resulting in overstatements of
27 earnings that were subsequently reversed; and (j) using aggressive securitization
28 practices, all of which constituted a highly risky business strategy culminating in

1 the collapse of the Company's financial position and stock price. In short, during
2 the Class Period, Fremont stock has precipitously declined, the Company has been
3 seriously mismanaged and has faced dire financial circumstances as a result of the
4 aforementioned circumstances.

5 6. Plaintiffs allege in Count I that the Defendants who were responsible
6 for the investment of the Plans' assets breached their fiduciary duties to the Plans'
7 participants in violation of ERISA by failing to prudently and loyally manage the
8 Plans' investment in Fremont stock. In Count II, Plaintiffs allege that the
9 Defendants, who were responsible for the selection, monitoring and removal of the
10 Plans' other fiduciaries, failed to properly monitor the performance of their
11 fiduciary appointees and remove and replace those whose performance was
12 inadequate. In Count III, Plaintiffs allege that Defendants breached their fiduciary
13 duty to inform the Plans' participants by failing to provide complete and accurate
14 information regarding the soundness of Fremont stock and the prudence of
15 investing and holding retirement contributions in Fremont equity. In Count IV,
16 Plaintiffs allege that Defendants breached their duties and responsibilities as co-
17 fiduciaries by failing to prevent breaches by other fiduciaries of their duties of
18 prudent and loyal management, complete and accurate communications, and
19 adequate monitoring.

20 7. As more fully explained below, during the Class Period, Defendants
21 imprudently permitted the Plans to hold and acquire millions of dollars in Fremont
22 stock. Based on publicly available Plan information, it appears that Defendants'
23 breaches have caused the Plans to lose tens of millions of dollars of retirement
24 savings.

25 8. This action is brought on behalf of the Plans and seeks to recover
26 losses to the Plans for which Defendants are personally liable pursuant to ERISA
27 §§ 409 and 502(a)(2), 29 U.S.C. §§ 1109, and 1132(a)(2). In addition, under
28 § 502(a)(3) of ERISA, 29 U.S.C. § 1132(a)(3), Plaintiffs seek other equitable relief

1 from Defendants, including, without limitation, injunctive relief and, as available
2 under applicable law, constructive trust, restitution, equitable tracing, and other
3 monetary relief.

4 9. ERISA §§ 409(a) and 502(a)(2) authorize participants such as
5 Plaintiffs to sue in a representative capacity for losses suffered by the Plans as a
6 result of breaches of fiduciary duty. Pursuant to that authority, Plaintiffs bring this
7 action as a class action under Fed. R. Civ. P. 23 on behalf of all participants and
8 beneficiaries of the Plans whose Plan accounts were invested in Fremont stock
9 during the Class Period.

10 10. In addition, because the information and documents on which
11 Plaintiffs' claims are based are, for the most part, solely in Defendants' possession,
12 certain of Plaintiffs' allegations are by necessity upon information and belief. At
13 such time as Plaintiffs have had the opportunity to conduct discovery, Plaintiffs
14 will, to the extent necessary and appropriate, amend this Complaint, or, if required,
15 seek leave to amend, to add such other additional facts as are discovered that
16 further support Plaintiffs' claims.

17 III. JURISDICTION AND VENUE

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19 11. **Subject Matter Jurisdiction.** This Court has subject matter
20 jurisdiction over this action pursuant to 28 U.S.C. § 1331 and ERISA § 502(e)(1),
21 29 U.S.C. § 1132(e)(1).

22 12. **Personal Jurisdiction.** ERISA provides for nationwide service of
23 process. ERISA § 502(e)(2), 29 U.S.C. § 1132(e)(2). All of the Defendants are
24 either residents of the United States or subject to service in the United States and
25 this Court therefore has personal jurisdiction over them. This Court also has
26 personal jurisdiction over them pursuant to Fed. R. Civ. P. 4(k)(1)(A) because they
27 would all be subject to the jurisdiction of a court of general jurisdiction in the State
28 of California.

1 18. Plaintiff Armando Salas is a resident of Moreno Valley, California.
2 Plaintiff Salas was a participant in both the 401(k) Plan and the ESOP throughout
3 the Class Period within the meaning of ERISA § 3(7), 29 U.S.C. § 1102(7). She
4 held shares of Company stock in her retirement accounts in the Plans during the
5 Class Period.

6 19. Plaintiff James K. Hopkins is a resident of Whittier, California.
7 Plaintiff Hopkins is a participant in the Plans within the meaning of ERISA § 3(7),
8 29 U.S.C. § 1102(7), and was a participant in both the 401(k) Plan and the ESOP
9 throughout the Class Period. He continues to hold shares of Company stock in his
10 retirement accounts in the Plans and did so throughout the Class Period.

11 **B. Defendants**

12 20. **Fremont General Corporation.** Fremont is a Nevada corporation,
13 incorporated in 1972, with its principal place of business and chief administrative
14 offices located at 2425 Olympic Boulevard, 3rd Floor East, Santa Monica,
15 California. According to its website, www.fremontgeneral.com, the Company is a
16 financial services holding company engaged in commercial real estate lending
17 nationwide and residential loan servicing through its wholly owned subsidiary,
18 Fremont Investment & Loan (“FIL”). Fremont’s activities are divided into three
19 business operations: residential real estate, commercial real estate and retail
20 banking. Fremont’s lending activities are primarily funded through deposit
21 accounts insured to the maximum legal limit by the Federal Deposit Insurance
22 Corporation, and to a lesser extent, advances from the Federal Home Loan Bank.
23 Fremont’s residential real estate division originates subprime residential loans
24 through a network of mortgage brokers in 47 states. The Company’s commercial
25 real estate division provides first mortgage financing to developers secured by
26 properties in 29 states. Fremont’s common stock is listed on the New York Stock
27 Exchange and trades under the ticker symbol “FMT.” As described more fully
28 below, the Company was a named fiduciary in both Plans.

1 21. **Board of Directors.** As explained more fully below, the Plans assign
2 fiduciary responsibilities and duties to Fremont’s Board of Directors (the “Board”).
3 The Defendants identified in this Paragraph are referred to as the “Director
4 Defendants.” On information and belief, the individual Director Defendants are as
5 follows:

6 (a). **Defendant Wayne R. Bailey** has served as the Executive Vice
7 President and Chief Operating Officer of Fremont since 2004.
8 Defendant Bailey also served as Executive Vice President, Treasurer
9 and Chief Financial Officer of the Company from 1995 to 2004.
10 Additionally, from 1994 to 1995, Defendant Bailey served as Senior
11 Vice President and Chief Operating Officer and as Vice President and
12 Chief Financial Officer from 1990 to 1994. Defendant Bailey has
13 been a member of the Fremont Board since 1996 and is currently a
14 member of the Board of FIL (hereafter the “FIL Board”).

15 (b). **Defendant Thomas W. Hayes** has served as a member of the
16 Fremont Board since 2001. Since at least the beginning of the Class
17 Period, Defendant Hayes has been a member of the Compensation
18 Committee of the Board (hereafter the “Compensation Committee”)
19 and the Governance and Nominating Committee of the Board
20 (hereafter the “Governance and Nominating Committee”) and has
21 served as Chair of the Audit Committee of the Board (hereafter the
22 “Audit Committee”). Defendant Hayes also currently serves on the
23 FIL Board and is Chairman of the Audit Committee of the FIL Board
24 (hereafter the “FIL Audit Committee”).

25 (c). **Defendant Robert F. Lewis** has served as a member of the
26 Fremont Board since 2002. Since at least the beginning of the Class
27 Period, Defendant Lewis has been a member of the Compensation
28 Committee, Executive Committee and Audit Committee and has

1 served as Chairman of the Governance and Nominating Committee.
2 Defendant Lewis also currently serves on the FIL Board and is a
3 member of the FIL Audit Committee.

4 (d). **Defendant Russell K. Mayerfield** has served as a member of
5 the Fremont Board of Directors since 2004. Since 2005, Defendant
6 Mayerfield has been a member of the Compensation, Governance and
7 Nominating Committee and Audit Committees of the Board.
8 Defendant Mayerfield also currently serves on the Board of FIL and is
9 a member of the Audit Committee of FIL

10 (e). **Defendant James J. McIntyre** has served as the Company's
11 Chairman of the Board since 1989 and has been a member of the
12 Board since 1972. From 1976 to 2004, Defendant McIntyre served as
13 Chief Executive Officer of Fremont.

14 (f). **Defendant Louis J. Rampino** has served as President of
15 Fremont since 1995 and was appointed as Chief Executive Officer in
16 2004. Defendant Rampino has been a member of the Board since
17 1994 and currently serves as Chairman of the FIL Board. From 1995
18 to 2004, Defendant Rampino served as Chief Operating Officer of the
19 Company.

20 (g). **Defendant Dickinson C. Ross** has served as a member of the
21 Board since 1987. During at least 2004, Defendant Ross was a
22 member of the Governance and Nominating Committee and has
23 served on the Compensation Committee since at least 2004 through
24 the present.

25 22. **401(k) Plan Committee.** As explained more fully below, the 401(k)
26 Plan assigns fiduciary responsibilities and duties to the 401(k) Plan Committee.
27 Specifically, the committee members have authority over determining the amount
28 of and, upon information and belief, vehicle for Company matching contributions

1 made pursuant to the Plan. The Defendants identified in this Paragraph are
2 referred to as the “401(k) Plan Committee Defendants.” On information and
3 belief, the individual 401(k) Plan Committee Defendants are as follows:

4 (a). **Defendant Wayne R. Bailey** has served as a member of the
5 401(k) Plan Committee since at least December 6, 2004.

6 (b). **Defendant Patrick E. Lamb** served as Senior Vice President,
7 Treasurer, and Chief Financial Officer of Fremont from 2005 until his
8 resignation on July 9, 2007. Defendant Lamb also served as the
9 Senior Vice President, Controller and Chief Accounting Officer of the
10 Company from 2002 to 2003 and as Vice President of Finance from
11 1998 to 2001. Additionally, Defendant Lamb served as a member of
12 the 401(k) Plan Committee since at least December 6, 2004 until his
13 resignation.

14 (c). **Defendant Raymond G. Meyers** has served as Senior Vice
15 President and Chief Administrative Officer of Fremont since 1989 and
16 as a member of the 401(k) Plan Committee since at least December 6,
17 2004.

18 (e). **Defendant Louis J. Rampino** has served has served as a
19 member of the 401(k) Committee since at least December 6, 2004.

20 23. **ESOP Committee.** As explained more fully below, the ESOP assigns
21 fiduciary responsibilities and duties to the ESOP Committee comprised of Fremont
22 officers, including the Company’s Chief Financial Officer, and other Fremont
23 employees. Specifically, these individuals have authority over determining the
24 amount of Company stock in the ESOP. The Defendants identified in this
25 Paragraph are referred to as the “ESOP Committee Defendants.” On information
26 and belief, the individual ESOP Committee Defendants are as follows:

1 (a). **Defendant Wayne R. Bailey** has served as a member of the
2 ESOP Committee since at least January 1, 2004.

3 (b). **Defendant Patrick E. Lamb** served as a member of the ESOP
4 Committee from 2005 until his resignation on July 9, 2007.

5 (c). **Defendant Raymond G. Meyers** has served as a member of
6 the ESOP Committee since at least January 1, 2004.

7 (d). **Defendant James J. McIntyre** served as a member of the
8 ESOP Committee since at least January 1, 2004 until December 6,
9 2004.

10 (e). **Defendant Louis J. Rampino** has served has served as a
11 member of the ESOP Committee since at least January 1, 2004.

12 (f). **Defendant Dickinson C. Ross** served as a member of the
13 ESOP Committee from at least January 1, 2004 until December 6,
14 2004. Upon information and belief, in his capacity as a member of
15 the ESOP Plan Committee, Defendant Ross was a “Named
16 Administrative Fiduciary” and a “Named Investment Fiduciary” of the
17 ESOP, responsible for the administration and operation of the Plan
18 and for investment and management of plan assets.

19 24. **John and Jane Does 1-10.** Plaintiffs do not currently know the
20 identity of all of the Plans’ fiduciaries during the Class Period. Therefore, some of
21 the fiduciaries are named fictitiously, as Defendants John and Jane Does 1-10.
22 Once their true identities are ascertained, Plaintiffs will seek leave to join them
23 under their true names.

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V. THE PLANS

25. The Plans, sponsored by Fremont, are “employee pension benefit plans,” as defined by § 3(2)(A) of ERISA, 29 U.S.C. § 1002(2)(A). The Plans are legal entities that can sue and be sued. ERISA § 502(d)(1), 29 U.S.C. § 1132(d)(1). However, in a breach of fiduciary duty action such as this, the Plans are neither defendants nor plaintiffs. Rather, pursuant to ERISA § 409, 29 U.S.C. § 1109, and the law interpreting it, the relief requested in this action is for the benefit of the Plans and their participants/beneficiaries.

26. The assets of an employee benefit plan, such as the Plans here, must be “held in trust by one or more trustees.” ERISA § 403(a), 29 U.S.C. § 1103(a). During the Class Period, the assets of the 401(k) Plan were held in the Fremont General Corporation Investment Incentive Program Trust and the assets of the ESOP were held in the Fremont Employee Stock Ownership Plan Trust (collectively, the “Trusts”). Merrill Lynch Trust Company of California (“Merrill Lynch”) served as the Trustee for both Trusts (hereafter “Trustee”). *See* Fremont General Corporation Employee Stock Ownership Plan Trust Agreement, restated effective Aug. 1, 1994 (“ESOP Trust Agreement”) (Exhibit D); Fremont General Corporation Investment Incentive Program Trust Agreement, amended and restated as of Nov. 28, 1994 (“401(k) Plan Trust Agreement”) (Exhibit E).

A. The 401(k) Plan

27. The 401(k) Plan, established effective February 1, 1986, provides benefits, except in limited circumstances, for all employees and certain temporary employees. An employee becomes eligible to participate in the 401(k) Plan as soon as “administratively feasible following his or her Employment Commencement Date or the date he becomes an Eligible Employee, if later.” *See* 401(k) Plan § 3.1; Fremont General Corporation Investment Incentive Plan,

1 Annual Report (Form 11-K) at 4 (Dec. 31, 2005) (hereafter the “2005 Form 11-
2 K”).

3 28. Under the 401(k) Plan, an account is maintained for each participant,
4 reflecting all contributions and the participant’s share of earnings or losses for each
5 respective investment fund. 401(k) Plan §§ 5.1-5.3. According to the 401(k) Plan
6 and 2005 Form 11-K, 401(k) Plan participants’ accounts are credited with the
7 participant’s contributions, Company contributions and Plan earnings or losses.
8 2005 Form 11-K at 5. For each participant, a separate account is maintained for:
9 (a) salary deferral contributions; (b) employer matching contributions; (c) qualified
10 matching contributions; (d) qualified nonelective contributions; (e) rollover
11 contributions; and (f) other accounts as necessary or appropriate. 401(k) Plan §
12 5.1(a).

13 29. Participants can elect to contribute a portion of their eligible pre-tax
14 compensation up to 15% of their compensation for the Plan year. 401(k) Plan
15 § 4.1(a); 2005 Form 11-K at 4.

16 30. Participant contributions vest immediately. 401(k) Plan § 6.1(a);
17 2005 Form 11-K at 4.

18 31. Employee contributions are matched by the Company at a rate of
19 100% of the first 6% of eligible compensation deferred by the employee. 401(k)
20 Plan § 4.2(a) (as amended Jan. 1, 2003); 2005 Form 11-K at 4. During 2002, the
21 comparable matching contribution was 85%. Fremont General Corporation
22 Investment Incentive Plan, Annual Report (Form 11-K) at 4 (Dec. 31, 2003)
23 (hereafter “2003 Form 11-K”).

24 32. “Employer matching contributions shall be made in such amount and
25 in such form (i.e., cash or Company Stock, or a combination thereof) as prescribed
26 by the Board.” 401(k) Plan § 4.2(a).

1 33. For the years 2004 - 2006, as determined by the Board through its
2 exercise of discretion, the Company made matching contributions to the 401(k)
3 Plan in shares of Company common stock. 2005 Form 11-K at 4; Fremont General
4 Corporation Investment Incentive Plan, Annual Report (Form 11-K) at 4 (Dec. 31,
5 2006) (hereafter the “2006 Form 11-K”).

6 34. As of April 13, 2007, employer matching contributions made on or
7 after April 13, 2007 were made in cash rather than Company stock. *See* Email
8 from HR Services to Employees Who Are Participants in the Fremont General
9 Corporation Employee Stock Ownership Plan and/or the Fremont General
10 Corporation and Affiliated Companies Investment Plan (Apr. 6, 2007) at FGC-
11 ERISA 00375 (hereafter the “April 6, 2007 Email”) (Exhibit F). Thereafter,
12 participants were permitted to reallocate matching contributions made on or after
13 April 13, 2007 into any other investment options. *Id.*

14 35. According to the Company’s 2005 Form 11-K, employees have
15 discretion to diversify out of Company common stock after the Company’s
16 contribution has been allocated into participants’ accounts. 2005 Form 11-K at 4.
17 However, the Plan provides that although the participant shall direct the investment
18 of his or her account, as to a participant’s election out of company stock, “the
19 Administrator may, in its sole discretion, suspend or limit the right of any
20 participant to make such an investment election.” 401(k) Plan § 9.3(a); *see also id.*
21 at § 9.4 (a) (“...no Participant may divest the Company stock held in his or her
22 Account, if any, in violation of the policies and guidelines established by the
23 Administration from time to time, in its sole and absolute discretion.”).

24 36. While the duty to diversify does not apply to investment in Company
25 stock in the 401(k) plan, ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2), the
26 fiduciaries remain bound by the other core ERISA fiduciaries duties, including the
27 duties to act loyally, prudently, and for the exclusive purpose of providing benefits
28 to plan participants. This is especially true where, as here, the 401(k) Plan is not

1 required to invest in Company stock, but rather the “Plan *may* acquire Company
2 Stock. . . .” 401(k) Plan § 9.3 (emphasis added).

3 37. Hence, if plan fiduciaries know or if an adequate investigation would
4 have revealed that company stock no longer was a prudent investment, the
5 fiduciaries are required to discontinue offering the stock as a plan investment
6 option, provide complete and accurate information to plan participants of the risk
7 of continuing to make and maintain investment in the stock, and, to the extent
8 appropriate under the circumstances, sell the plan’s holding of company stock, and
9 invest the plan assets in other suitable investments. Defendants took none of these
10 actions.

11 38. During the Class Period, Fremont Company Stock represented more
12 than 50% of the 401(k) Plan’s net assets, as illustrated below:

| Plan FY Ending | Net Assets of Plan | Fremont Company Stock Value | Percentage of Plan Assets in Stock |
|---------------------------|-------------------------------|--|---|
| 2003 | \$137,683,636 | \$ 77,347,574 | 56.17% |
| 2004 | \$190,550,380 | \$108,951,480 | 57.17% |
| 2005 | \$206,571,139 | \$ 98,922,288 | 47.88% |
| 2006 | \$204,342,507 | \$ 67,943,298 | 33.3% |

18 Fremont General Corporation Investment Incentive Plan, Annual Report (Form 11-
19 K) at 3, 8 (Dec. 31, 2004) (hereafter “2004 Form 11-K”); 2005 Form 11-K at 3, 8;
20 2006 Form 11-K at 3, 8.

21 39. The 401(k) Plan incurred substantial losses as a result of the Plan’s
22 investment in Fremont stock. As of December 31, 2004, the 401(k) Plan held
23 approximately 4.6 million shares of Fremont stock, valued at its market price of
24 over \$108 million. Fremont General Corporation and Affiliated Companies
25 Investment Incentive Plan Form 5500 (Dec. 31, 2005) at 8. Following revelations
26 regarding Fremont’s serious mismanagement, including but not limited to its
27 predatory subprime lending practices, Fremont stock price collapsed. Currently,
28 Fremont is trading at \$3.14 per share, and Fremont’s ongoing viability is at risk.

