SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER

MBIA INSURANCE CORPORATION,

Plaintiff,

-against-

J.P. MORGAN SECURITIES LLC (f/k/a BEAR, STEARNS & CO. INC.),

Defendant.

Index No. 64676/2012
Commercial Division
Scheinkman, J.

FIRST AMENDED COMPLAINT

Plaintiff MBIA Insurance Corporation ("MBIA"), by its attorneys, Quinn Emanuel Urquhart & Sullivan, LLP, for its Complaint herein against J.P. Morgan Securities LLC ("J.P. Morgan Securities" or "Defendant") alleges as follows:

NATURE OF THE ACTION

1. MBIA seeks to recover damages it suffered as a result of the fraudulent acts and omissions by Defendant's predecessor-in-interest, Bear, Stearns & Co. Inc. ("Bear Stearns") to induce MBIA to issue a financial-guaranty-insurance policy in connection with the GMAC Mortgage Corporation Home Equity Loan Trust 2006-HE4 (the "2006-HE4 Securitization"). Bear Stearns was the lead securities underwriter on the 2006-HE4 Securitization.

2. To make the securities issued by the 2006-HE4 Securitization more marketable, Bear Stearns sought a financial guaranty insurer to guarantee the trust's payments to investors in the event that cash flows to the trust were impaired by the failure of mortgage borrowers to make payments of principal and interest. To secure MBIA's agreement to provide this insurance, the sponsor of the securitization, GMAC Mortgage Corporation ("GMAC Mortgage"), made a set of comprehensive representations and warranties to MBIA about the characteristics of the securitized loans and the underwriting standards under which they were originated. Among

other things, GMAC Mortgage represented and warranted to MBIA that the securitized loans were underwritten generally in accordance with GMAC Mortgage's underwriting standards and complied in all material respects with applicable local, state, and federal laws.

3. To induce MBIA to insure the 2006-HE4 Securitization, Bear Stearns agreed to arrange for a third party to perform a due-diligence review designed to test the accuracy of the representations and warranties that GMAC Mortgage made to MBIA, and to provide MBIA with the results of that review. In furtherance of that obligation, Bear Stearns hired a third-party underwriting firm—Mortgage Data Management Corporation ("MDMC")—to perform the due-diligence review on a random sample of the loans within the collateral pool. That review was designed to assess the extent to which the originators of the loans in the pool may have failed to adhere to the loan-underwriting guidelines of GMAC Mortgage and applicable laws and regulations when originating the loans. It was an explicit condition of MBIA's bid to provide financial guaranty insurance that Bear Stearns must provide MBIA with the results of this due-diligence review, and Bear Stearns knew that MBIA needed to know whether the results of the due diligence review showed problems in the underlying collateral pool.

4. When MDMC reviewed the loan files for the sample of the loans in the 2006-HE4 transaction, it found a host of serious problems. Most importantly, MDMC concluded that approximately one-third of the loans in the sample had not been originated in compliance with GMAC Mortgage's loan-underwriting guidelines or with applicable laws. MDMC provided these results to Bear Stearns in the form of electronic spreadsheets that assigned a "grade" from "1" to "3" for each loan (with a grade of 3 indicating a "large, possibly unacceptable risk" or an "unacceptable serious compliance violation"), and described the numerous problems that MDMC found.

5. Rather than share the actual results with MBIA, as was its obligation, Bear Stearns refrained from providing MBIA with any information about the due diligence review for over a week—despite requests from MBIA expressing its need for same. Bear Stearns then, only hours before the closing of the transaction, sent MBIA an altered report, in an attempt to fraudulently conceal the problems that MDMC had found. In particular, Bear Stearns knowingly removed from MDMC's spreadsheets approximately 50 columns of information indicating underwriting and compliance problems with loans, including the columns specifying the grades for each loan and each entry that indicated MDMC had given a loan a failing "grade 3." Bear Stearns then sent the altered report to MBIA.