1 40. Upon information and belief, the value of Fremont stock in the 401(k)
2 Plan is now approximately \$13.2 million, which represented a decline of 88%
3 since the beginning of the Class period.¹

4 **B. The ESOP**

5 41. The ESOP was established effective December 1, 1988 to enable
6 eligible employees of the Company to share in the profits of the Company and to
7 accumulate an ownership interest in the Company stock. Fremont General
8 Corporation Employee Stock Ownership Plan Summary Plan Description, effective
9 Oct. 1, 2004 at FGC-ERISA 00345 (hereafter the “ESOP SPD”) (Exhibit H);
10 ESOP at FGC-ERISA 00225.

11 42. The ESOP is designed to invest primarily but not exclusively in
12 employer stock. ESOP at FGC-ERISA 00225; ESOP Trust Agreement § 1.1,
13 5.2(a).

14 43. The ESOP is a retirement plan under ERISA governed by the same
15 strict fiduciary duties as the 401(k) Plan, including the duties to act loyally,
16 prudently, and for the exclusive purpose of providing benefits to plan participants.

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19 ¹ As of April 26, 2007, after much of the loss already had been incurred by the
20 Plan, Fremont announced it would temporarily suspend all participant investment
21 in Company stock effective May 1, 2007 due to the Company’s failure to file its
22 annual report on Form 10-K within the time period required by the SEC. *See*
23 *Notice to All Participants in the Fremont General Corporation and Affiliated*
24 *Companies Investment Incentive Plan Re Temporary Suspension of Company*
25 *Stock Fund (Apr. 26, 2007) (Exhibit G); Fremont General Corp., Current Report*
26 *(Form 8-K) (Apr. 26, 2007). During the suspension, contributions that would*
27 *have otherwise been invested in the Fremont Stock Fund will instead be invested*
28 *in the Merrill Lynch Retirement Preservation Trust or until participants make an*
investment election change. Id. Moreover, beginning as of April 13, 2007, all
Company matching contributions made in the 401(k) Plan will be contributed in
cash rather than in Company stock. See Fremont General Corp. Memorandum To
Employees who are Participants in the Fremont General Corporation Employee
Stock Ownership Plan and/or the Fremont General Corporation and Affiliated
Companies Investment Incentive Plan (Apr. 13, 2007) at FGC-ERISA 00376
(hereafter the “April 13, 2007 Memo.”) (Exhibit I).

1
2 44. Hence, with respect to an ESOP, if the fiduciaries know or if an
3 adequate investigation would reveal that company stock no longer is a prudent
4 investment, the fiduciaries must disregard the plan direction to invest in such stock
5 and protect the plan by investing the Plan assets in other suitable investments.

6 45. The ESOP Plan Documents incorporate these basic ERISA
7 requirements and designate the named fiduciary, the ESOP Committee, with the
8 responsibility for establishing and carrying out the Plan’s funding policy consistent
9 with the objectives of the Plan and the requirements of ERISA and the authority to
10 direct the Trustee [Merrill Lynch] to “invest, reinvest and hold the assets of the
11 Trust Fund in cash or in any other forms of investment....” ESOP Trust Agreement
12 § 5.2(b).

13 46. Thus, unlike many ESOPs, which restrict investments to employer
14 securities, cash or cash equivalents, the Company’s ESOP does not in any manner
15 limit the types of investments that the fiduciaries can make in the event that
16 Fremont stock is not prudent.

17 47. The ESOP provides benefits, except in limited circumstances, for all
18 employees, including certain temporary employees who become eligible to
19 participate in the ESOP after they have worked 1,000 hours within a consecutive
20 twelve month period beginning on the date of hire. ESOP § 2.14.

21 48. Pursuant to the ESOP Trust Agreement and the ESOP Plan, assets of
22 the ESOP are held in a “Trust” for the benefit of eligible Fremont employees.
23 ESOP §§ 2.34, 10.1; Fremont General Corp., Proxy Statement (Form 14A) (Apr.
24 13, 2006) (hereafter the “2006 Proxy Statement”) at 23. The Trust is administered
25 according to the ESOP Trust Agreement by the Trustee, Merrill Lynch, at the
26 direction of the Plan Administrator, the Company, or its designee, the ESOP
27 Committee. ESOP Trust Agreement at FGC-ERISA 00296 (Exhibit D).

1 49. The Trust is comprised of accounts maintained for each ESOP
2 participant, reflecting all employer contributions and earnings. ESOP § 5.1. For
3 each participant, separate accounts are maintained for (a) employer stock; (b) other
4 investments; and (c) repayment of Company loans. *Id.*

5 50. Under the ESOP, the amount of the employer contribution is
6 determined at the discretion of the Board, up to the maximum amount allowable
7 under ERISA § 404, 29 U.S.C. § 1104, and may be made in cash or in Company
8 stock. ESOP § 4.1; 2006 Proxy Statement at 23. Since 1989, the Board has
9 approved contribution levels ranging between 0% and 15% of the eligible
10 compensation of each eligible participant. 2006 Proxy Statement at 23. Company
11 contributions for plan years 2004 and 2005 were made in shares of Company
12 common stock. *Id.*; Fremont General Corp. Proxy Statement (Form 14A) (Apr. 14,
13 2005) at 22 (hereafter the “2005 Proxy Statement”).

14 **1. Plan Restrictions Preventing Participants from Selling Shares of**
15 **Fremont Stock in the ESOP.**

16 51. Once allocated, Participants’ ability to sell the Fremont stock in their
17 ESOP accounts is severely restricted by the various limitations set out in the ESOP
18 Plan Document. Basically, participants cannot sell any shares they hold in
19 Company stock in the ESOP until they are 55 years old and have completed 10
20 years of service.² Thus, even after Fremont’s mismanagement and dire financial
21 circumstances came to light, participants could not sell shares of Fremont stock in
22 their ESOP accounts. Conversely, the Plan fiduciaries could have sold the stock in
23 the ESOP, but they failed to do so.

24 _____
25 ² ESOP participants who reach the age of 55 with 10 years of Plan participation
26 may elect to diversify up to 25% of the assets in their Company stock account
27 during a limited 90-day period following the end of the Plan Year by directing the
28 Plan Committee to invest in one or more of the at least three alternative
investment options offered by the ESOP Plan to each participant who elects to
diversify his or her Company stock holdings. ESOP, § 6.10(a)-(c).

52. During the Class Period, Fremont common stock represented as much as 85% of the ESOP's net assets, as illustrated below:

| Plan FY Ending | Net Assets of Plan | Fremont Company Stock Value | Percentage of Plan Assets in Stock |
|----------------|--------------------|-----------------------------|------------------------------------|
| 2003 | \$ 86,143,024 | \$ 73,210,716 | 84.98% |
| 2004 | \$126,777,184 | \$108,176,286 | 85.32% |
| 2005 | \$131,610,141 | \$111,158,561 | 84.46% |

53. The losses to the ESOP caused by Defendants' breaches of fiduciary duty are enormous. As of December 31, 2004, the ESOP held approximately 4.5 million shares of Fremont stock, valued at its market price of over \$108 million. 2006 Proxy Statement at 23. Now, following revelations that Fremont engaged in predatory subprime lending practices, among other improper actions, Fremont stock is trading at approximately \$3.14 per share, representing a decline of approximately 69% since the beginning of the Class Period. Upon information and belief, the value of Fremont stock in the ESOP is now approximately \$34 million.

VI. DEFENDANTS' FIDUCIARY STATUS

A. The Nature of Fiduciary Status

54. **Named Fiduciaries.** Every ERISA plan must have one or more "named fiduciaries." ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1). The person named as the "administrator" in the plan instrument is automatically a named fiduciary, and in the absence of such a designation, the sponsor is the administrator. ERISA § 3(16)(A), 29 U.S.C. § 1002(16)(A).

55. **De Facto Fiduciaries.** ERISA treats as fiduciaries not only persons explicitly named as fiduciaries under § 402(a)(1), 29 U.S.C. § 1102(a)(1), but also any other persons who in fact perform fiduciary functions. Thus, a person is a fiduciary to the extent "(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment

1 advice for a fee or other compensation, direct or indirect, with respect to any
2 moneys or other property of such plan, or has any authority or responsibility to do
3 so, or (iii) he has any discretionary authority or discretionary responsibility in the
4 administration of such plan.” ERISA § 3(21)(A)(i), 29 U.S.C. § 1002(21)(A)(i).

5 56. Each of the Defendants was a fiduciary with respect to one or both of
6 the Plans and owed fiduciary duties to one or both of the Plans and the participants
7 under ERISA in the manner and to the extent set forth in the Plans’ documents,
8 through their conduct, and under ERISA.

9 57. As fiduciaries, Defendants were required by ERISA § 404(a)(1), 29
10 U.S.C. § 1104(a)(1), to manage and administer the Plans, and the Plans’
11 investments solely in the interest of the Plans’ participants and beneficiaries and
12 with the care, skill, prudence, and diligence under the circumstances then
13 prevailing that a prudent man acting in a like capacity and familiar with such
14 matters would use in the conduct of an enterprise of a like character and with like
15 aims.

16 58. Plaintiffs do not allege that each Defendant was a fiduciary with
17 respect to all aspects of the Plans’ management and administration. Rather, as set
18 forth below, Defendants were fiduciaries to the extent of the specific fiduciary
19 discretion and authority assigned to or exercised by each of them, and, as further
20 set forth below, the claims against each Defendant are based on such specific
21 discretion and authority.

22 59. Instead of delegating all fiduciary responsibility for the Plans to
23 external service providers, Fremont chose to assign the appointment and removal
24 of fiduciaries to itself and the other monitoring Defendants named herein. These
25 persons and entities in turn selected Fremont employees, officers and agents to
26 perform most relevant fiduciary functions. Although the Plans had an institutional
27 trustee unrelated to Fremont, the Trust Agreements required the trustee to take
28 directions from Fremont personnel.

1 60. ERISA permits fiduciary functions to be delegated to insiders without
2 an automatic violation of the rules against prohibited transactions, ERISA §
3 408(c)(3), 29 U.S.C. § 1108(c)(3), but insider fiduciaries, like external fiduciaries,
4 must act solely in the interest of participants and beneficiaries, not in the interest of
5 the Plan sponsor.

6 **1. The Company’s Fiduciary Status Under the 401(k) Plan**

7 61. Fremont is a fiduciary under the 401(k) Plan, in that it is responsible
8 for administering, interpreting and carrying out Plan provisions. 401(k) Plan § 7.1.
9 In addition, Fremont is granted full and complete discretionary authority to
10 construe and interpret the terms of the 401(k) Plan and all powers necessary to
11 discharge its duties under the 401(k) Plan, including the following:

- 12 (a). establish a funding and investment policy;
- 13 (b). select additional or alternative investment funds or vehicles;
- 14 (c). receive and review reports on the financial condition of the trust
15 fund and statements of the receipts and disbursements of the trust fund
16 from the trustee;
- 17 (d). appoint or employ one or more investment managers to manage
18 all or any part of the assets of the Plan.

19 401(k) Plan § 7.1.

20 62. The Company is also charged with the appointment, monitoring and
21 removal of the Trustee and execution of the Trust documents with the Trustee to
22 provide for the investment, management and control of the assets of the 401(k)
23 Plan. 401(k) Plan § 9.1.

24 63. The Company, upon information and belief, through the Director
25 Defendants, was required to establish and did establish the 401(k) Plan Committee
26 to carry out fiduciary duties with respect to the 401(k) Plan. 401(k) Plan § 7.2(a).³

27
28 ³ The nature of the 401(k) Plan Committee’s fiduciary duties are described in §§ VI. C.1 below.

1 The Company had responsibility to appoint, and hence to monitor, and to remove,
2 the members of the 401(k) Plan Committee. *Id.*; Fremont General Corporation
3 Investment Incentive 401(k) Plan SPD (“401(k) Plan SPD”) (Oct. 1, 2005) at FGC-
4 ERISA 00407 (“The Company has delegated its duties to the Plan Committee (the
5 ‘Committee’), which is appointed by the Company.”) (Exhibit I). The Plan
6 provides that the Company may, “in its sole and absolute discretion, change the
7 composition of the [Plan] Committee (including, without limitation, the number of
8 members of the Committee) from time to time.” 401(k) Plan § 7.2(a). As
9 Department of Labor regulations make clear, this is a fiduciary function under
10 ERISA. 29 C.F.R. § 2509.75-8 (D-4).

11 64. Moreover, Fremont, at all applicable times, has exercised control over
12 the activities of its employees that performed fiduciary functions with respect to
13 the 401(k) Plan, including the 401(k) Plan Committee Defendants, and can hire or
14 appoint, terminate, and replace such employees at will. Fremont is, thus,
15 responsible for the activities of its employees through traditional principles of
16 agency and respondeat superior liability.

17 65. Finally, under basic tenants of corporate law, Fremont is imputed with
18 the knowledge that the Defendants had knowledge of the misconduct alleged
19 herein, even if not communicated to Fremont.

20 **2. The Company’s Fiduciary Status Under the ESOP**

21 66. Fremont is a fiduciary under the ESOP, in that it is responsible for
22 administering, interpreting and carrying out Plan provisions. ESOP § 8.1. In
23 addition, Fremont is granted full and complete discretionary authority to construe
24 and interpret the terms of the ESOP and all powers necessary to discharge its
25 duties under the ESOP, including the following:

- 26 (a). establish a funding and investment policy;
- 27 (b). select additional or alternative investment funds or vehicles;

1 (c). receive and review reports on the financial condition of the
2 Trust and statements of the receipts and disbursements of the Trust
3 from the Trustee;

4 (d). appoint or employ one or more investment managers to manage
5 all or any part of the assets of the Plan.

6 ESOP §§ 8.1, 8.2.

7 67. Contributions to the ESOP were made by at the Company at the
8 discretion of the Board and could be made, at the Company’s discretion, in cash or
9 a combination of Company stock and cash. Audited Financial Statements and
10 Supplemental Schedules to Fremont General Corporation Employee Stock
11 Ownership Plan Form 5500, at FCG-ERISA at 00334 (Dec. 31, 2005) (Exhibit J).

12 68. Likewise under the ESOP, the Company, upon information and belief,
13 through the Director Defendants, was required to establish and did establish an
14 ESOP Committee (referred to in the ESOP Plan Document merely as the “Plan
15 Committee”) to which it delegated its administrative fiduciary duties with respect
16 to the ESOP.⁴ ESOP at §§ 8.1, 8.3; ESOP SPD at FGC-ERISA 00355 (Exhibit H).
17 The Company had responsibility to appoint, and hence to monitor and to remove
18 the members of the ESOP Committee, a fiduciary function under ERISA. 29
19 C.F.R. § 2509.75-8 (D-4).

20 69. Consequently, in light of the foregoing duties, responsibilities, and
21 actions, Fremont was a named fiduciary of the both the 401(k) Plan and the ESOP
22 pursuant to ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1), and a *de facto* fiduciary of
23 the Plans within the meaning of ERISA § 3(21), 29 U.S.C. § 1002(21), during the
24 Class Period in that it exercised discretionary authority or discretionary control
25 respecting management of the Plans, exercised authority or control respecting
26

27 ⁴ The nature of the ESOP Committee’s fiduciary duties are described in §§ VI. C.2
28 below.

1 management or disposition of the Plans' assets, and/or had discretionary authority
2 or discretionary responsibility in the administration of the Plans.

3 **B. The Director Defendants' Fiduciary Status Under the Plans.**

4 70. Fremont, as a corporate entity, cannot act on its own without any
5 human counterpart. In this regard, during the Class Period, upon information and
6 belief, Fremont relied and continues to rely directly on the individual Defendants
7 named herein to carry out its fiduciary responsibilities under the Plans and ERISA.
8 As a result, the Director Defendants are functional fiduciaries under ERISA.

9 71. The Company, through the Director Defendants, was required to
10 establish and did establish the 401(k) Plan Committee and ESOP Committee to
11 carry out fiduciary duties with respect to the 401(k) Plan and the ESOP. 401(k)
12 Plan § 7.2(a); ESOP § 8.3.⁵

13 72. Moreover, as the Company's human counterpart, upon information
14 and belief, the Director Defendants assumed the Company's responsibility to
15 appoint, and hence to monitor, and to remove, the members of the ESOP and
16 401(k) Plan Committees. ESOP § 8.3; 401(k) Plan § 7.2(a). Thus, according to
17 Department of Labor regulations, the Director Defendants exercised a fiduciary
18 function under ERISA. 29 C.F.R. § 2509.75-8 (D-4).

19 73. Lastly, certain members of the Board of Directors enhanced their
20 fiduciary oversight responsibilities even further as members of the ESOP
21 Committee, and upon information and belief, the 401(k) Plan Committee. As
22 detailed above, Directors Bailey and Rampino serve as members of the 401(k) Plan
23 Committee and Defendants Bailey, McIntyre, Rampino and Ross serve or have
24 served as members of the ESOP Committee.

25
26
27 ⁵ The nature of the 401(k) Plan Committee and ESOP Committee's fiduciary duties
28 are described in §§ VI. C.1 & VI. C.2 below.

1 74. Consequently, in light of the foregoing duties, responsibilities, and
2 actions, the Director Defendants were and are fiduciaries of both the 401(k) Plan
3 and the ESOP within the meaning of ERISA § 3(21), 29 U.S.C. § 1002(21), during
4 the Class Period in that they exercised discretionary authority or discretionary
5 control respecting management of the Plans, exercised authority or control
6 respecting management or disposition of the Plans' assets, and/or had discretionary
7 authority or discretionary responsibility in the administration of the Plans.

8 **C. The Committee Defendants**

9 **1. The Committee Defendants' Fiduciary Status Under the 401(k)** 10 **Plan**

11 75. The 401(k) Plan provides that the Company establish a "Plan
12 Committee" to discharge the duties of the Company under the Plan. 401(k) Plan
13 § 7.2. During the Class Period and before, upon information and belief, Fremont
14 acted through its Board in carrying out this responsibility.

15 76. Upon information and belief, the Company through its Board,
16 delegated its administrative duties to the 401(k) Plan Committee, including those
17 outlined in Section IV. A.1 above. 401(k) Plan § 7.2; 401(k) Plan SPD at FGC-
18 ERISA 00407. As such, the members of the 401(k) Plan Committee were
19 fiduciaries to the Plan in that they had the power and discretionary authority to
20 administer the 401(k) Plan, interpret its provisions and make factual determinations
21 concerning claims for benefits and other matters relating to the administration of
22 the 401(k) Plan. 401(k) Plan §§ 7.1, 7.2.

23 77. Specifically, under the 401(k) Plan, the 401(k) Plan Committee, "has
24 full and complete power to administer the Plan and also has overall responsibility
25 for selecting the Investment Options." 401(k) Plan SPD at FGC-ERISA 00415.
26 Likewise, the 401(k) Plan Committee "has the right to change, at any time, the
27 number of Investment Options offered by the Plan." *Id.* at FGC-ERISA 00396.
28

1 78. Pursuant to Board resolution, each of the members of the 401(k) Plan
2 Committee acted as a “Named Administrative Fiduciary” and a “Named
3 Investment Fiduciary” of the 401(k) Plan, “responsible for the administration and
4 operation of the Plan” and “for investment and management of plan assets.” *See*
5 Action Taken By Unanimous Written Consent of The Board of Directors of
6 Fremont General Corporation (hereafter the “Board Resolution”) (Dec. 6, 2004) at
7 FGC-ERISA 00378, 382 (Exhibit C); *see also* 401(k) Plan Trust Agreement § 2.01
8 (“‘Named Administrative Fiduciary’ refers to the person provided for in the Plan
9 as responsible for the administration and operation of the Plan, and the term
10 ‘Named Investment Fiduciary’ refers to the person provided for in the Plan as
11 responsible for the investment and management of Plan assets. . . .”) (Exhibit E).