6. MBIA relied on Bear Stearns as underwriter to inform MBIA if the results of the due diligence review showed issues with the underlying collateral, including through the report that it received, which had been altered by Bear Stearns, in deciding to issue its financial-guaranty insurance policy for the 2006-HE4 Securitization.

7. The policy that Bear Stearns fraudulently induced MBIA to issue enabled Bear Stearns to market the securities issued in the 2006-HE4 Securitization with a credit rating of "AAA," the highest possible investment grade. Bear Stearns's deception thus helped it to sell hundreds of millions of dollars worth of securities to investors, while transferring risks that it knew about and actively concealed, to investors and ultimately MBIA.

8. Bear Stearns's success in concealing the risks embedded in the collateral pool of the 2006-HE4 securitization has caused MBIA to suffer significant harm. Since closing, the number of delinquencies and charge-offs for mortgage loans in the collateral pool of the 2006-HE4 Securitization have been much higher than would be expected for pools of loans that conformed to GMAC Mortgage's Underwriting Guidelines and complied with applicable laws.

The losses experienced by the 2006-HE4 Securitization have caused MBIA to pay, as of September 2014, approximately $188 million in claims. Because Bear Stearns's fraud and concealment caused MBIA to issue a policy that it never would have issued otherwise, MBIA is entitled to recover from Bear Stearns, at a minimum, the value of claims payments that MBIA has made.

PARTIES

9. Plaintiff MBIA is a New York corporation with its principal place of business at 113 King Street, Armonk, New York. MBIA is one of the nation's oldest and largest monoline insurers, and provides financial guaranty insurance and other forms of credit protection, generally on financial obligations, which are sold in the new issue and secondary markets.

10. Defendant J.P. Morgan Securities is a Delaware limited liability company with its principal place of business at 277 Park Avenue, New York, New York. J.P. Morgan Securities was formerly known as J.P. Morgan Securities Inc. On or about September 1, 2010, J.P. Morgan Securities Inc. was converted into a limited liability company. J.P. Morgan Securities is an SEC-registered broker-dealer, engages in investment banking activities in the United States, and is the primary nonbank subsidiary of J.P. Morgan Chase. J.P. Morgan Securities is the successor-in-interest to Bear, Stearns & Co. Inc.

11. Bear Stearns was, at all relevant times, an SEC-registered broker-dealer with its principal place of business at 383 Madison Avenue, New York, New York. Bear Stearns was a wholly owned subsidiary of The Bear Stearns Companies, Inc. Bear Stearns was the lead securities underwriter for the 2006-HE4 Securitization.

12. On or about October 1, 2008, J.P. Morgan Securities merged with and into Bear Stearns, and the surviving entity was renamed J.P. Morgan Securities Inc. J.P. Morgan Chase's 2008 Annual Report described the transaction between J.P. Morgan Securities and Bear Stearns

as a merger: "On October 1, 2008, J.P. Morgan Securities Inc. merged with and into Bear, Stearns & Co. Inc., and the surviving entity changed its name to J.P. Morgan Securities Inc." The former Bear Stearns website redirects customers to J.P. Morgan Securities' website. On information and belief, Bear Stearns no longer exists. Defendant J.P. Morgan Securities is thus the successor-in-interest to Bear Stearns by merger. All allegations against Bear Stearns are thus made against its successor-in-interest, Defendant J.P. Morgan Securities.

JURISDICTION AND VENUE

13. This Court has jurisdiction over this proceeding pursuant to CPLR §§ 301 and 302. Defendant J.P. Morgan Securities is subject to personal jurisdiction in this Court because J.P. Morgan Securities is authorized to do business within New York and regularly transacts business within the State.

14. Venue is proper in this Court pursuant to CPLR § 503(a) and 503(c). Plaintiff MBIA resides in and maintains its principal place of business in Westchester County, New York.

FACTUAL ALLEGATIONS

A. The 2006-HE4 Securitization

15. Asset-backed securitization is the process by which risk is distributed by pooling cash-producing financial assets, such as mortgage loans, and issuing securities backed by the pool.