12 79. As a “Named Investment Fiduciary,” each of the 401(k) Plan
13 Committee Defendants was charged with managing the investments of the Trust
14 Fund of the 401(k) Plan. *See* 401(k) Plan Trust Agreement § 5.01.

15 80. Furthermore, according to the 401(k) Plan Trust Agreement, the
16 “Trustee shall invest the Trust Fund as directed by the Named Investment
17 Fiduciary. . . and the Trustee shall have no discretionary control over, nor any
18 other discretion regarding, the investment or reinvestment of any asset of the Trust.
19 401(k) Plan Trust Agreement § 5.01.

20 81. Additionally, under the 401(k) Plan, the 401(k) Plan Committee has
21 the authority to employ legal counsel to assist in the performance of its duties, as
22 well as to delegate any of its authorities and duties to other person or persons as it
23 determines necessary. 401(k) Plan § 7.2. The 401(k) Plan Committee need not
24 take formal action to achieve such a delegation. *Id.*

25 **2. The Committee Defendants’ Fiduciary Status Under the ESOP**

26 82. Upon information and belief, the Company directs the Director
27 Defendants to create an ESOP Committee to discharge the Company’s duties under
28 the Plan. ESOP §§ 8.3. Moreover, “[e]xcept as otherwise specifically provided in

1 the Plan or [the Trust Agreement], any action required or permitted to be taken by
2 the [Company] may be taken by the [ESOP] Committee.” ESOP Trust Agreement
3 § 9.1. The ESOP Committee and its members are named fiduciaries under the Plan
4 and is responsible for the general administration and interpretation of the ESOP
5 Plan, as well as for carrying out the ESOP Plan’s provisions, including, but not
6 limited to the following powers and duties:

- 7 (a). construe and interpret the ESOP;
- 8 (b). decide all questions of eligibility and to amount, manner and
9 time of payment of any benefits;
- 10 (c). request and receive from the Company any information
11 necessary for the proper administration of the ESOP;
- 12 (d). file and distribute to participants and beneficiaries all reports
13 and other information required under ERISA;
- 14 (e). review reports on the financial condition of the Trust;
- 15 (f). direct the Trustee regarding the management, disposition and
16 investment of Trust assets; and
- 17 (g). value and manage the disposition and investment of Company
18 stock.

19 ESOP §§ 8.1-8.3, ESOP Trust Agreement §§ 1.1, 5.1.

20 83. Pursuant to Board resolution, each of the members of the ESOP
21 Committee acted as a “Named Administrative Fiduciary” and a “Named
22 Investment Fiduciary” of the ESOP, “responsible for the administration and
23 operation of the Plan” and “for investment and management of plan assets.” *See*
24 Board Resolution, *supra* at FGC-ERISA 00382 (Exhibit C).

25 84. Additionally, the ESOP Committee has the power to poll the
26 participants to determine how Company stock should be voted and whether
27 Company stock should be sold and must follow the participants’ instructions in
28

1 directing the Trustee regarding the voting or sale of Company stock. ESOP Trust
2 Agreement § 1.1.

3 85. The ESOP Committee may employ counsel and agents, including
4 investment managers, it deems necessary to carry out the provisions of the ESOP.
5 ESOP § 8.1, 8.3; ESOP Trust Agreement § 5.1.

6 86. Consequently, in light of the foregoing duties, responsibilities, and
7 actions, the Committee Defendants were and are fiduciaries of both the 401(k) Plan
8 and the ESOP within the meaning of ERISA § 3(21), 29 U.S.C. § 1002(21), during
9 the Class Period in that they exercised discretionary authority or discretionary
10 control respecting management of the Plans, exercised authority or control
11 respecting management or disposition of the Plans' assets, and/or had discretionary
12 authority or discretionary responsibility in the administration of the Plans.

13 **VII. FACTS BEARING ON FIDUCIARY BREACH**

14 **A. Fremont Was an Imprudent Investment for the Plans during the Class** 15 **Period Because of the Precipitous Decline in the Price of its Stock,** 16 **Serious Mismanagement, and Dire Financial Condition.**

17 **1. The Expansion of the Subprime Lending Industry.**

18 The mortgage lending business has changed dramatically since the 1970s with the
19 development of national markets for mortgages, technological changes, and the
20 advent of securitization. In fact, the mortgage market has been the fastest growing
21 securitization debt market, larger than the market for U.S. Treasury bonds and
22 notes. Between 2004 and 2005, the subprime mortgage lending industry grew
23 from \$120 billion to \$625 billion. Ruth Simon & James R. Hagerty, *More*
24 *Borrowers With Risky Loans Are Falling Behind – Subprime Mortgages Surged As*
25 *Housing Market Soared; Now, Delinquencies Mount*, Wall St. J., Dec. 5, 2006, at
26 A1.

1 87. One of the products of this new mortgage market is phenomenal
2 growth in subprime lending. The term “subprime” generally refers to “borrowers
3 who do not qualify for prime interest rates because they exhibit one or more of the
4 following characteristics: weakened credit histories typically characterized by
5 payment delinquencies, previous charge-offs, judgments, or bankruptcies; low
6 credit scores; high debt-burden ratios; or high loan-to-value ratios.” Sandra F.
7 Braunstein, Dir., Div. of Consumer and Cmty. Affairs, Fed. Reserve Bd, *Testimony*
8 *Before the Subcommittee on Financial Institutions and Consumer Credit,*
9 *Committee on Financial Services,* U.S. House of Representatives: Subprime
10 Mortgages. Mar. 27, 2007, available at
11 <http://www.federalreserve.gov/boarddocs/testimony/2007/20070327/default.htm>.

12 88. As of the end of 2006, subprime borrowers represented approximately
13 13-14% of the 43 million first-lien mortgage loans outstanding in the United
14 States. Subprime lending has grown rapidly in recent years. In 1994, fewer than
15 5% of mortgage originations were subprime, but by 2005 about 20% of new
16 mortgage loans were subprime.

17 89. Many industry experts and regulators, including the Federal Deposit
18 Insurance Corporation (the “FDIC”), have attributed the rapid growth in the
19 subprime lending market to a confluence of factors that occurred in 2004 and 2005,
20 including rising home prices, declining affordability, historically low interest rates,
21 intense lender competition, innovations in the structure and marketing of
22 mortgages, and an abundance of capital from lenders and mortgage securities
23 investors. Sandra L. Thompson, Dir., Div. of Supervision and Consumer Prot.,
24 *Testimony Before the Committee on Banking, Housing and Urban Affairs, U.S.*
25 *Senate: Federal Deposit Insurance Corporation on Mortgage Market Turmoil:*
26 *Causes and Consequences,* Mar. 22, 2007, available at
27 <http://www.fdic.gov/news/news/speeches/chairman/spmar22071.html>.

1 90. In 2004, as interest rates began to climb, the pool of potential prime
2 borrowers looking to refinance began to dry up and lenders began extending loans
3 to subprime borrowers with troubled credit histories in an effort to maintain or
4 grow market share in a declining origination environment. Thus, between 2003
5 and 2005, the prevalence of subprime loans among all mortgage originations more
6 than doubled.

7 91. In order to take advantage of this new market, lenders began
8 weakening their underwriting standards, including:

- 9 (a). reducing the minimum credit score borrowers need to qualify
10 for certain loans;
- 11 (b). allowing borrowers to finance a greater percentage of a home's
12 value or to carry a higher debt load;
- 13 (c). introducing new products designed to lower borrowers'
14 monthly payments for an initial period; and
- 15 (d). allowing borrowers to take out loans with little, if any,
16 documentation of income and assets.

17 Ruth Simon, *Mortgage Lenders Loosen Standards – Despite Growing Concerns,*
18 *Banks Keep Relaxing Credit-Score, Income and Debt-Load Rules*, Wall St. J., July
19 26, 2005, at D1.

20 92. In addition to lowering underwriting standards, lenders began offering
21 novel loan products to entice borrowers which put them at greater risk of
22 defaulting:

- 23 (a). **No-documentation and low-documentation loans:** Known in
24 the industry as “liar loans,” the practice of requiring little or no
25 documentation from borrowers constituted as much as 40% of
26 subprime mortgages issued in 2006, up from 25% in 2001. Gretchen
27 Morgenson, *Crisis Looms In Mortgages*, N.Y. Times, Mar. 11, 2007.
28 Moreover, industry research reported in April 2006 revealed that 90%

1 of borrowers had overstated their incomes by 5% or more and in 60%
2 of the cases, borrowers had inflated their incomes by more than half.
3 *Id.*

4 (b). **Piggy-back loans:** These combine a mortgage with a home-
5 equity loan or line of credit, allowing borrowers to finance more than
6 80% of the home's value without paying for private mortgage
7 insurance. As of 2006, about half of all subprime loans included
8 "piggyback" loans, and on average all borrowers financed 82% of the
9 underlying value of their property, markedly up from 48% in 2000.
10 Morgenson, *Crisis, supra*; James R. Hagerty & Ruth Simon, *Home*
11 *Lenders Pare Risky Loans – More Defaults Prompt Cut in*
12 *'Piggyback' Mortgages; Housing Market May Suffer*, Wall St. J., Feb.
13 14, 2007, at A3.

14 (c). **Interest-only mortgages:** These allow borrowers to pay
15 interest and no principal in the loan's early years, which keep
16 payments low for a time.

17 (d). **Option adjustable-mortgages:** The most prevalent of which
18 are hybrid adjustable rate mortgages ("ARMs"), the loans are
19 marketed with promotional or "teaser" rates during the loan's
20 introductory period that later balloon to much higher rates once the
21 introductory period has ended. ARMs currently account for between
22 one-half and one-third of subprime mortgages. Testimony of Roger
23 T. Cole, Director, Division of Banking Supervision and Regulation,
24 The Federal Reserve Board, *Mortgage Markets*, Before the
25 Committee on Banking, Housing and Urban Affairs, U.S. Senate,
26 Mar. 22, 2007, available at [http://www.federalreserve.gov/boarddocs/](http://www.federalreserve.gov/boarddocs/testimony/2007/20070322/default.htm)
27 [testimony/2007/20070322/default.htm](http://www.federalreserve.gov/boarddocs/testimony/2007/20070322/default.htm).
28

1 **2. The Demise of the Subprime Lending Industry.**

2 93. In late 2004 and early 2005, industry watchdogs began expressing
3 growing fears that relaxed lending practices were increasing risks for borrowers
4 and lenders in overheated housing markets unlikely to persist. Simon, *Mortgage*
5 *Lenders, supra*. As lenders were making it easier for borrowers to qualify for a
6 loan by such practices as described above, they were also greatly increasing the
7 likelihood that borrowers would be unable to make payments, and that defaults
8 would rise.

9 94. Of particular concern was the prevalence of adjustable-rate loans,
10 which in combination with the lowered lending standards, were more likely to
11 result in borrowers' early payment defaults.

12 95. In May 2005, bank regulators issued their first-ever guideline for
13 credit-risk management for home-equity lending and, in December 2005, new
14 guidelines for mortgage lenders were issued as well. *Id.*; Testimony of Sandra L.
15 Thompson, *supra*. The proposed "Interagency Guidance on Nontraditional
16 Mortgage Product Risks", sent a clear message to the marketplace that bank
17 regulators were concerned about the lessened underwriting standards and general
18 risk management exhibited by subprime lenders.

19 96. However, most subprime lenders, failed to heed these and other
20 warnings. Despite rising interest rates and general housing market cooling in
21 2005, lenders continued to offer borrowers credit under weakened lending
22 standards. Many lenders kept introductory "teaser" rates low even after short-term
23 interest rates began rising in June 2005. It was not until mid to late 2006 when
24 lenders began to tighten up their terms.

25 97. Thus, in mid-2005, delinquency rates for subprime loans (60-days or
26 more past due) rose for the first time since they began falling in 2002. By the
27 fourth quarter of 2005, delinquencies and foreclosures began to rise even more
28

1 severely -- as of October 2005 the delinquency rate was twice that recorded on new
2 subprime loans a year earlier. Simon and Hagerty, *More Borrowers, supra*.

3 98. According to the FDIC, total subprime delinquencies rose from
4 10.33% in the fourth quarter of 2004 to 13.33% in the fourth quarter of 2006 and
5 foreclosures rose from 1.47% to 2.0% over the same period. Testimony of Sandra
6 L. Thompson, *supra*.

7 99. Subprime loans with ARMs accounted for the largest rise in
8 delinquency rates, an increase from 9.83% to 14.44% between the fourth quarter of
9 2004 and the fourth quarter of 2006; whereas foreclosures rose from 1.5% to 2.7%
10 during the same period. *Id.*

11 100. In 2006 alone, roughly 80,000 subprime borrowers who took out
12 mortgages which were packaged into securities fell into delinquency. Simon &
13 Hagerty, *More Borrowers, supra*.

14 101. Particularly egregious, was the unusual number of subprime loans
15 going into foreclosure shortly after origination in 2006.

16 102. In reaction to lax underwriting standards in commercial lending, bond
17 rating agencies began to raise alarms about these risky lending practices and the
18 looming threat of rising delinquencies which lurk down the road. Terry Pristin, *A*
19 *Warning on Risk in Commercial Mortgages*, N.Y. Times, May 2, 2007. Fitch has
20 predicted a 15% increase in defaults of commercial loans that are being written
21 now because of the lax underwriting standards. *Id.*

22 103. In short, the rate of delinquency and foreclosure suggests that lenders
23 underestimated the risk involved and borrowers did not fully understand the full
24 costs of these loans.

1 **3. Fremont Engaged in Risky and Inappropriate Subprime Lending**
2 **Practices and Serious Mismanagement.**

3 **a. Fremont Ignored the Warnings of a Subprime Lending**
4 **Industry Crisis Until It Was Too Little Too Late.**

5 104. Fremont participated in the record growth in the subprime mortgage
6 industry. Between 2003 and 2005, Fremont's subprime loan origination grew from
7 \$13.7 billion to \$36 billion. By 2006, Fremont was the third largest subprime
8 mortgage lender in the U.S. with approximately half of the Company's business
9 focused on the subprime mortgage sector and the rest specializing in commercial
10 real estate lending and retail banking. Gretchen Morgenson, *When Regulators*
11 *Knock Twice*, N.Y. Times, Mar. 18, 2007. Moreover, in 2006 alone, 25% of first
12 mortgages originated by Fremont came with a second mortgage. Hagerty, *Home*
13 *Lenders, supra*.

14 105. However, as of September 30, 2006, Fremont reported a \$16.4 million
15 loss for the first nine months of 2006 as compared to a net gain of \$316.4 million
16 for the same period in 2005. Fremont General Corp. Quarterly Report (10-Q)
17 (Sept. 30, 2006) (hereafter "3Q 2006 Form 10-Q"). In response, Fremont
18 announced that it was instituting some limited changes to its underwriting
19 standards including "dropping or scaling back on some low-down payment loans
20 and on some loans to subprime customers to reduce mortgage buybacks" and
21 setting aside capital to cover defaulting borrowers. Ruth Simon & Michael
22 Hudson, *Whistling Past Housing's Graveyard? – Bad Loans Draw Bad Blood*,
23 Wall St. J., Oct. 9, 2006, at C1; Jesse Eisinger, *Long & Short: Mortgage Market*
24 *Begins to See Cracks As Subprime-Loan Problems Emerge*, Wall St. J., Aug. 30,
25 2006, at C1.

26 106. Upon information and belief, Fremont made no further effort to
27 tighten its underwriting standards until January 2007, when it announced that it had
28 severed ties with some 8,000 brokers in the previous quarter "whose loans were
responsible for the highest delinquency rates in the industry." Al Yoon, *Defaults*

1 *Cause Fremont to End Ties to 8,000 Brokers*, Reuters.com, Jan. 29, 2007.
2 Fremont also then claimed that it had taken further steps to reduce the number of
3 “liar loans” and had cut the number of second loans it made on top of first
4 mortgages. *Id.*

5 107. By early 2007, it became clear that Fremont had ignored the many
6 warnings of industry analysts and government regulators, including bond rating
7 companies Standard & Poor’s Corp. (hereafter “S&P”), Moody’s Investor Service
8 (hereafter “Moody’s”) and Fitch Ratings (hereafter “Fitch”), which had
9 specifically advised Fremont that its bonds were likely to be downgraded in
10 November 2006. *Id.* In particular, S&P put a deal backed by loans issued by
11 Fremont on credit watch for possible downgrade. Ruth Simon & Hagerty, *More*
12 *Borrowers, supra.*

13 108. Upon information and belief, Fremont acted to tighten its
14 underwriting standards in early 2007 only once its back was already up against the
15 wall: It was no longer able to find investors willing to buy loans that were prone to
16 default and the rate of early defaults on Fremont’s subprime mortgages had soared
17 (to 6% in mid-2006) such that it was forced to buy back loans sold to investment
18 banks resulting in a \$16.4 million loss on the sale of its mortgages in the first nine
19 months of 2006, compared with a \$316.4 million gain for the same period of 2005.
20 Hagerty, *Home Lenders supra*; Yoon, *supra*; 3Q 2006 Form 10-Q at 27.

21 109. In January 2007, Fitch revised its ratings outlook for Fremont and FIL
22 to “negative” from “stable,” citing the “the current difficult market environment
23 that [Fremont] faces, particularly the company’s exposure to the subprime
24 residential mortgage sector.” *Fitch Revises Fremont General’s Outlook to*
25 *Negative; Affirms IDR at ‘BB-’*, MarketWatch.com, Jan. 25, 2007.

26 110. And as of February 27, 2007, Fremont announced in a filing with the
27 SEC that it would postpone the release of its fourth quarter and full-year 2006
28 results of operations and would fail to file its annual report for fiscal year ended

1 December 31, 2006 by the regulatory deadline of March 1, 2007. Fremont General
2 Corp., Current Report (Form 8-K) (Feb. 28, 2007).

3 111. Following the announcement, Fremont stock closed at \$8.81 on
4 February 28, 2007, a one-day drop of 24%.

5 112. On February 28, 2007, Fitch announced it had downgraded Fremont's
6 long-term issuer default rating to 'B+' from 'BB-', its long-term senior debt to 'B'
7 from 'B+', and its individual rating to 'D' from 'C/D'. Concurrent with this rating
8 action, Fitch placed both Fremont and FIL on a negative rating watch. On March
9 1, 2007, S&P also placed Fremont on a negative rating watch.

10 113. On March 2, 2007, Fremont announced its intention "to exit its sub-
11 prime residential real estate operations." Fremont General Corp., Current Report
12 (Form 8-K) (Mar. 2, 2007). Fremont stated the sale was necessary to "restrict the
13 level of lending in its sub-prime residential mortgage business" and attributed its
14 decision to sell to "recent legislative and regulatory events, as well as changing
15 competitive dynamics in the sub-prime market..." *Id.*

16 114. In the wake of its March 2, 2007 announcement, Fremont placed a
17 portion of its residential loan staff on paid leave. *Subprime Lender Under Inquiry*
18 *Puts Some Workers on Leave*, N.Y. Times, Mar. 6, 2007, at C3.

19 115. In light of the Company's announcements, on March 5, 2007, Fitch
20 announced it had downgraded Fremont's senior unsecured debt rating from 'B' to
21 'CC' and that the Company would remain on a negative ratings watch. *See Fitch*
22 *Downgrades Fremont General's IDR to 'CCC'; Remains on Rating Watch*
23 *Negative*, MarketWatch.com, Mar. 5, 2007. Likewise, Moody's Investors Service
24 downgraded Fremont's senior unsecured debt rating from 'B2' to 'B3'. *See*
25 *Moody's Downgrades Fremont General*, Yahoo! Finance, Mar. 5, 2007. In
26 addition S&P also downgraded Fremont's long term issuer credit from 'B+' to
27 'B-.'

1 116. Several days later, on March 16, 2007, Fremont announced that it
2 would not file its annual report on Form 10-K for the fiscal year ended December
3 31, 2006 before the extended deadline of March 16, 2007, due to volatility in the
4 subprime market and the impact of closing its subprime mortgage origination
5 business. Fremont General Corp. Press Release, *Fremont General Corporation*
6 *Announces The Delay in the Filing of Its 2006 Annual Report on Form 10-K*,
7 (attached as Exhibit 99.1 to Fremont General Corp, Current Report (Form 8-K)
8 (Mar. 16, 2007)). Fremont also announced that FIL had received an increased line
9 of credit, to \$1 billion, from Credit Suisse. *Id.*

10 117. In an effort to create much needed cash flow, on March 21, 2007,
11 Fremont announced that the Company's wholly-owned industrial banking
12 subsidiary, FIL, had entered into an agreement to sell approximately \$4 billion of
13 its subprime residential real estate loans. Fremont General Corp. Press Release,
14 *Fremont General Corporation Announces Agreements To Sell \$4 Billion of Its*
15 *Sub-Prime Residential Loans*, (attached as Exhibit 99.1 to Fremont General Corp.,
16 Current Report (Form 8-K) (Mar. 21, 2007)). According to the Company's press
17 release, the loans would be sold at a discount, "reflecting current conditions in the
18 sub-prime mortgage market" and a pre-tax loss of approximately \$140 million. *Id.*

19 118. Some weeks later, on April 18, 2007, reports surfaced that a hedge
20 fund, Ellington Capital Management, had finalized a deal with the Company to buy
21 \$2.9 billion of its subprime real estate loans, including its mortgage bond
22 investments and loan origination platform. *See, e.g., Hedge Fund Buying Fremont*
23 *Loans*, Reuters.com, Apr. 18, 2007, *available at* [http://yahoo.reuters.com/
24 news/articlehybrid.aspx?storyID=urn:newsml:reuters.com:20070418:MTFH79927
25 _2007-04-18_10-29-36_N18230147&type=comktNews&rpc=44](http://yahoo.reuters.com/news/articlehybrid.aspx?storyID=urn:newsml:reuters.com:20070418:MTFH79927_2007-04-18_10-29-36_N18230147&type=comktNews&rpc=44).

26 119. On April 26, 2007, the Company announced that, as of May 1, 2007,
27 all trading in Company stock would be suspended in the Company's employee
28 benefit plans, including the 401(k) Plan and the ESOP, during an indefinite

1 blackout period. Fremont General Corp., Current Report (Form 8-K) (Apr. 26,
2 2006). The filing explained that the Company's directors, officers and 401(k)
3 Participants' inability to make any "purchases, sales or other acquisitions or
4 transfers" of any shares of Company stock was due to the Company's failure to file
5 its Annual Report for the year ending 2006 in compliance with SEC regulations.
6 *Id.* In addition, the Company concurrently ceased making its matching
7 contribution in Company stock as provided under the 401(k) Plan. April 13, 2007
8 Memo., *supra* at FCG-ERISA 00376 (Exhibit I).

9 120. On May 11, 2007, the Company announced that it could not file its
10 Quarterly Report on form 10-Q for the fiscal quarter ended March 31, 2007 and
11 had not, as of yet, filed its 10-K for the fiscal year ended December 31, 2006.
12 Notification of Late Filing (Form 12b-25) (May 11, 2007).

13 121. On May 22, 2007, Fremont announced the sale of its commercial real
14 estate lending business and outstanding loan portfolio to iStar Financial Inc. for
15 approximately \$1.9 billion. Fremont General Corp., Current Report (Form 8-K)
16 (May 22, 2007) ("May 22, 2007 Form 8-K"). The commercial lending segment
17 represents a majority of what remains of the Company after the sale of Company's
18 subprime home loan business.

19 122. On the same day, Fremont also announced the sale of a minority
20 interest in the remaining Company, consisting, mainly, of the Company's bank,
21 Fremont Investment & Loan ("FIL"), following the sale of its commercial lending
22 and subprime residential lending segments. May 22, 2007 Form 8-K. The
23 proposed deal includes a sale of 20% of the Company for approximately \$80
24 million and the appointment of new senior management, including a new
25 Chairman, Chief Executive Officer and Chief Financial Officer. *Id.*

26 123. On July 2, 2007, Fremont announced the completion of the sale of the
27 Company's commercial real estate lending business and outstanding commercial
28 real estate loan portfolio to iStar Financial Inc. Fremont General Corp., Current

1 Report (Form 8-K) (July 2, 2007). The Company also announced the appointment
2 of Alan W. Faigin as interim President and Chief Executive Officer of the Bank.
3 *Id.*

4 124. On July 6, 2007, the Company announced that, as of June 29, 2007,
5 the employment agreement with former President and Chief Executive Officer of
6 FIL, Kyle R. Walker, had been terminated. Fremont General Corp., Current
7 Report (Form 8-K) (July 6, 2007).

8 125. On July 9, 2007, the Company announced the voluntary resignation of
9 Defendant Lamb who had served as Senior Vice President, Treasurer, Chief
10 Financial Officer and Chief Accounting Officer of the Company. Fremont General
11 Corp., Current Report (Form 8-K) (July 9, 2007).

12 126. On September 26, 2007, Fremont stock lost as much as 19% of its
13 value, falling to \$4.14, when it was announced that the proposed deal, selling a
14 20% stake in the Company in exchange for \$80 million, would not be
15 consummated. John Spence, *Fremont General Plunges With Deal in Doubt*,
16 MarketWatch, Sept. 26, 2007, available at [http://www.marketwatch.com/news/
17 story/fremont-generals-shares-fall-concerns/story.aspx?guid=%7B86A4D93C%2D
18 5849%2D411B%2DB58A%2D8EC9C01BB2FE%7D&dist=TQP_Mod_mktwN](http://www.marketwatch.com/news/story/fremont-generals-shares-fall-concerns/story.aspx?guid=%7B86A4D93C%2D5849%2D411B%2DB58A%2D8EC9C01BB2FE%7D&dist=TQP_Mod_mktwN).

19 127. On October 9, 2007, an investment group, Harbinger Management
20 Corp., announced purchase of a minority stake in the Company. Shares of
21 Company stock jumped 15% to \$4.38 following the announcement. Bradley
22 Keoun, *Fremont General Attracts Investment by Harbinger*, Bloomberg.com, Oct.
23 5, 2007, available at [http://www.bloomberg.com/apps/news?pid=20601014&sid
24 =aogy_POsbZnc&refer=funds](http://www.bloomberg.com/apps/news?pid=20601014&sid=aogy_POsbZnc&refer=funds).

25 128. On October 17, 2007, Fremont filed its delayed Annual Report for the
26 year ended December 31, 2006 and Quarterly Reports for the first and second
27 quarters of 2007. Fremont General Corp., Annual Report (Form 10-K) (Dec. 31,
28 2006) (hereafter the “2006 Form 10-K”); Fremont General Corp. Quarterly Report

1 (10-Q) (Mar. 31, 2007) (hereafter the “1Q 2007 Form 10-Q”); Fremont General
2 Corp. Quarterly Report (10-Q) (June 30, 2007) (hereafter the “2Q 2007 Form 10-
3 Q”). In total, for the eighteen months ended June 30, 2007, Fremont reported a
4 \$1.06 billion loss. 2006 Form 10-K at 30; 1Q 2007 Form 10-Q at 4; 2Q 2007
5 Form 10-Q at 4. For 2006, Fremont reported losses of \$202.3 million, or \$2.72 per
6 share. 2006 Form 10-K at 30. For the six months ending June 30, 2007, Fremont
7 reported a loss of \$855.8 million, or \$11.19 per share, compared with earnings of
8 \$83.6 million or \$1.10 per share, during the first half of 2006. 1Q 2007 Form 10-Q
9 at 4; 2Q 2007 Form 10-Q at 4. Excluding the charges and costs of exiting the
10 subprime business, net income from continuing operations during the first half of
11 2007 totaled \$84,000. 2Q 2007 Form 10-Q at 6. Fremont’s 2007 losses were in
12 large part due to the \$877 million loss taken on the sale of its portfolio of sub-
13 prime loans. *Id.* at 15. The Company announced that it expects a net loss from
14 continuing operations for at least the rest of 2007 and expects interest income,
15 which totaled \$332 million from January to June, to be its main source of revenue.
16 *Id.* at 32.

17 129. Included in Fremont’s 2006 Form 10-K was a report from Fremont’s
18 independent auditor stating that Fremont had failed to maintain an effective
19 internal control over financial reporting as of December 31, 2006 and identified the
20 following material weaknesses in management’s assessment:

- 21 • Management did not maintain effective monitoring controls over
22 the Company’s commercial real estate loan portfolio; specifically,
23 the grading of some commercial loans were not consistent with the
24 Company’s loan grading guidelines; and the valuation methodology
25 used for collateral dependent loans was inappropriate;
- 26 • As a result, there was an understatement of the allowance for loan
27 losses in the preliminary consolidated financial statements as of
28 December 31, 2006 of approximately \$35.7 million. This

1 adjustment to the allowance for loan losses is properly reflected in
2 the Company's consolidated financial statements;

- 3 • Management did not maintain effective operation of internal control
4 over the application of accounting principles generally accepted in
5 the United States of America, resulting in material adjustments to
6 the Company's preliminary consolidated financial statements.
7 Specifically, the Company misapplied the application of subsequent
8 events accounting literature to its residential real estate loans held
9 for sale, residual interests in securitized assets, and repurchase
10 reserves;
- 11 • This misapplication resulted in a net understatement of loss on
12 whole loan sales and securitizations of residential real estate loans
13 of approximately \$34.8 million and a net understatement of
14 impairment of retained residual interests of approximately \$25.6
15 million. These adjustments are properly reflected in the Company's
16 consolidated financial statements.

17 2006 Form 10-K at F4-F5.

18 130. Shares of Company stock fell 20% to \$3.52 following the release of
19 Fremont's financial reports.

20 131. On October 18, 2007, following the filing of its Annual Report on
21 Form 10-K for the year ended December 31, 2006, the Company announced that,
22 effective October 17, 2007, the 401(k) Plan's suspension had been lifted and the
23 blackout period for directors and executive officers had ceased. Fremont General
24 Corp., Current Report (Form 8-K) (Oct. 18, 2007).

1 **4. Fremont’s Serious Mismanagement and Inappropriate Lending**
2 **Practices Come to Light.**

3 **a. Fremont Consents to FDIC Cease and Desist Order.**

4 132. On March 7, 2007, Fremont issued a press release announcing that the
5 Company the Company’s wholly-owned industrial banking subsidiary, FIL, and
6 the Company’s wholly owned subsidiary, Fremont General Credit Corporation
7 (“FGCC”), had consented to a Cease and Desist Order issued by the FDIC.
8 Fremont General Corp. Current Report (Form 8-K) (Mar. 7, 2007) (hereafter
9 “March 7, 2007 Form 8-K”).⁶ In taking this action, the FDIC found that FIL “was
10 operating without effective risk management policies and procedures in place in
11 relation to its subprime mortgage and commercial real estate lending operations.”
12 FDIC Press Release, *FDIC Issues Cease and Desist Order Against Fremont*
13 *Investment & Loan, Brea, California, and Its Parents*, March 7, 2007, available at
14 <http://www.fdic.gov/news/news/press/2007/pr07022.html> (hereafter “FDIC March
15 7, 2007 Press Release”). The FDIC also determined that FIL had been “operating
16 without adequate subprime mortgage loan underwriting criteria, and that it was
17 marketing and extending subprime mortgage loans in a way that substantially
18 increased the likelihood of borrower default or other loss to the bank.” *Id.*

19 133. Among other things, the FDIC Cease and Desist Order (“FDIC
20 Order”) revealed that Fremont had been engaged in exceedingly inappropriate
21 business and lending practices, including the following:

- 22 (a). Operating with management whose policies and practices are
23 detrimental to FIL;
- 24 (b). Operating FIL without effective risk management policies and
25 procedures in place in relation to FIL’s brokered subprime mortgage

26 _____

27 ⁶ Order to Cease and Desist, *In the Matter of Fremont Investment & Loan*, et al,
28 No. FDIC-07-035b (F.D.I.C. Wash. D.C. Mar. 7, 2007) (“FDIC Order”) (attached
as Exhibit 99.2 to Mar. 7, 2007 Form 8-K) (Exhibit L).

1 lending and commercial real estate construction lending businesses;

2 (c). Operating with inadequate underwriting criteria and excessive
3 risk in relation to the kind and quality of assets held by FIL;

4 (d). Operating without an accurate, rigorous and properly
5 documented methodology concerning its allowance for loan and lease
6 losses;

7 (e). Operating with a large volume of poor quality loans;

8 (f). Engaging in unsatisfactory lending practices;

9 (g). Operating without an adequate strategic plan in relation to the
10 volatility of FIL's business lines and the kind and quality of assets
11 held by FIL;

12 (h). Operating with inadequate capital in relation to the kind and
13 quality of assets held by FIL;

14 (i). Operating in such a manner as to produce low and
15 unsustainable earnings;

16 (j). Operating with inadequate provisions for liquidity in relation to
17 the volatility of FIL's business lines and the kind and quality of assets
18 held by FIL;

19 (k). Marketing and extending adjustable-rate mortgage ("ARM")
20 products to subprime borrowers in an unsafe and unsound manner that
21 greatly increases the risk that borrowers will default on the loans or
22 otherwise cause losses to FIL, including (1) ARM products that
23 qualify borrowers for loans with low initial payments based on an
24 introductory rate that will expire after an initial period, without
25 adequate analysis of the borrower's ability to repay at the fully
26 indexed rate, (2) ARM products containing features likely to require
27 frequent refinancing to maintain affordable monthly payment or to
28 avoid foreclosure, and (3) loans or loan arrangements with loan-to-

1 value ratios approaching or exceeding 100 percent of the value of the
2 collateral;

3 (l). Making mortgage loans without adequately considering the
4 borrower's ability to repay the mortgage according to its terms;

5 (m). Operating in violation of Section 23B of the Federal Reserve
6 Act, in that FIL engaged in transactions with its affiliates on terms and
7 under circumstances that in good faith would be offered to, or would
8 not apply to nonaffiliated companies; and

9 (n). Operating inconsistently with the FDIC's Interagency Advisory
10 on Mortgage Banking and Interagency Expanded Guidance for
11 Subprime Lending Programs.

12 March 7, 2007 Form 8-K; FDIC Order at 2-4.

13 134. In fact, the Company's subprime lending practices exhibit those
14 characteristics most often associated with predatory lending as recognized by
15 financial institution regulatory agencies:

16 (a). Making unaffordable loans based on the collateral of the
17 borrower rather than on the borrower's ability to repay an obligation;

18 (b). Inducing a borrower to refinance a loan repeatedly in order to
19 charge high points and fees each time the loan is refinanced; and

20 (c). Engaging in fraud or deception to conceal the true nature of the
21 loan obligation, or ancillary products, from an unsuspecting or
22 unsophisticated borrower.

23 Sheila Bair, Chairman, Fed. Deposit Ins. Corp., *Subprime and Predatory Lending:*
24 *New Regulatory Guidance, Current Market Conditions, and Effects on Regulated*
25 *Institutions*, Testimony Before the Subcommittee on Financial Institutions and
26 Consumer Credit of the Committee on Financial Services; U.S. House of
27 Representatives, Mar. 27, 2007, available at <http://www.fdic.gov/news/news/speeches/chairman/spmar2707.html>.
28

1 135. The FDIC Order requires Fremont to cease and desist from these
2 practices and set forth a variety of corrective actions to be undertaken by the
3 Company, including that FIL adopt a subprime mortgage lending policy within 90
4 days which sets out provisions designed to correct its lending practices, including
5 that it underwrite future subprime loans with an analysis of the borrowers' ability
6 to repay at the fully indexed rate and provide borrowers with clear information
7 about the benefits and risks of the products. FDIC March 7, 2007 Press Release,
8 *supra*.

9 136. The FDIC Order also requires Fremont, and FIL in particular, to take
10 a number of steps, including:

- 11 (a). having and retaining qualified management;
- 12 (b). limiting the Company's and FGCC's representation on FIL's
13 board of directors and requiring that independent directors comprise a
14 majority of FIL's board of directors;
- 15 (c). revising and implementing written lending policies to provide
16 effective guidance and control over FIL's residential lending function;
- 17 (d). revising and implementing policies governing communications
18 with consumers to ensure that borrowers are provided with sufficient
19 information;
- 20 (e). implementing control systems to monitor whether FIL's actual
21 practices are consistent with its policies and procedures;
- 22 (f). implementing a third-party mortgage broker monitoring
23 program and plan;
- 24 (g). developing a five-year strategic plan, including policies and
25 procedures for diversifying FIL's loan portfolio;
- 26 (h). implementing a policy covering FIL's capital analysis on
27 subprime residential loans;

- 1 (i). performing quarterly valuations and cash flow analyses on
- 2 FIL's residual interests and mortgage servicing rights from its
- 3 residential lending operation, and obtaining annual independent
- 4 valuations of such interests and rights;
- 5 (j). implementing a written profit plan;
- 6 (k). limiting the payment of cash dividends by FIL without the prior
- 7 written consent of the FDIC and the Commissioner of the California
- 8 Department of Financial Institutions;
- 9 (l). implementing a written liquidity and funds management policy
- 10 to provide effective guidance and control over FIL's liquidity position
- 11 and needs; and
- 12 (m). prohibiting the receipt, renewal or rollover of brokered deposit
- 13 accounts without obtaining a Brokered Deposit Waiver.

14 March 7, 2007 Form 8-K; FDIC Order, at 5-23.

15 137. As discussed above, the FDIC issued a Cease and Desist Order not
16 only in relation to Fremont's subprime residential mortgage business but its
17 commercial lending division as well. Of particular concern to the FDIC is
18 Fremont's heavy concentration in construction loans: Fremont currently holds
19 approximately \$6 billion in construction loans, over half of which are to developers
20 of condos or condo conversions. Alex Frangos, *Fremont Exits Subprimes to Make*
21 *Risky Bets on Condos*, Wall St. J., Apr. 18, 2007, at A4. Like the subprime lending
22 market, delinquencies in construction loans have been on the rise. Fremont
23 currently ranks in the top 10% of banks in terms of the concentration of its loans in
24 construction. *Id.* As of the end of 2006, Fremont had reported \$321 million in
25 delinquent commercial loans, up from \$219 million in the third quarter and a mere
26 \$48 million at the end of 2005. *Id.*

1 138. Moreover, at the end of 2006, Fremont’s construction and land
2 development loans to Tier 1 capital ratio was 3:1 compared to the median U.S.
3 bank which carries construction loans worth only 37% of Tier 1 capital.⁷ *Id.*

4 139. In its Cease and Desist Order, the FDIC instructed Fremont to alter its
5 underwriting procedure on construction loans and to cease: “operating the Bank
6 without effective risk management policies and procedures in place in relation to
7 the Bank’s other primary line of business of commercial real estate construction
8 lending[.]” FDIC Order at 2. And instructed Fremont to take the following steps
9 as to its commercial lending practices, including:

10 (a). limiting extensions of credit to certain commercial real estate
11 borrowers;

12 (b). implementing a written lending and collection policy to provide
13 effective guidance and control over FIL’s commercial real estate
14 lending function, including a planned material reduction in the volume
15 of funded and unfunded nonrecourse lending and loans for
16 condominium conversion and construction as a percentage of Tier 1
17 capital; and

18 (c). submitting a capital plan that will include a Tier 1 capital ratio
19 of not less than 14% of FIL’s total assets.

20 March 7, 2007 Form 8-K; FDIC Order, at 5-23.

21 140. Following the FDIC Order, Fremont stock fell to \$6.18 on March 13,
22 2007, 73% off its 52-week high.

25 ⁷ The Tier 1 capital ratio is a risk-weighted assessment frequently used by federal
26 regulators to determine a bank’s financial strength. Frangos, *supra*. According to
27 Fremont’s 2005 Form 10-K, Tier 1 capital includes common stockholder’s equity,
28 a certain portion of mortgage servicing rights not includable in regulatory capital
and other adjustments. Fremont General Corp., Annual Report (Form 10-K)
(Dec. 31, 2005) at F-41.

1 **b. Resignation of Fremont’s Auditor.**

2 141. On March 27, 2007, Fremont’s auditor, Grant Thornton LLP, advised
3 the Company that it was resigning as the Company’s independent registered public
4 accounting firm. In its Form 8-K announcing Grant Thornton’s resignation, the
5 Company claimed that “there has not been any matter that was the subject of a
6 disagreement [] between the Company and Grant Thornton and...no reportable
7 event [] has occurred.” Fremont General Corp., Current Report (Form 8-K) (Apr.
8 2, 2007) (hereafter “April 2, 2007 Form 8-K”). The Company further revealed that
9 Grant Thornton had sought to “expand significantly the scope of their audit” and
10 had requested “additional information in connection with its audit beginning in the
11 latter part of February and stated at that time that it [Grant Thornton] needed to
12 perform additional procedures and testing in connection with completing its audit.”
13 *Id.* The Company further claimed that the “[a]t no time did the Company fail to
14 provide to Grant Thornton any requested information on a timely basis or
15 communicate to Grant Thornton that it was opposed to any additional procedures
16 or testing or that it was opposed to such an expanded audit scope.” *Id.*

17 142. In its April 2, 2007 letter to the Securities and Exchange Commission,
18 Grant Thornton disagreed with the Company’s version of events, stating that it’s
19 communications with the Company characterized a “reportable event” and that the
20 Company had failed, in several instances, to provide Grant Thornton with the
21 requested information on dates previously agreed upon with management. April 2,
22 2007 Letter from Grant Thornton LLP to U.S. Securities and Exchange
23 Commission (attached as Exhibit 16.1 to April 2, 2007 Form 8-K).

24 143. In the wake of Grant Thornton’s resignation and letter to the SEC,
25 Fremont common stock fell to \$5.78 on April 4, 2007, 75% off its 52-week high.
26
27
28

1 **c. Predatory Lending Allegations Filed by Massachusetts**
2 **AGO.**

3 144. On October 4, 2007, the Massachusetts Attorney General filed a
4 lawsuit against the Company in Massachusetts Superior Court for Suffolk County
5 on behalf of borrowers in Massachusetts, *Commonwealth of Massachusetts v.*
6 *Fremont Inv. & Loan, and Fremont General Corp.*, and it is the first lawsuit to be
7 brought under Massachusetts' 2004 Predatory Homes Practices Act. The lawsuit
8 alleges that Fremont engaged in unfair and deceptive conduct on a broad scale in
9 connection with origination and servicing of residential mortgage loans which has
10 significantly contributed to the foreclosure crisis in Massachusetts, including:

11 (a). Selling exceedingly risky loan products that Fremont knew or
12 should have known were designed to fail, including loan products that
13 combined 100% financing, no income documentation ("stated
14 income" loans), and adjustable rate mortgages that caused large
15 increases in monthly payments after two or three years;

16 (b). Selling exceedingly risky loans through third party mortgage
17 brokers and providing financial incentives to those brokers to sell high
18 cost products, but failing to meaningfully monitor or control the unfair
19 and deceptive conduct used by brokers to sell Fremont loans. Such
20 conduct includes the rampant abuse of stated income loans and
21 misleading borrowers about the loans offered and their ability to
22 refinance to lower cost products; and

23 (c). Engaging in unfair or deceptive loan servicing conduct, which
24 led to unnecessary foreclosures for Massachusetts borrowers.

25 The Commonwealth of the Massachusetts Office of the Attorney General Press
26 Release, *Attorney General Martha Coakley Files Lawsuit Against National*
27 *Mortgage Lender-Fremont Investment And Loan*, Oct. 5, 2007, available at
28 <http://www.mass.gov/?pageID=pressreleases&agId=Cago&prModName=cagopres>

1 srelease&prFile=2007_10_05_fremont_lawsuit.xml; Complaint, *Commonwealth of*
2 *Mass. v. Fremont Inv. & Loan, and Fremont General Corp.*, No. 07-4373 (Mass.
3 Super. Ct. Oct. 4, 2007) (Suffolk County) (Exhibit M).

4 145. The Massachusetts Attorney General’s Complaint (the Mass.
5 Complaint”) also alleges that Fremont’s business model was “indifferent to
6 whether a borrower could afford the loan beyond a very short term, *i.e.* after
7 Fremont had sold the loan to the secondary market.” *Mass. v. Fremont, et. al.* at ¶
8 15. As such, Fremont designed its loan origination model in order to produce a
9 huge volume of loans for quick resale in the secondary market -- to third parties
10 investors or for securitization -- by purposefully relaxed its underwriting
11 guidelines. *Id.* at ¶¶ 11, 13-15. Furthermore, the Mass. Complaint alleges that
12 Fremont’s underwriting requirements were “so lax that in many instances, its
13 underwriters took no meaningful steps to determine whether Fremont borrowers
14 could actually repay a loan. *Id.* at ¶ 14.

15 146. The Mass. Complaint also reiterated many of the allegations contained
16 in the FDIC Order, including Fremont’s aggressive marketing of loan products
17 which were “structurally unfair [to borrowers] due to multiple layers of risk in each
18 loan product.” *Id.* at ¶ 21; see also ¶¶ 20-32. For example, Fremont commonly
19 marketed ARM loans to Massachusetts borrowers with an initial rate of 6.5 or
20 7.0% for two years, which would balloon up to 14.0% within four years –
21 increasing the monthly payments by up to 80%. *Id.* at ¶ 23. However, when
22 Fremont’s brokers approved these “teaser” rate loans for borrowers, they did so
23 despite borrowers’ inability to pay after the initial rate expired and often failed to
24 “meaningfully disclose the interest rate increases” and “the well-known impact of
25 those adjustments on monthly payments and borrowers’ ability to pay the loans.”
26 *Id.* at ¶¶ 24-25. In particular, the Mass. Complaint describes a pattern of unfair and
27 deceptive practices in which Fremont provided borrowers with “incomplete and
28 confusing information relative to product features, material loan terms and product

1 risks, prepayment penalties, and the borrowers' obligations for property taxes and
2 insurances." *Id.* at ¶ 26. These practices included, for example:

3 (a). Routinely convincing borrowers to ignore loan terms, including
4 upward adjusting rates, by promising to arrange a new loan prior to
5 the ARM adjustment;

6 (b). Commonly approving 80/20 piggyback loans with onerous
7 terms which Fremont's brokers failed to explain required borrowers'
8 homes to appreciate in value in order to avoid their home mortgages
9 becoming worth more than their homes;

10 (c). Marketing "twist pig" loans -- 80/20 piggy loans which
11 assigned the first 80% loan to one entity, and the second 20% loan to
12 a different entity, making it more difficult for borrowers to refinance
13 or negotiate new loan terms;

14 (d). Disguising short-term high-cost loans and attempting to evade
15 violation of the Predatory Home Loan Practices Act by separating
16 short-term loans into two parts: a short-term introductory period with
17 a teaser rate and a longer-term adjustable rate; and

18 (d). Underwriting loans based on false information such as inflated
19 real estate appraisals, false borrowers credit scores, income or asset
20 information.

21 *Id.* at ¶¶ 26-31, 53-63.

22 147. The Mass. Complaint also details how Fremont exacerbated the ill
23 effects of its unfair and deceptive lending practices on borrowers by encouraging
24 the third party mortgage brokers it primarily relied on to sell its loans to market
25 exceedingly risky mortgage products. *Id.* at ¶ 33-43. Fremont did so with
26 inducements and rewards for originating "unduly risky, inappropriate, and in some
27 cases, fraudulent loans, while failing to monitor these brokers' sales and
28

1 underwriting conduct in a meaningful way.” *Id.* at ¶ 33; *see also* ¶¶ 34-43.

2 Fremont’s conduct in this regard included:

3 (a). Divesting virtually all responsibility for reviewing underwriting
4 decisions to third party mortgage brokers, including the obligation to
5 interview and counsel the borrower;

6 (b). Failing to adopt and implement clear standard reporting
7 procedures and control systems to monitor third-party mortgage
8 brokers’ practices and adherence to state and federal laws or to
9 independently verify the information which brokers provided Fremont
10 in connection with loan applications;

11 (c). Instituting a broker compensation structure which rewarded
12 brokers for the amount of mortgages they originated without regard to
13 the veracity of the information on which loans were based or the risk
14 of borrower foreclosure; and

15 (d) Steering borrowers to loans that were not in borrowers’ best
16 interests, and often which borrowers could not afford, by paying
17 mortgage brokers additional inducements known as yield spread
18 premiums when they successfully marketed loan products to
19 borrowers that were riskier and costlier than those for which
20 borrowers were qualified.

21 *Id.* at ¶¶ 34-47.

22 148. These inherent conflicts between the broker’s interests in generating
23 fees and the interests of the borrower were not disclosed to the borrower by
24 Fremont or the brokers that sold Fremont loans. *Id.* at ¶¶ 50, 51.

25 149. As the Mass. Complaint alleges, these practices resulted in numerous
26 Massachusetts borrowers facing delinquency and foreclosure and ultimately losing
27 their homes and often their life savings. *Id.* at ¶ 52.

1 150. The Mass. Complaint also alleges that Fremont participated in unfair
2 and deceptive conduct as to its servicing of loans in Massachusetts. *Id.* at ¶ 110-
3 130. In particular, Fremont often unfairly denied qualified borrowers, facing
4 upward adjusting mortgage rates, from participating in its loan modification
5 program which would allow borrowers to negotiate more favorable terms. *Id.* at ¶¶
6 111-113. Moreover, Fremont often induced borrowers to accept mortgages
7 containing introductory or “teaser” rates by touting borrowers’ ability to qualify for
8 Fremont’s loan modification program. *Id.* Fremont failed to disclose to borrowers
9 at the time of origination that few if any borrowers qualified for its program. *Id.* at
10 ¶ 112. “As a loan servicer, Fremont attempts to extract as much money as possible
11 from borrowers, despite knowing that the majority of borrowers will be unable to
12 avoid foreclosure through Fremont’s promised loan modification program or
13 similar loss mitigation solutions.” *Id.* Furthermore, Fremont generally failed to
14 respond to borrowers’ requests and to act in good faith and to conduct due
15 diligence when foreclosing on borrowers’ properties. These behaviors constitute
16 illegal action against borrowers under Massachusetts state law, including unfair
17 and deceptive practices under G.L. c. 93A § 2 and are in violation of the Predatory
18 Home Loan Practices Act, G.L. c. 183C. *See id.* at ¶¶ 53-63, 138-142.

19 151. The Mass. Complaint also alleges that Fremont’s unfair and deceptive
20 lending and servicing practices have contributed to escalating foreclosures in
21 Massachusetts – an increase by 76% in the first quarter of 2007, as compared to the
22 first quarter of 2006. *Id.* at ¶ 132. Fremont was one of the principle lenders that
23 made loans ultimately resulting in foreclosure. *Id.* at ¶ 133. For instance 10% of
24 all foreclosure deeds on condominiums, 1-family, 2-family and 3-family properties
25 in Boston from 2005 to the present were based on loans made by Fremont. *Id.* at ¶
26 134.

1 152. On October 5, 2007, Fremont responded to the Mass. Complaint by
2 stating that it was “continuing to work with regulators throughout the country to
3 help delinquent borrowers retain home ownership through loan modifications and
4 other proactive measures” and that it “finds it regrettable that the Massachusetts
5 Attorney General has abandoned these cooperative efforts to help borrowers keep
6 their homes.” *Fremont General Responds to Lawsuit Filed by Massachusetts*
7 *Attorney General’s Office*, Fremont General Corp., Current Report (attached as
8 Exhibit 99.1 to Fremont General Corp., Current Report (Form 8-K) (Oct. 5, 2007)).

9 **d. Misrepresentation and Breach of Warranty Claims Filed by**
10 **Morgan Stanley Against Fremont for Hundreds of Bad**
11 **Loans Purchased from Fremont.**

12 153. Fremont’s woes have now extended to another front, further
13 demonstrating Fremont’s perilous circumstances. On October 23, 2007, Morgan
14 Stanley filed a lawsuit in federal court in Manhattan alleging FIL had violated
15 agreements under which Morgan Stanley Mortgage Capital Inc. had purchased
16 hundreds of residential mortgages between May 1, 2005 and Dec. 28, 2006.
17 *Morgan Stanley Unit Sues Fremont General*, Yahoo Finance, Oct. 24, 2007,
18 *available at* [http://biz.yahoo.com/ap/071024/morgan_stanley_fremont.html?.v=1&](http://biz.yahoo.com/ap/071024/morgan_stanley_fremont.html?.v=1&printer=1)
19 [printer=1](http://biz.yahoo.com/ap/071024/morgan_stanley_fremont.html?.v=1&printer=1). Among the allegations are that Fremont marketed loans to Morgan
20 Stanley which failed to meet Fremont’s stated underwriting guidelines and that
21 Fremont misrepresented the appraisal value and condition of properties as well as
22 some borrowers’ income and employment. *Id.* The lawsuit further alleges that
23 “[a]lthough required to do so under the clear and unambiguous terms of the
24 purchase agreements, Fremont has neither cured the breaches nor repurchased
25 those mortgage loans.” *Id.*

1 **5. Fremont’s Gain on Sale Accounting Practices Resulted in**
2 **Overstatements of Earnings That Were Subsequently Reversed.**

3 154. Substantially all of the residential mortgages that Fremont originates
4 are “held-for-sale.” The Company eventually securitized most of these mortgages,
5 by transferring pools of them to a new entity and selling securities of the entity to
6 highly sophisticated investors. The securities, of which there may be many
7 tranches in a given entity, represent entitlements to different cash flows, with
8 different degrees of backing by collateral, coming from the pooled mortgages. The
9 transfer of the mortgages is not entire, so Fremont remains obligated for various
10 defects in the mortgages, including fraud, irregularities in their documentation or
11 process, or Fremont’s own breach of representations and warranties in the sale. As
12 the Company notes, “The Company does have a potential liability under standard
13 industry representations and warranties for loans sold into securitization or whole
14 loan sale transactions.” 2006 10-K at F-14.

15 155. So-called “gain on sale” accounting rules permit Fremont to recognize
16 revenue and income from the transfer of mortgages “held-for-sale” to the
17 securitization entity, based on estimates and assumptions made by the Company.
18 “Gain on sale” accounting is not in of itself improper; however, Fremont used the
19 accounting treatment in an aggressive and ill-founded manner such that it resulted
20 in overstatements of earnings that the Company has subsequently reversed. For
21 example, for 2005, Fremont recorded income from gain on sale of \$346 million.
22 *Id.* at 37. These phantom gains constituted 105 percent of Fremont’s reported 2005
23 profit of \$328 million. *Id.* at 33, 37. That is to say, without enhancing its 2005
24 earnings with “gains on sale,” Fremont would have reported a loss in 2005 instead
25 of a \$328 million profit. That profit was obliterated in 2006, for which Fremont
26 recorded a loss on sale of \$338 million, a swing of nearly \$700 million. This
27 reversal of fortune arose largely from a ten-fold increase in the Company’s
28 reserves for potential liabilities arising from its loan securitization transactions,

1 from \$67 million for 2005 to \$672 million for 2006. *Id.* The Company's
2 drastically increased reserves in 2006 were primarily due to greatly increased
3 levels of early payment defaults and repurchase requests from whole loan
4 purchasers. The Company's loan repurchases and re-pricings increased to \$1.09
5 billion during 2006, as compared to \$393.7 million during 2005. *Id.* at 35.

6 156. Upon information and belief, Fremont used gain on sale accounting to
7 overstate its income and inflate its stock price. The Company's overstated income
8 provided the investing public [and the plaintiff class] with incomplete and
9 inaccurate information which depicted an overly rosy forecast of Fremont's
10 financial health and, in particular, its liabilities related to impaired loans. The
11 Company intentionally underestimated the proper amount of the repurchase reserve
12 required in respect of loans it would have to reprice or repurchase from buyers.

13 **6. Common Financial Measures Show that Fremont Has Been in**
14 **Dire Financial Condition throughout the Class Period.**

15 157. As set forth in detail above, Defendants were responsible for the
16 prudent management of Plan investments, including the Fremont stock in the
17 Plans. A prudent fiduciary in like-circumstances would have evaluated objective
18 measures of Fremont's financial conditions, and acted accordingly to protect the
19 Plans from large losses.

20 158. Of the many measures available to Defendants to evaluate the risk of
21 continuing to invest participants' retirement assets in Fremont stock, the
22 Company's credit rating painted a bleak picture during the Class Period.

23 159. Credit ratings provide a ready measure of a company's financial
24 condition and risk of bankruptcy. Fremont's financial deterioration was not
25 unnoticed by the major credit rating agencies. Indeed, throughout the Class Period,
26 Fremont debt has been rated as non-investment grade (otherwise known as *junk*).

27 160. Standard & Poor's rating of Fremont was CCC+, three steps below
28 investment grade, at the beginning of the Class Period, increased slightly to B+,

1 still two steps below investment grade, in September 2005 before falling back to
2 B- on March 5, 2007, where it remains today.

| <u>Moody's ratings of Fremont during Class</u> | | <u>Standard & Poor's ratings of Fremont during Class</u> | |
|--|-------------|--|-------------|
| <u>Period</u> | | <u>Period</u> | |
| Beginning | <i>B3</i> | Beginning | <i>CCC+</i> |
| 9/20/05 | <i>B2</i> | 9/20/05 | <i>B+</i> |
| 3/5/07 | <i>B3</i> | 3/5/07 | <i>B-</i> |
| 8/27/07 | <i>Caa2</i> | | |
| 10/12/07 | <i>Caa3</i> | | |

9 (Italics indicate high risk or 'junk' status.) The lowering of bond ratings has a
10 spiraling effect, as the downgrades increase a company's cost of borrowing, which
11 results in increased cash interest expense when circumstances are already difficult,
12 as reflected by the downgrades.

13 161. According to Moody's, "Obligations rated B are judged to have
14 *speculative elements* and are subject to *substantial credit risk*. Moody's Investor
15 Service, Moody's Rating Symbols & Definitions (Aug. 2003) at 6 (emphasis
16 added).

17 162. According to Standard & Poor's, "Obligations rated 'BB', 'B',
18 'CCC', 'CC', and 'C' are regarded as having *significant speculative*
19 *characteristics*." Standard & Poor's, Standard & Poor's Ratings Definitions (Dec.
20 11, 2006), *available at* [http://www2.standardandpoors.com/portal/site/
21 sp/en/us/page.article/2,1,3,0,1148442391999.htm](http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/2,1,3,0,1148442391999.htm) (emphasis added).

22 163. Individually and taken together, the above measures paint a bleak
23 picture for Fremont that was readily viewable by all Defendants.

24 164. Fremont's decline continued throughout 2006, with the Company
25 posting a \$202.3 million loss. 2006 Form 10-K at 30.

26 165. Given the above-described factors, it was clear that since the
27 beginning of the Class Period, Fremont was confronting serious business and
28 financial difficulties, and facing dire financial circumstances. Prudent fiduciaries

1 do not invest participants' retirement assets, let alone a substantial percentage of
2 the assets, in stock of a Company teetering on the edge of collapse.

3 **B. Defendants Knew or Should Have Known That Fremont Stock Was an**
4 **Imprudent Investment.**

5 166. Given the above-described factors, it was clear that since the
6 beginning of the Class Period, Fremont was engaged in a perilous business
7 strategy, was being seriously mismanaged and faced dire financial circumstances.
8 These problems caused a dramatic downturn in Fremont equity, and, thus,
9 staggering losses to the Plans as a result of the Plans' massive Fremont stock
10 holdings.

11 167. As such, at all relevant times, Defendants knew or should have known
12 that Fremont stock was an imprudent investment for the Plans due to the numerous
13 operational problems and regulatory red flags described above. Specifically,
14 Defendants ignored industry regulations, sound business practices, the numerous
15 warnings from industry observers and regulators regarding the risks of weakening
16 underwriting standards in order to extend subprime mortgages and commercial
17 construction loans to high default risk borrowers, and objecting financial measures
18 indicating that Fremont stock was no longer a prudent investment for participants'
19 retirement savings. Fremont also engaged in improper accounting practices that
20 artificially inflated the price of Fremont stock. Moreover, as alleged by the
21 Massachusetts Attorney General, Fremont routinely engaged in illegal predatory
22 lending practices which caused numerous borrowers to unnecessarily fall into
23 delinquency or foreclosure, and has subsequently irreparably damaged the
24 Company's financial circumstances.

25 168. Accordingly, it was imprudent for the Plans' fiduciaries to continue
26 offering Fremont stock as a Plan investment option, holding Fremont stock in the
27 Plans, and making new investment in the stock during the Class Period. Fremont
28 stock posed an inordinate risk of significant loss, and this risk is not one that could

1 have been prudently borne on behalf of the beneficiaries of the Plans. In short, the
2 fiduciaries in this case disregarded the Company's deteriorating financial
3 circumstances when it came to managing the Plans' investment in Fremont stock,
4 and were unwilling or unable to act prudently to rescue the Plans' investments.
5 Under the circumstances, the continued investment of millions of dollars of
6 participants' retirement savings in Fremont stock was reckless and imprudent, and
7 contrary to the best interests of the Plans' participants.

8 169. Despite these facts, Defendants took no meaningful action to protect
9 the heavily Fremont-invested Plans and their participants from the massive losses
10 that have occurred.

11 170. Throughout this period and especially during the Class Period,
12 prudent fiduciaries of the Plans would not have ignored the circumstances and
13 allowed the risk of loss to the Plans' participants and beneficiaries to increase to
14 unacceptable levels. Unfortunately, the fiduciaries of the Plans did exactly that
15 and for all intents and purposes wiped out much of the value of the Plans.

16 171. Due to their high ranking positions within the Company, Defendants
17 knew or should have known of the existence of the above-mentioned problems.

18 172. As a result of Defendants' knowledge of and, at times, implication in
19 creating and maintaining public misconceptions concerning the true financial
20 health of the Company, any generalized warnings of market and diversification
21 risks that Defendants made to the Plans' participants regarding the Plans'
22 investment in Fremont stock did not effectively inform the Plans' participants of
23 the past, immediate, and future dangers of investing in Company stock.

24 173. Defendants failed to conduct an appropriate investigation into whether
25 Fremont stock was a prudent investment for the Plans and, in connection therewith,
26 failed to provide the Plans' participants with information regarding Fremont's
27 risky business plan so that participants could make informed decisions regarding
28 their investments in Fremont stock in the Plans.

1 174. An adequate investigation by Defendants would have revealed to a
2 reasonable fiduciary that investment by the Plans in Fremont stock, under these
3 circumstances, was clearly imprudent. A prudent fiduciary acting under similar
4 circumstances would have acted to protect participants against unnecessary losses,
5 and would have made different investment decisions.

6 175. Because Defendants knew or should have known that Fremont stock
7 was not a prudent investment option for the Plans, they had an obligation to protect
8 the Plans and its participants from unreasonable and entirely predictable losses
9 incurred as a result of the Plans' investment in Fremont stock.

10 176. Defendants had available to them several different options for
11 satisfying this duty, including: making appropriate public disclosures as necessary;
12 divesting the Plans of Fremont stock; discontinuing further contributions to and/or
13 investment in Fremont stock under the Plans; consulting independent fiduciaries
14 regarding appropriate measures to take in order to prudently and loyally serve the
15 participants of the Plans; and/or resigning as fiduciaries of the Plans to the extent
16 that as a result of their employment by Fremont they could not loyally serve the
17 Plans and their participants in connection with the Plans' acquisition and holding
18 of Fremont stock.

19 177. Despite the availability of these and other options, Defendants failed
20 to take any action to protect participants from losses as a result of the Plans'
21 investment in Fremont stock.

22 **C. Defendants Failed to Provide Plan Participants with Complete and**
23 **Accurate Information about the True Risks of Investment in Fremont**
24 **Stock in the Plans.**

25 178. ERISA mandates that plan fiduciaries have a duty of loyalty to the
26 plan and its participants which includes the duty to speak truthfully to the plan and
27 its participants when communicating with them. A fiduciary's duty of loyalty to
28 plan participants under ERISA includes an obligation not to materially mislead, or
knowingly allow others to materially mislead, plan participants and beneficiaries.

1 179. During the Class Period, upon information and belief, Defendants
2 made direct and indirect communications with participants in the Plans which
3 included statements regarding investments in Company stock. These
4 communications included, but were not limited to, SEC filings, annual reports,
5 press releases, and Plan documents (including Summary Plan Descriptions and
6 Prospectuses regarding the Plans' offering of Company stock as an investment
7 option), in which Defendants failed to disclose that Company stock was not a
8 prudent retirement investment. The Company regularly communicated with
9 employees, including participants in the Plans, about the performance, future
10 financial and business prospects of the Company's common stock, which was, far
11 and away, the single largest asset of the Plans.

12 180. Defendants, as the Plans' fiduciaries, knew or should have known
13 certain basic facts about the characteristics and behavior of the Plans' participants,
14 well-recognized in the 401(k) literature and the trade press, concerning investment
15 in company stock, including that:

- 16 (a). Employees tend to interpret a match in company stock as an
17 endorsement of the company and its stock;
- 18 (b). Out of loyalty, employees tend to invest in company stock;
- 19 (c). Employees tend to over-extrapolate from recent returns,
20 expecting high returns to continue or increase going forward;
- 21 (d). Employees tend not to change their investment option
22 allocations in the plan once made;
- 23 (e). No qualified retirement professional would advise rank and file
24 employees to invest more than a modest amount of retirement savings
25 in company stock, and many retirement professionals would advise
26 employees to avoid investment in company stock entirely;
- 27 (f). Lower income employees tend to invest more heavily in
28 company stock than more affluent workers, though they are at greater

1 risk; and

2 (g). Even for risk-tolerant investors, the risks inherent to company
3 stock are not commensurate with its rewards.

4 Bridgitte C. Mandrian and Dennis F. Shea, *The Power of Suggestion: Inertia in*
5 *401(k) Participation and Savings Behavior*, 116 Q. J. Econ. 4, 1149 (2001)
6 (available at http://mitpress.mit.edu/journals/pdf/qjec_116_04_1149_0.pdf); Nellie
7 Liang & Scott Weisbenner, *Investor Behavior and the Purchase Of Company Stock*
8 *in 401(k) Plans - the Importance of Plan Design*, Board of Governors for the
9 Federal Reserve System Finance and Economics Discussion Series, No. 2002-36
10 (2002) (available at <http://www.federalreserve.gov/pubs/feds/2002/200236/200236>
11 [pap.pdf](http://www.federalreserve.gov/pubs/feds/2002/200236/200236pap.pdf)).

12 181. Even though Defendants knew or should have known these facts, and
13 even though Defendants knew of the high concentration of the Plans' funds in
14 Company stock during the Class Period, Defendants failed to take any meaningful
15 ameliorative action to protect the Plans and their participants from their heavy
16 investment in an imprudent retirement vehicle, Fremont stock.

17 182. In addition, Defendants failed to provide participants, and the market
18 as a whole, with complete and accurate information regarding the true financial
19 condition of the Company. As such, participants in the Plans could not appreciate
20 the true risks presented by investments in Company stock and therefore could not
21 make informed decisions regarding their investments in Company stock in the
22 Plans.

23 183. Specifically, Defendants failed to provide the Plans' participants with
24 complete and accurate information regarding the Company's continual flouting of
25 industry regulations and sound business practices, including operating with
26 inadequate underwriting criteria, predatory lending practices and excessive risk in
27 relation to the assets held by the Company, and inappropriate accounting methods.
28 As such, the participants were not informed of the true risks of investing their

1 retirement assets in the Plans in Fremont stock.

2 **D. Defendants Breached Their Duty of Loyalty under ERISA.**

3 184. Defendants did nothing to protect the Plans and the Plans' participants
4 from the inevitable losses the Plans would suffer as the Company's problems
5 continued, the value of Company stock steadily declined and the news regarding
6 the Company's problems finally came to light.

7 185. Yet, certain of the Director Defendants and Officer Defendants, who
8 knew or should of known of Fremont's inflated stock price during much of the
9 Class Period, benefited directly from this knowledge or neglect by selling their
10 personal holdings of Fremont stock for significant gain. During the Class Period,
11 the following Defendants sold over 2 million shares of Fremont stock for proceeds
12 of over \$40 million:

- 13 • Defendant Bailey sold over 300,000 shares of Company stock for
14 proceeds of approximately \$6.8 million. In fact, just weeks prior to
15 the March 7, 2007 Cease and Desist Order issued by the Federal
16 Deposit Insurance Corporation (the "FDIC Order"), described at ¶¶
17 132-139 above, Defendant Bailey sold 121,929 shares of Fremont
18 stock on January 4, 2007 (comprising approximately 24% of his
19 holdings of Company stock) at \$16.21 per share, for proceeds of
20 more than \$1.9 million;
- 21 • Defendant Lamb sold over 88,000 shares of Company stock for
22 proceeds of approximately \$1.8 million. Just weeks prior to the
23 March 7, 2007 issuance of the FDIC Order, Defendant Lamb sold
24 35,249 shares of Fremont stock (comprising approximately 19% of
25 his holdings of Company stock) on January 4, 2007 at \$16.21 per
26 share, for proceeds of more than \$570,000;
- 27 • Defendant Lewis sold over 6,000 shares of Company stock for
28 proceeds of approximately \$139,000;

- Defendant McIntyre sold over 1 million shares of Company stock for proceeds of approximately \$19 million. Just weeks prior to the March 7, 2007 issuance of the FDIC Order, Defendant McIntyre sold 142,214 shares of Fremont stock on January 4, 2007 at \$16.21 per share, for proceeds of more than \$2.3 million;
- Defendant Meyers sold over 146,000 shares of Company stock for proceeds of approximately \$3.2 million. Just weeks prior to the FDIC's issuance of its Cease and Desist Order, Defendant Meyers sold 39,223 shares of Fremont stock (comprising approximately 29% of his holdings of Company stock) on January 4, 2007 at \$16.21 per share, for proceeds of more than \$635,000;
- Defendant Rampino sold over 400,000 shares of Company stock for proceeds of approximately \$8.5 million. Just weeks prior to the March 7, 2007 issuance of the FDIC Order, Defendant Rampino sold 151,164 shares of Fremont stock (comprising approximately 24% of his holdings of Company stock) on January 4, 2007 at \$16.21 per share, for proceeds of more than \$2.4 million; and
- Defendant Ross sold 28,000 shares of Company stock for proceeds of approximately \$385,000.

186. The following is a summary of the insider sales by the Plans' fiduciaries since April 2005:

| Name | Date of Sale(s) | Proceeds of Sale(s)⁸ |
|-------------|------------------------|--|
| Bailey | January 4, 2007 | \$1,976,469 |
| | January 5, 2006 | \$4,884,595 |
| Lamb | January 4, 2007 | \$ 571,386 |
| | January 5, 2006 | \$1,246,730 |
| Lewis | January 5, 2006 | \$ 139,380 |

⁸ Estimated proceeds based on average of multiple prices reported.

| | | | |
|----|----------|-------------------|-------------|
| 1 | McIntyre | January 4, 2007 | \$2,305,288 |
| 2 | | August 31, 2006 | \$ 708,000 |
| 3 | | August 30, 2006 | \$ 709,000 |
| 4 | | August 24, 2006 | \$1,326,000 |
| 5 | | August 23, 2006 | \$1,026,000 |
| 6 | | August 21, 2006 | \$ 10,575 |
| 7 | | August 18, 2006 | \$1,153,000 |
| 8 | | August 17, 2006 | \$1,868,000 |
| 9 | | August 16, 2006 | \$1,016,000 |
| 10 | | August 15, 2006 | \$ 1,389 |
| 11 | | August 14, 2006 | \$1,744,000 |
| 12 | | January 5, 2006 | \$7,120,784 |
| 13 | Meyers | January 4, 2007 | \$ 635,804 |
| 14 | | January 5, 2006 | \$2,075,344 |
| 15 | | August 18, 2005 | \$ 404,752 |
| 16 | Rampino | January 4, 2007 | \$2,450,368 |
| 17 | | January 5, 2006 | \$6,130,420 |
| 18 | Ross | January 5, 2006 | \$ 120,796 |
| 19 | | November 14, 2005 | \$ 255,000 |
| 20 | | August 18, 2005 | \$ 118,000 |

17 187. While the above Defendants protected themselves, they took no action
18 to protect the Plans. Instead, they stood idly by as the Plans lost millions of dollars
19 because of the Plans' investment in Fremont stock.

20 VIII. THE RELEVANT LAW

21
22 188. ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2), provides, in pertinent
23 part, that a civil action may be brought by a participant for relief under ERISA §
24 409, 29 U.S.C. § 1109.

25 189. ERISA § 409(a), 29 U.S.C. § 1109(a), "Liability for Breach of
26 Fiduciary Duty," provides, in pertinent part, that

27 any person who is a fiduciary with respect to a plan who
28 breaches any of the responsibilities, obligations, or duties

1 imposed upon fiduciaries by this subchapter shall be personally
2 liable to make good to such plan any losses to the plan resulting
3 from each such breach, and to restore to such plan any profits of
4 such fiduciary which have been made through use of assets of
5 the plan by the fiduciary, and shall be subject to such other
6 equitable or remedial relief as the court may deem appropriate,
7 including removal of such fiduciary.

8 190. ERISA § 502(a)(3), 29 U.S.C. § 1132(a)(3), authorizes individual
9 participants to seek equitable relief from defendants, including, without limitation,
10 injunctive relief and, as available under applicable law, constructive trust,
11 restitution, and other monetary relief.

12 191. ERISA §§ 404(a)(1)(A) and (B), 29 U.S.C. §§ 1104(a)(1)(A) and (B),
13 provides, in pertinent part, that a fiduciary shall discharge his duties with respect to
14 a plan solely in the interest of the participants and beneficiaries, for the exclusive
15 purpose of providing benefits to participants and their beneficiaries, and with the
16 care, skill, prudence, and diligence under the circumstances then prevailing that a
17 prudent man acting in a like capacity and familiar with such matters would use in
18 the conduct of an enterprise of a like character and with like aims.

19 192. These fiduciary duties under ERISA §§ 404(a)(1)(A) and (B) are
20 referred to as the duties of loyalty, exclusive purpose and prudence and are the
21 “highest known to the law.” *Chao v. Hall Holding Co.*, 285 F.3d 415, 426 (6th
22 Cir. 2002). They entail, among other things:

23 (a). The duty to conduct an independent and thorough investigation
24 into, and to continually monitor, the merits of all the investment
25 alternatives of a plan, including in this instance Fremont stock, to
26 ensure that each investment is a suitable option for the plan;

27 (b). The duty to avoid conflicts of interest and to resolve them
28 promptly when they occur. A fiduciary must always administer a plan

1 with an “eye single” to the interests of the participants and
2 beneficiaries, regardless of the interests of the fiduciaries themselves
3 or the plan sponsor;

4 (c). The duty to follow the terms of the plan document only “insofar
5 as such documents and instruments are consistent with the provisions
6 of [title I] and title IV” of ERISA. 29 U.S.C. § 1104(a)(1)(D).
7 Therefore, if a plan’s terms are inconsistent with ERISA, a prudent
8 fiduciary acting in the best interests of the plan’s participants must
9 effectively override the plan’s terms. The Department of Labor’s
10 regulations interpreting ERISA also demonstrate that the fiduciary’s
11 duty of prudence trumps even his obligations to comply with plan
12 terms, including statements of investment policy or plan design.

13 (d). The duty to disclose and inform, which encompasses: (1) a
14 negative duty not to misinform; (2) an affirmative duty to inform
15 when the fiduciary knows or should know that silence might be
16 harmful; and (3) a duty to convey complete and accurate information
17 material to the circumstances of participants and beneficiaries.

18 193. ERISA § 405(a), 29 U.S.C. § 1105(a), “Liability for Breach by Co-
19 Fiduciary,” provides, in pertinent part, that:

20 In addition to any liability which he may have under any other
21 provision of this part, a fiduciary with respect to a plan shall be
22 liable for a breach of fiduciary responsibility of another
23 fiduciary with respect to the same plan in the following
24 circumstances:

25 (1) if he participates knowingly in, or knowingly undertakes to
26 conceal, an act or omission of such other fiduciary, knowing
27 such act or omission is a breach;

28

1 (2) if, by his failure to comply with section 404(a)(1), 29 U.S.C.
2 § 1104(a)(1), in the administration of his specific
3 responsibilities which give rise to his status as a fiduciary, he
4 has enabled such other fiduciary to commit a breach; or
5 (3) if he has knowledge of a breach by such other fiduciary,
6 unless he makes reasonable efforts under the circumstances to
7 remedy the breach.

8 194. Co-fiduciary liability is an important part of ERISA's regulation of
9 fiduciary responsibility. Because ERISA permits the fractionalization of the
10 fiduciary duty, there may be, as in this case, several ERISA fiduciaries involved in
11 a given issue, such as the role of company stock in a plan. In the absence of co-
12 fiduciary liability, fiduciaries would be incentivized to limit their responsibilities as
13 much as possible and to ignore the conduct of other fiduciaries. The result would
14 be a setting in which a major fiduciary breach could occur, but the responsible
15 party could not easily be identified. Co-fiduciary liability obviates this. Even if a
16 fiduciary merely knows of a breach, a breach he had no connection with, he must
17 take steps to remedy it:

18 [I]f a fiduciary knows that another fiduciary of the plan has
19 committed a breach, and the first fiduciary knows that this is a
20 breach, the first fiduciary must take reasonable steps under the
21 circumstances to remedy the breach. . . . [T]he most
22 appropriate steps in the circumstances may be to notify the plan
23 sponsor of the breach, or to proceed to an appropriate Federal
24 court for instructions, or bring the matter to the attention of the
25 Secretary of Labor. The proper remedy is to be determined by
26 the facts and circumstances of the particular case, and it may be
27 affected by the relationship of the fiduciary to the plan and to
28 the co- fiduciary,

1 the duties and responsibilities of the fiduciary in question, and
2 the nature of the breach.

3 1974 U.S.C.C.A.N. 5038, 1974 WL 11542, at 5080.

4 195. Plaintiffs therefore brings this action under the authority of ERISA §
5 502(a)(2) for relief under ERISA § 409(a) to recover losses sustained by the Plan
6 arising out of the breaches of fiduciary duties by the Defendants for violations
7 under ERISA § 404(a)(1) and ERISA § 405(a).

8 **IX. ERISA § 404(c) DEFENSE INAPPLICABLE**

9
10 196. ERISA § 404(c) is an affirmative defense that provides a limited
11 exception to fiduciary liability for losses that result from participants' exercise of
12 control over investment decisions. In order for § 404(c) to apply, participants must
13 in fact exercise "independent control" over investment decisions, and the
14 fiduciaries must otherwise satisfy the numerous procedural and substantive
15 requirements of ERISA § 404(c), 29 U.S.C. § 1104(c), and the regulations
16 promulgated under it.

17 197. ERISA § 404(c) does not apply here for several reasons.

18 198. First, § 404(c) does not and cannot apply to the ESOP because
19 participants do not exercise control over the ESOP's investment in Fremont stock.

20 199. Second, as to the 401(k) Plan, ERISA § 404(c) does not and cannot
21 provide any defense to the fiduciaries' imprudent decision to select and continue
22 offering Fremont stock as an investment option in the 401(k) Plan, or to continue
23 matching in Fremont stock, as these are not decisions that were made or controlled
24 by the participants. *See* Final Reg. Regarding Participant Directed Individual
25 Account Plans (ERISA Section 404(c) Plans) ("Final 404(c) Reg."), 57 Fed. Reg.
26 46906-01, 1992 WL 277875, at *46924 n.27 (Oct. 13, 1992) (codified at 29 C.F.R.
27 pt. 2550) (noting that "the act of limiting or designating investment options which
28 are intended to constitute all or part of the investment universe of an ERISA

1 § 404(c) plan is a fiduciary function which, whether achieved through fiduciary
2 designation or express plan language, is not a direct or necessary result of any
3 participant direction of such plan”).

4 200. Third, ERISA § 404(c) does not apply to any company stock in the
5 Plans over which the participant did not have even nominal control, such as the
6 employer match. Additionally, it does not apply because at times during the Class
7 Period, participants’ ability to divest much of their Plan investments in Fremont
8 stock was restricted, which prevented true participant control over their Plan
9 investment in Fremont stock.

10 201. Fourth, even as to participant directed investment in Fremont stock,
11 ERISA § 404(c) does not apply because Defendants failed to ensure effective
12 participant control by providing complete and accurate material information to
13 participants regarding Fremont stock. *See* 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)
14 (the participant must be provided with “sufficient information to make informed
15 decisions”). As a consequence, participants in the Plans did not have informed
16 control over the portion of the Plans’ assets that were invested in Fremont stock as
17 a result of their investment directions, and the Defendants remain entirely
18 responsible for losses that result from such investment.

19 202. Because ERISA § 404(c) does not apply here, the Defendants’
20 liability to the Plans, the Plaintiffs and the Class (as defined below) for losses
21 caused by the Plans’ investment in Fremont stock is established upon proof that
22 such investments were or became imprudent and resulted in losses in the value of
23 the assets in the Plans during the Class Period.

24 **X. DEFENDANTS’ INVESTMENT IN FREMONT STOCK IS NOT**
25 **ENTITLED TO A PRESUMPTION OF PRUDENCE**

26 203. The presumption of prudence that some courts have found to apply to
27 company stock investments in ESOP or 401(k) plans does not apply here because
28 the Plans did not require the fiduciaries to offer company stock as an investment

1 option, or continue investing any assets of the Plans exclusively, or even primarily
2 in the stock.

3 204. To the extent that a presumption of reasonableness is found to apply at
4 the evidentiary stage of the case, such presumption will be overcome by the facts
5 alleged here, including among other averments:

- 6 • A precipitous stock price decline from over \$25.33 to \$3.14 during the
7 Class Period;
- 8 • Serious and gross mismanagement evidenced by, among other things:
 - 9 ○ aggressively marketing exceedingly risky loan products to
10 borrowers without adequate consideration of the borrower's ability
11 to repay and with high risk of borrower default in order to produce
12 huge volumes of loans for quick resale to third party investors
13 securitization;
 - 14 ○ producing huge volumes of loans for quick resale to third party
15 investors securitization without regard to whether a borrower could
16 afford the loan by instituting improperly lax underwriting
17 guidelines;
 - 18 ○ providing financial incentives to third party mortgage brokers to
19 sell high cost products, but failing to meaningfully monitor or
20 control the unfair and deceptive conduct used by brokers to sell
21 Fremont loans or to disclose the inherent conflicts of interest
22 created by such practices;
 - 23 ○ misleading borrowers about loan terms and their ability to
24 refinance to lower cost products by providing incomplete,
25 confusing and often, intentionally inaccurate information to
26 borrowers;
 - 27 ○ engaging in unfair or deceptive loan servicing conduct, which led
28 to unnecessary foreclosures for borrowers;

- operating with ineffective risk management policies and procedures, including inadequate underwriting criteria;
- operating with inadequate liquidity in relation to the volatility of Fremont's business lines and assets;
- operating with a large volume of poor quality loans and in such a manner as to produce low and unsustainable earnings; and
- use of improper accounting methods causing artificial inflation of the price of Fremont stock.

- Fremont's deteriorating and desperate financial condition as a result of the Company's risky and inappropriate lending and accounting practices; and
- Insider self-dealing by Defendants identified above.

205. The imprudence of continued investment by Defendants in Fremont stock during the Class Period runs afoul of Department of Labor regulations:

[B]ecause every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.

29 C.F.R. 2509.94-1. Defendants had available to them investment alternatives to Fremont stock that had either a higher rate of return with risk commensurate to Fremont stock or an expected rate of return commensurate to Fremont stock but with less risk.

206. Based on these circumstances, and the others alleged herein, it was imprudent and an abuse of discretion for Defendants to continue to make and maintain investment in Fremont stock, and, effectively, to do nothing at all to protect the Plans from large losses as a result of such investment during the Class

1 Period.

2 XI. CAUSES OF ACTION

3 A. Count I: Failure to Prudently and Loyalily Manage the Plans and Assets 4 of the Plans

5 207. Plaintiffs incorporate by this reference the paragraphs above.

6 208. This Count alleges fiduciary breach against all Defendants.

7 209. The Plans are governed by the provisions of ERISA, 29 U.S.C. §§
8 1001, *et. seq.*, and Plaintiffs are participants of the Plans.

9 210. Each of the Defendants were named fiduciaries pursuant to ERISA
10 § 402(a)(1), 29 U.S.C. § 1102(a)(1), or *de facto* fiduciaries within the meaning of
11 § 3(21)(A), 29 U.S.C. § 1002(21)(A), or both. Thus, they were bound by the
12 duties of loyalty, exclusive purpose, and prudence.

13 211. Each of the Defendants was also a co-fiduciary of the other
14 Defendants, under ERISA § 405, 29 U.S.C. § 1105, with respect to the Plans and
15 their participants. As co-fiduciaries, each of the Defendants is liable for the others'
16 conduct under the terms of ERISA § 405(a), 29 U.S.C. § 1005(a).

17 212. As alleged above, the scope of the fiduciary duties and responsibilities
18 of the Defendants included managing the assets of the Plans for the sole and
19 exclusive benefit of the Plans' participants and beneficiaries, and with the care,
20 skill, diligence, and prudence required by ERISA. The Defendants were directly
21 responsible for, among other things, selecting prudent investment options,
22 eliminating imprudent options, determining how to invest employer contributions
23 to the Plans and directing the Trustee regarding the same, evaluating the merits of
24 the Plans' investments on an ongoing basis, and taking all necessary steps to
25 ensure that the Plans' assets were invested prudently.

26 213. Yet, contrary to their duties and obligations under the Plans'
27 documents and ERISA, the Defendants failed to loyally and prudently manage the
28 assets of the Plans. Specifically, during the Class Period, the Defendants knew or

1 should have known that Fremont stock not a suitable and appropriate investment
2 for the Plans, but was, instead, a highly speculative and risky investment in light of
3 the Company's fundamental weaknesses. Nonetheless, during the Class Period,
4 these Defendants continued to offer Fremont stock as an investment option for
5 participant contributions in the 401(k) Plan, as well as the sole investment for
6 matching contributions in the 401(k) Plan for the majority of the Class Period.
7 Additionally, during much of the Class Period, the Defendants continued to offer
8 Fremont stock as the sole investment for contributions to the ESOP. They did so
9 despite evidence that the Company was engaged in a perilous business plan
10 including rife predatory lending, and had ignored industry regulations, sound
11 business and accounting practices and numerous warnings from industry observers
12 and regulators regarding the risks of weakening underwriting standards in order to
13 extend subprime mortgages to high default risk borrowers.

14 214. The Defendants were obliged to prudently and loyally manage all of
15 the Plans' assets. However, their duties of prudence and loyalty were heightened
16 with respect to Company stock because: (a) company stock is a particularly risky
17 and volatile investment, even in the absence of company misconduct; and (b)
18 participants tend to underestimate the likely risk and overestimate the likely return
19 of investment in company stock. In view of this, the Defendants were obliged to
20 have in place a regular, systematic procedure for evaluating the prudence of
21 investment in Company stock.

22 215. The Defendants had no such procedure. Moreover, they failed to
23 conduct an appropriate investigation of the merits of continued investment in
24 Fremont stock even in light of the collapsing stock price, the Company's highly
25 risky and inappropriate loan underwriting, lending and servicing practices, and the
26 particular dangers that these practices posed to the Plans. Such an investigation
27 would have revealed to a reasonably prudent fiduciary the imprudence of
28 continuing to make and maintain investment in Fremont stock under these

1 circumstances.

2 216. The Defendants' decisions respecting the Plans' investment in
3 Fremont stock described above, under the circumstances alleged herein, abused
4 their discretion as ERISA fiduciaries in that a prudent fiduciary acting under
5 similar circumstances would have made different investment decisions.
6 Specifically, based on the above, a prudent fiduciary could not have reasonably
7 believed that further and continued investment of the Plans' contributions and
8 assets in Fremont stock was in keeping with the Plan's settlor's expectations of
9 how a prudent fiduciary would operate.

10 217. The Defendants were obligated to discharge their duties with respect
11 to the Plans with the care, skill, prudence, and diligence under the circumstances
12 then prevailing that a prudent man acting in a like capacity and familiar with such
13 matters would use in the conduct of an enterprise of a like character and with like
14 aims. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

15 218. According to DOL regulations and case law interpreting this statutory
16 provision, a fiduciary's investment or investment course of action is prudent if: (a)
17 he has given appropriate consideration to those facts and circumstances that, given
18 the scope of such fiduciary's investment duties, the fiduciary knows or should
19 know are relevant to the particular investment or investment course of action
20 involved, including the role the investment or investment course of action plays in
21 that portion of the plan's investment portfolio with respect to which the fiduciary
22 has investment duties; and (b) he has acted accordingly.

23 219. Again, according to DOL regulations, "appropriate consideration" in
24 this context includes, but is not necessarily limited to:

- 25 a. A determination by the fiduciary that the particular investment or
26 investment course of action is reasonably designed, as part of the
27 portfolio (or, where applicable, that portion of the plan portfolio with
28 respect to which the fiduciary has investment duties), to further the

1 purposes of the plan, taking into consideration the risk of loss and the
2 opportunity for gain (or other return) associated with the investment
3 or investment course of action; and

4 b. Consideration of the following factors as they relate to such portion of
5 the portfolio:

- 6 • The composition of the portfolio with regard to diversification;
- 7 • The liquidity and current return of the portfolio relative to the anticipated
8 cash flow requirements of the plan; and
- 9 • The projected return of the portfolio relative to the funding objectives of
10 the plan.

11 220. Given the conduct of the Company as described above, the
12 Defendants could not possibly have acted prudently when they continued to invest
13 the Plans' assets in Fremont stock because, among other reasons, the Defendants
14 knew of and/or failed to investigate the Company's improper accounting methods,
15 non-compliance with industry regulations, numerous warnings from industry
16 observers and regulators regarding the risks of weakening underwriting standards
17 in order to extend subprime mortgages to high default risk borrowers and
18 originating subprime residential mortgages which constituted predatory lending
19 practices, such as:

- 20 • marketing and extending subprime mortgage loans without adequate
21 consideration of the borrower's ability to repay and with high risk of
22 borrower default in order to produce huge volumes of loans for quick
23 resale to third party investors securitization;
- 24 • misleading borrowers about loan terms and their ability to refinance to
25 lower cost products by providing incomplete, confusing and often,
26 intentionally inaccurate information to borrowers;
- 27 • engaging in unfair or deceptive loan servicing conduct, which led to
28 unnecessary foreclosures for borrowers;

- 1 • providing financial incentives to third party mortgage brokers to sell high
2 cost products, but failing to meaningfully monitor or control the unfair
3 and deceptive conduct used by brokers to sell Fremont loans or to
4 disclose the inherent conflicts of interest created by such practices;
- 5 • operating with ineffective risk management policies and procedures,
6 including inadequate underwriting criteria;
- 7 • operating with inadequate liquidity in relation to the volatility of
8 Fremont's business lines and assets; and
- 9 • operating with a large volume of poor quality loans and in such a manner
10 as to produce low and unsustainable earnings, all of which constituted a
11 risky business strategy culminating in the weakening of the Company's
12 financial position; and through the use of improper accounting methods
13 as described above.

14 221. The risk associated with the investment in Fremont stock during the
15 Class Period was far above and beyond the normal, acceptable risk associated with
16 investment in company stock.

17 222. This abnormal investment risk could not have been known by the
18 Plans' participants, and the Defendants knew that it was unknown to them (as it
19 was to the market generally), because the fiduciaries never disclosed it.

20 223. Knowing of this extraordinary risk, and knowing the participants did
21 not know it, the Defendants had a duty to avoid permitting the Plans or any
22 participant from investing the Plans' assets in Fremont stock.

23 224. Further, knowing that the Plans were not diversified portfolios, but
24 were heavily invested in Company stock, the Defendants had a heightened
25 responsibility to divest the Plans of Company stock if it became or remained
26 imprudent.

27 225. The fiduciary duty of loyalty entails, among other things, a duty to
28 avoid conflicts of interest and to resolve them promptly when they occur. A

1 fiduciary must always administer a plan with single-minded devotion to the
2 interests of the participants and beneficiaries, regardless of the interests of the
3 fiduciaries themselves or the plan sponsor. On information and belief, the
4 Defendants acted in their own self-interest in benefiting by selling huge amounts of
5 Company stock owned by Defendants at inflated values. Fiduciaries laboring
6 under such conflicts, must, in order to comply with the duty of loyalty, make
7 special efforts to assure that their decisions are untainted by the conflict and made
8 in a disinterested fashion, typically by seeking independent financial and legal
9 advice obtained only on behalf of the plan.

10 226. The Defendants breached their duty to avoid conflicts of interest and
11 to promptly resolve them by, *inter alia*, failing to engage independent advisors
12 who could make independent judgments concerning the Plans' investment in
13 Fremont; failing to notify appropriate federal agencies, including the DOL, of the
14 facts and circumstances that made Fremont stock an unsuitable investment for the
15 Plans; failing to take such other steps as were necessary to ensure that participants'
16 interests were loyally and prudently served; with respect to each of these above
17 failures, doing so in order to avoid adversely impacting their own compensation or
18 drawing attention to Fremont's inappropriate practices; engaging in insider sales of
19 Fremont stock and yet, taking no action to disclose to the Plans' participants the
20 reason for their sales or to protect the Plans' holdings of Fremont stock once
21 proper disclosure was made; and by otherwise placing their own and Fremont's
22 improper interests above the interests of the participants with respect to the Plans'
23 investment in Fremont stock.

24 227. Moreover, a fiduciary's duties of loyalty and prudence require it to
25 disregard plan documents or directives that it knows or reasonably should know
26 would lead to an imprudent result or would otherwise harm plan participants or
27 beneficiaries. ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D). Thus, a
28 fiduciary may not blindly follow plan documents or directives that would lead to

1 an imprudent result or that would harm plan participants or beneficiaries, nor allow
2 others, including those whom they direct or who are directed by the plan, to do so.

3 228. The Defendants breached this duty by (a) continuing to offer Fremont
4 stock as an investment option for participant contributions in the Plans; and (b) for
5 both employee and employer contributions, continuing to invest the assets of the
6 Plans in Fremont stock rather than in cash or other short-term investment options,
7 and for each of these actions doing so when the Defendants knew or should have
8 known that Fremont stock no longer was a prudent investment for participants'
9 retirement savings.

10 229. As a consequence of the Defendants' breaches of fiduciary duty
11 alleged in this Count, the Plans suffered tremendous losses. If the Defendants had
12 discharged their fiduciary duties to prudently invest the Plans' assets, the losses
13 suffered by the Plans would have been minimized or avoided. Therefore, as a
14 direct and proximate result of the breaches of fiduciary duty alleged herein, the
15 Plans, and indirectly Plaintiffs and the other Class members, lost hundreds of
16 millions of dollars of retirement savings.

17 230. Pursuant to ERISA §§ 409, 502(a)(2) and (a)(3), 29 U.S.C. §§
18 1109(a), 1132(a)(2) and (a)(3), the Defendants are liable to restore the losses to the
19 Plans caused by their breaches of fiduciary duties alleged in this Count and to
20 provide other equitable relief as appropriate.

21 **B. Count II: Failure to Monitor Fiduciaries**

22 231. Plaintiffs incorporate by this reference the allegations above.

23 232. This Count alleges fiduciary breach against the following Defendants:
24 Fremont and the Director Defendants (the "Monitoring Defendants").

25 233. As alleged above, during the Class Period the Monitoring Defendants
26 were named fiduciaries pursuant to ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1), or
27 *de facto* fiduciaries within the meaning of ERISA § 3(21)(A), 29 U.S.C.
28 § 1002(21)(A), or both. Thus, they were bound by the duties of loyalty, exclusive

1 purpose, and prudence.

2 234. As alleged above, the scope of the fiduciary responsibilities of the
3 Monitoring Defendants included the responsibility to appoint, and remove, and
4 thus, monitor the performance of other fiduciaries, as follows:

5

| 6 Monitoring Fiduciary | 7 Monitored Fiduciary | 8 Reference |
|-------------------------------|---|--------------------|
| 9 Fremont | 401(k) Plan Committee ESOP Committee | ¶63 ¶68 |
| Director Defendants | 401(k) Plan Committee ESOP Committee | ¶72 ¶72 |

10 235. Under ERISA, a monitoring fiduciary must ensure that the monitored
11 fiduciaries are performing their fiduciary obligations, including those with respect
12 to the investment and holding of plan assets, and must take prompt and effective
13 action to protect the plan and participants when they are not.

14 236. The monitoring duty further requires that appointing fiduciaries have
15 procedures in place so that on an ongoing basis they may review and evaluate
16 whether the “hands-on” fiduciaries are doing an adequate job (for example, by
17 requiring periodic reports on their work and the plan’s performance, and by
18 ensuring that they have a prudent process for obtaining the information and
19 resources they need). In the absence of a sensible process for monitoring their
20 appointees, the appointing fiduciaries would have no basis for prudently
21 concluding that their appointees were faithfully and effectively performing their
22 obligations to plan participants or for deciding whether to retain or remove them.

23 237. Furthermore, a monitoring fiduciary must provide the monitored
24 fiduciaries with complete and accurate information in their possession that they
25 know or reasonably should know that the monitored fiduciaries must have in order
26 to prudently manage the plan and the plan assets, or that may have an extreme
27 impact on the plan and the fiduciaries’ investment decisions regarding the plan.
28

1 238. The Monitoring Defendants breached their fiduciary monitoring
2 duties by, among other things: (a) failing, at least with respect to the Plans’
3 investment in Company stock, to monitor their appointees, to evaluate their
4 performance, or to have any system in place for doing so, and standing idly by as
5 the Plans suffered enormous losses as a result of their appointees’ imprudent
6 actions and inaction with respect to Company stock; (b) failing to ensure that the
7 monitored fiduciaries appreciated the true extent of Fremont’s highly risky and
8 inappropriate business and accounting practices, and the likely impact of such
9 practices on the value of the Plans’ investment in Fremont stock; (c) to the extent
10 any appointee lacked such information, failing to provide complete and accurate
11 information to all of their appointees such that they could make sufficiently
12 informed fiduciary decisions with respect to the Plans’ assets; and (d) failing to
13 remove appointees whose performance was inadequate in that they continued to
14 make and maintain investments in Fremont stock despite their knowledge of
15 practices that rendered Fremont stock an imprudent investment during the Class
16 Period for participants’ retirement savings in the Plans, and who breached their
17 fiduciary duties under ERISA.

18 239. As a consequence of the Monitoring Defendants’ breaches of
19 fiduciary duty, the Plans suffered tremendous losses. If the Monitoring Defendants
20 had discharged their fiduciary monitoring duties as described above, the losses
21 suffered by the Plans would have been minimized or avoided. Therefore, as a
22 direct and proximate result of the breaches of fiduciary duty alleged herein, the
23 Plans, and indirectly Plaintiffs and the other Class members, lost millions of
24 dollars of retirement savings.

25 240. Pursuant to ERISA §§ 409, 502(a)(2) and (a)(3), 29 U.S.C. §§
26 1109(a), 1132(a)(2) and (a)(3), the Monitoring Defendants are liable to restore the
27 losses to the Plans caused by their breaches of fiduciary duties alleged in this
28 Count and to provide other equitable relief as appropriate.

1 **C. Count III: Breach of Fiduciary Duty – Failure to Provide Complete and**
2 **Accurate Information to the Plans’ Participants and Beneficiaries**

3 241. Plaintiffs incorporate by this reference the allegations above.

4 242. This Count alleges fiduciary breach against all of the Defendants.

5 243. At all relevant times, as alleged above, Defendants listed in this Count
6 were fiduciaries within the meaning of ERISA § 3(21)(A), 29 U.S.C. §
7 1002(21)(A). Thus, they were bound by the duties of loyalty, exclusive purpose,
8 and prudence.

9 244. At all relevant times, the scope of the fiduciary responsibility of the
10 Defendants included the communications and material disclosures to the Plan
11 participants and beneficiaries.

12 245. The duty of loyalty under ERISA requires fiduciaries to speak
13 truthfully to participants, not to mislead them regarding the plan or plan assets, and
14 to disclose information that participants need in order to exercise their rights and
15 interests under the plan. This duty to inform participants includes an obligation to
16 provide participants and beneficiaries of the plan with complete and accurate
17 information, and to refrain from providing false information or concealing material
18 information, regarding plan investment options such that participants can make
19 informed decisions with regard to the prudence of investing in such options made
20 available under the plan. This duty applies to all of the Plans’ investment options,
21 including investment in Fremont stock.

22 246. The Defendants breached their duty to inform participants by failing
23 to provide complete and accurate information regarding Fremont’s serious
24 mismanagement and improper business practices, public misrepresentations and
25 material accounting irregularities, and the consequential artificial inflation of the
26 value of Fremont stock, and, generally, by conveying incomplete information
27 regarding the soundness of Fremont stock and the prudence of investing and
28 holding retirement contributions in Fremont equity. These failures were

1 particularly devastating to the Plans and their participants; a heavy percentage of
2 the Plans' assets were invested in Fremont stock during the Class Period and, thus,
3 losses in this investment had a significant impact on the value of participants'
4 retirement assets.

5 247. Defendants' omissions clearly were material to participants' ability to
6 exercise informed control over their Plan accounts, as in the absence of such
7 information, participants did not know the true risks presented by the Plans'
8 investment in Fremont stock.

9 248. Defendants' omissions and incomplete statements alleged herein were
10 Plan-wide and uniform in that Defendants failed to provide complete and accurate
11 information to any of the Plans' participants.

12 249. Periodically during the Class Period, Fremont or its delegate, as the
13 Plan Administrator, disseminated information to the participants of the Plans
14 including Summary Plan Descriptions ("SPD") for the Plans. The SPDs and, on
15 information and belief, other information disseminated by Fremont to the
16 participants of the Plans, incorporated by reference the SEC filings, which
17 contained omissions and misstatements regarding the financial condition of the
18 Fremont and its results of operations. *See* 401(k) Plan SPD at FGC-ERISA 00424-
19 425 (Incorporating by reference the following documents filed with the SEC by the
20 Company: the Company's Annual Report on Form 10-K for the fiscal year ended
21 December 31, 2003, filed with the SEC on March 15, 2004; the Company's
22 Quarterly Report on Form 10-Q for the quarters ended June 30, 2004; March 31,
23 2004; and September 30, 2003 filed with the SEC on August 9, 2004, May 10,
24 2004; and November 14, 2003, respectively; the Company's Current Reports on
25 Form 8-K, filed with the SEC on January 29, 2004; May 21, 2004; May 27, 2004;
26 and June 18, 2004; and the description of the Company's Common Stock
27 contained in the Registration Statements on Form S-8 filed with the SEC on March
28 23, 1993; October 17, 1997; and November 20, 2000 respectively, pursuant to

1 Section 12(b) of the Exchange Act and any amendments or reports filed for the
2 purpose of updating such description).

3 250. As a direct and proximate result of the breaches of fiduciary duties
4 alleged herein, the Plans, and indirectly Plaintiffs and the Plans' other participants
5 and beneficiaries, lost a significant portion of their retirement investment.

6 251. Pursuant to ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2) and ERISA
7 § 409(a), 29 U.S.C. § 1109(a), Defendants in this Count are liable to restore the
8 losses to the Plans caused by their breaches of fiduciary duties alleged in this
9 Count.

10 **D. Count IV: Co-Fiduciary Liability**

11 252. Plaintiffs incorporate by this reference the allegations above.

12 253. This Count alleges co-fiduciary liability against the following
13 Defendants: all Defendants (the "Co-Fiduciary Defendants").

14 254. As alleged above, during the Class Period the Co-Fiduciary
15 Defendants were named fiduciaries pursuant to ERISA § 402(a)(1), 29 U.S.C. §
16 1102(a)(1), or *de facto* fiduciaries within the meaning of ERISA § 3(21)(A), 29
17 U.S.C. § 1002(21)(A), or both. Thus, they were bound by the duties of loyalty,
18 exclusive purpose, and prudence.

19 255. As alleged above, ERISA § 405(a), 29 U.S.C. § 1105, imposes
20 liability on a fiduciary, in addition to any liability which he may have under any
21 other provision, for a breach of fiduciary responsibility of another fiduciary with
22 respect to the same plan if knows of a breach and fails to remedy it, knowingly
23 participates in a breach, or enables a breach. The Co-Fiduciary Defendants
24 breached all three provisions.

25 256. **Knowledge of a Breach and Failure to Remedy.** ERISA §
26 405(a)(3), 29 U.S.C. § 1105, imposes co-fiduciary liability on a fiduciary for a
27 fiduciary breach by another fiduciary if, he has knowledge of a breach by such
28 other fiduciary, unless he makes reasonable efforts under the circumstances to

1 remedy the breach. Each Defendant knew of the breaches by the other fiduciaries
2 and made no efforts, much less reasonable ones, to remedy those breaches. In
3 particular, they did not communicate their knowledge of the Company's improper
4 activity to the other fiduciaries.

5 257. Fremont, through its officers and employees, engaged in highly risky
6 and inappropriate business practices, withheld material information from the
7 market, and profited from such practices, and, thus, knowledge of such practices is
8 imputed to Fremont as a matter of law.

9 258. Because Defendants knew of the Company's failures and
10 inappropriate business practices, they also knew that the Defendants were
11 breaching their duties by continuing to invest in Company stock. Yet, they failed
12 to undertake any effort to remedy these breaches. Instead, they compounded them
13 by downplaying the significance of Fremont's failed and inappropriate business
14 practices, and obfuscating the risk that the practices posed to the Company, and,
15 thus, to the Plans.

16 259. **Knowing Participation in a Breach.** ERISA § 405(a)(1), 29 U.S.C.
17 § 1105(1), imposes liability on a fiduciary for a breach of fiduciary responsibility
18 of another fiduciary with respect to the same plan if he participates knowingly in,
19 or knowingly undertakes to conceal, an act or omission of such other fiduciary,
20 knowing such act or omission is a breach. Fremont knowingly participated in the
21 fiduciary breaches of the Defendants in that it benefited from the sale or
22 contribution of its stock at prices that were disproportionate to the risks for the
23 Plans' participants. Likewise, Monitoring Defendants knowingly participated in
24 the breaches of the Defendants because, as alleged above, they had actual
25 knowledge of the facts that rendered Fremont stock an imprudent retirement
26 investment and yet, ignoring their oversight responsibilities, permitted the
27 Defendants to breach their duties.

1 participant control over the investment decision-making process, as required by
2 ERISA § 404(c), 29 U.S.C. § 1104(c), and the regulations promulgated thereunder.

3 266. The Defendants also are liable for losses that resulted from their
4 decision to invest a majority of the assets of the Plans in Fremont stock rather than
5 cash or other short-term investment options, as authorized by the Plans, and clearly
6 prudent under the circumstances presented here.

7 267. Had the Defendants properly discharged their fiduciary and co-
8 fiduciary duties, including the monitoring and removal of fiduciaries who failed to
9 satisfy their ERISA-mandated duties of prudence and loyalty, eliminating Fremont
10 stock as an investment alternative when it became imprudent, and divesting the
11 Plans of Fremont stock when maintaining such an investment became imprudent,
12 the Plans would have avoided some or all of the losses that they, and indirectly, the
13 participants suffered.

14 **XIII. REMEDY FOR BREACHES OF FIDUCIARY DUTY**

15
16 268. The Defendants breached their fiduciary duties in that they knew or
17 should have known the facts as alleged above, and therefore knew or should have
18 known that the Plans' assets should not have been invested in Fremont stock
19 during the Class Period.

20 269. As a consequence of the Defendants' breaches, the Plans suffered
21 significant losses.

22 270. ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2) authorizes a plan
23 participant to bring a civil action for appropriate relief under ERISA § 409, 29
24 U.S.C. § 1109. Section 409 requires "any person who is a fiduciary...who
25 breaches any of the...duties imposed upon fiduciaries...to make good to such plan
26 any losses to the plan...." Section 409 also authorizes "such other equitable or
27 remedial relief as the court may deem appropriate...."
28

1 271. With respect to calculation of the losses to the Plans, breaches of
2 fiduciary duty result in a presumption that, but for the breaches of fiduciary duty,
3 the Plans would not have made or maintained their investments in the challenged
4 investment and, instead, prudent fiduciaries would have invested the Plans' assets
5 in the most profitable alternative investment available to them. Alternatively,
6 losses may be measured not only with reference to the decline in stock price
7 relative to alternative investments, but also by calculating the additional shares of
8 Fremont stock that the Plans would have acquired had the Plan fiduciaries taken
9 appropriate steps to protect the Plans. The Court should adopt the measure of loss
10 most advantageous to the Plans. In this way, the remedy restores the Plans' lost
11 value and puts the participants in the position they would have been in if the Plans
12 had been properly administered.

13 272. Plaintiffs and the Class are therefore entitled to relief from the
14 Defendants in the form of: (a) a monetary payment to the Plans to make good to
15 the Plans the losses to the Plans resulting from the breaches of fiduciary duties
16 alleged above in an amount to be proven at trial based on the principles described
17 above, as provided by ERISA § 409(a), 29 U.S.C. § 1109(a); (b) injunctive and
18 other appropriate equitable relief to remedy the breaches alleged above, as
19 provided by ERISA §§ 409(a), 502(a)(2) and (3), 29 U.S.C. §§ 1109(a),
20 1132(a)(2) and (3); (c) injunctive and other appropriate equitable relief pursuant to
21 ERISA § 502(a)(3), 29 U.S.C. 1132(a)(3), for knowing participation by a non-
22 fiduciary in a fiduciary breach; (d) reasonable attorney fees and expenses, as
23 provided by ERISA § 502(g), 29 U.S.C. § 1132(g), the common fund doctrine, and
24 other applicable law; (e) taxable costs and interest on these amounts, as provided
25 by law; and (6) such other legal or equitable relief as may be just and proper.

26 273. Under ERISA, each Defendant is jointly and severally liable for the
27 losses suffered by the Plans in this case.
28

XIV. CLASS ACTION ALLEGATIONS

1
2
3 274. **Class Definition.** Plaintiffs bring this action as a class action
4 pursuant to Rules 23(a), (b)(1), (b)(2) and (b)(3) of the Federal Rules of Civil
5 Procedure on behalf of Plaintiffs and the following class of persons similarly
6 situated (the “Class”):

7 275. All persons, other than Defendants, who were participants in or
8 beneficiaries of the Plans at any time between January 1, 2005 and the present, and
9 whose accounts included investments in Fremont stock.

10 276. **Class Period.** The fiduciaries of the Plans knew or should have
11 known at least by January 1, 2005 that the Company’s material weaknesses were
12 so pervasive that Fremont stock could no longer be offered as a prudent investment
13 for retirement Plans.

14 277. **Numerosity.** The members of the Class are so numerous that joinder
15 of all members is impracticable. While the exact number of Class members is
16 unknown to Plaintiffs at this time, and can only be ascertained through appropriate
17 discovery, Plaintiffs believe there are, based on the Plans’ Form 5500s for Plan
18 year 2005, 3,338 active participants in the 401(k) Plan and 1,496 active
19 participants in the ESOP who participated in, or were beneficiaries of, the Plans
20 during the Class Period.

21 278. **Commonality.** Common questions of law and fact exist as to all
22 members of the Class and predominate over any questions affecting solely
23 individual members of the Class. Among the questions of law and fact common to
24 the Class are:

- 25 (a). whether Defendants each owed a fiduciary duty to Plaintiffs
26 and members of the Class;
27 (b). whether Defendants breached their fiduciary duties to Plaintiffs
28 and members of the Class by failing to act prudently and solely in the

1 interests of the Plans' participants and beneficiaries;

2 (c). whether Defendants violated ERISA; and

3 (d). whether the Plans have suffered losses and, if so, what is the
4 proper measure of damages.

5 279. **Typicality.** Plaintiffs' claims are typical of the claims of the members
6 of the Class because: (1) to the extent Plaintiffs seek relief on behalf of the Plans
7 pursuant to ERISA § 502(a)(2), their claim on behalf of the Plans is not only
8 typical to, but identical to a claim under this section brought by any Class member;
9 and (2) to the extent Plaintiffs seek relief under ERISA § 502(a)(3) on behalf of
10 themselves for equitable relief, that relief would affect all Class members equally.

11 280. **Adequacy.** Plaintiffs will fairly and adequately protect the interests
12 of the members of the Class and have retained counsel competent and experienced
13 in class action, complex, and ERISA litigation. Plaintiffs have no interests
14 antagonistic to or in conflict with those of the Class.

15 281. **Rule 23(b)(1)(B) Requirements.** Class action status in this ERISA
16 action is warranted under Rule 23(b)(1)(B) because prosecution of separate actions
17 by the members of the Class would create a risk of adjudications with respect to
18 individual members of the Class which would, as a practical matter, be dispositive
19 of the interests of the other members not parties to the actions, or substantially
20 impair or impede their ability to protect their interests.

21 282. **Other Rule 23(b) Requirements.** Class action status is also
22 warranted under Rule 23(b)(1)(a) because prosecution of separate actions by the
23 members of the Class would create a risk of establishing incompatible standards of
24 conduct for Defendants; and under 23(b)(2) because Defendants have acted or
25 refused to act on grounds generally applicable to the Class, thereby making
26 appropriate final injunctive, declaratory, or other appropriate equitable relief with
27 respect to the Class as a whole; and in the alternative under 23(b)(3) because
28 questions of law or fact common to members of the Class predominate over any

1 questions affecting only individual members and a class action is superior to the
2 other available methods for the fair and efficient adjudication of this controversy.

3
4 **XV. PRAYER FOR RELIEF**

5 WHEREFORE, Plaintiffs pray for:

6 A. A Declaration that the Defendants, and each of them, have breached
7 their ERISA fiduciary duties to the participants;

8 B. A Declaration that the Defendants, and each of them, are not entitled
9 to the protection of ERISA § 404(c)(1)(B), 29 U.S.C. § 1104(c)(1)(B);

10 C. An Order compelling the Defendants to make good to the Plans all
11 losses to the Plans resulting from Defendants' breaches of their fiduciary duties,
12 including losses to the Plans resulting from imprudent investment of the Plans'
13 assets, and to restore to the Plans all profits the Defendants made through use of
14 the Plans' assets, and to restore to the Plans all profits which the participants would
15 have made if the Defendants had fulfilled their fiduciary obligations;

16 D. Imposition of a Constructive Trust on any amounts by which any
17 Defendant was unjustly enriched at the expense of the Plans as the result of
18 breaches of fiduciary duty;

19 E. An Order requiring Defendants to appoint one or more independent
20 fiduciaries to participate in the management of the Plans' investment in Fremont
21 stock;

22 F. Actual damages in the amount of any losses the Plans suffered;

23 G. An Order awarding costs pursuant to 29 U.S.C. § 1132(g);

24 H. An Order awarding attorneys' fees pursuant to the common fund
25 doctrine, 29 U.S.C. § 1132(g), and other applicable law; and

1 I. An Order for equitable restitution and other appropriate equitable and
2 injunctive relief against the Defendants.

3 DATED this 25th day of October, 2007.

4 BRAUN LAW GROUP, P.C.

5 

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1 **CERTIFICATE OF SERVICE**

2 STATE OF CALIFORNIA)
3) ss.:
4 COUNTY OF LOS ANGELES)

5 I am employed in the county of Los Angeles, State of California, I am over
6 the age of 18 and not a party to the within action; my business address is 12304
7 Santa Monica Boulevard, Suite 109, Los Angeles, California 90025.

8 On October 25, 2007, I served the foregoing document described as
9 ***CONSOLIDATED COMPLAINT FOR BREACHES OF FIDUCIARY DUTY***
10 ***UNDER ERISA*** by placing a true copies thereof enclosed in a sealed
11 envelope(s) addressed as follows:

12 --SEE ATTACHED SERVICE LIST--

13 I served the above document(s) as follows:

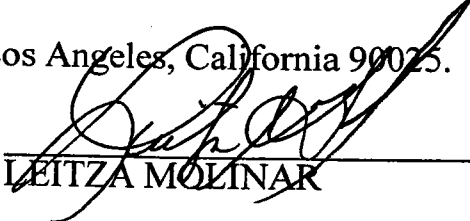
14 BY FACSIMILE TRANSMISSION. I caused a facsimile machine
15 transmission from facsimile machine telephone number (310) 442-7756 to the
16 facsimile machine telephone number(s) listed above. Upon completion of said
17 facsimile machine transmission(s), the transmitting machine issued a transmission
18 report(s) showing the transmission(s) was/were complete and without error.

19 BY E-MAIL. I caused the above document to be transmitted by PDF
20 format, to the parties and e-mail addresses indicated on the Service List.

21 I declare that I am employed in the office of a member of the bar of this court
22 at whose direction the service was made.

23 I further declare under penalty of perjury under the laws of the United States
24 of America that the above is true and correct.

25 Executed on October 25, 2007, at Los Angeles, California 90025.

26 
LEITZA MOLINAR