16. The 2006-HE4 Securitization involved the most common form of securitization of mortgage loans. That form involves a sponsor—the original owner of the mortgages, in this case, GMAC Mortgage—and the creation of a trust—here, GMACM Home Equity Loan Trust 2006-HE4 (the "2006-HE4 Trust")—to which the sponsor sells a portfolio of mortgage loans. After receiving the portfolio of mortgage loans, the trust will issue debt securities using the pool of loans as collateral. Investors in those securities acquire rights to the income flowing from the

mortgage pools. This income is generated by homeowners' payments of principal and interest on the mortgage loans held by the trust.

17. The securities issued by the 2006-HE4 Trust here were initially purchased by a number of securities underwriters, including Bear Stearns, which was the lead securities underwriter on the 2006-HE4 Securitization. Bear Stearns, in turn, offered and managed the sale of the securities to investors. Underwriters of residential-mortgage-backed securities ("RMBS") ordinarily collect a percentage of between 0.2% and 1.5% of the sale of the securities in discounts, concessions, or commissions. These commissions could yield millions of dollars at closing in a deal the size of the 2006-HE4 Securitization, the notes from which had an aggregate balance of $1,159,060,631 at closing.

18. In addition to offering and selling the securities to investors, as lead securities underwriter, Bear Stearns was responsible for: (a) soliciting bids from monoline insurers and providing to the monoline insurers the information needed by them; (b) working with GMAC Mortgage to structure the Securitization, price the Securitization, and select the monoline insurer for the Securitization; (c) taking the lead in coordinating the flow of documents and information among the parties and persons involved in the Securitization; and (d) retaining a third-party due-diligence firm to perform due diligence to ensure that the loans were originated in compliance with GMAC Mortgage's underwriting guidelines and applicable laws.

19. To decrease the risk to investors of a shortfall in cash flows to the trust, and to make the securitization more attractive to investors, the Securitization included additional credit "enhancement" in the form of a financial-guaranty-insurance policy issued by MBIA. Under the terms of that policy, MBIA, in consideration of a premium and subject to the terms and conditions of the policy, guaranteed to investors that in the event there is a shortfall in cash flows

to the trust, MBIA would insure certain payments with respect to current interest and ultimate principal to the trustee for the benefit of the investors. In this way, the risk to the investors of a shortfall in the anticipated cash flows to the trust is mitigated, thus increasing the marketability and pricing of the securities. The insurance obtained from MBIA enabled Bear Stearns to market the 2006-HE4 securities with a credit rating of AAA, instead of the lower credit rating appropriate for the collateral and structure of the Securitization alone.

20. The underwriter Bear Stearns undertook the responsibility—along with GMAC Mortgage—for selecting an insurer. Bear Stearns initiated contact with MBIA and was responsible for soliciting a bid from MBIA for insuring the Securitization on behalf of the eventual insured entity: the 2006-HE4 Trust. Bear Stearns provided MBIA with the information about the Securitization that MBIA used to decide whether to bid on insuring the Securitization—including the preliminary and final loan tapes containing information regarding the collateral underlying the Securitization—communicated only with Bear Stearns about its bid, and transmitted both its initial bid and its final bid letter via e-mail to an employee of Bear Stearns. Likewise, the Time and Responsibility Schedule for the Securitization listed Bear Stearns and GMAC Mortgage as responsible for "Select[ing the] Monoline," and e-mail traffic confirmed that MBIA was selected as insurer by both GMAC Mortgage and Bear Stearns. After Bear Stearns and GMAC Mortgage selected MBIA as insurer for the Securitization, Bear Stearns was responsible for informing MBIA that it had been selected and continued afterward to serve as an intermediary between MBIA and the other parties—including the issuer GMAC Mortgage and the insured entity 2006-HE4 Trust.

21. Because the cash flow from the underlying loans is the source of payments to investors, the risk of a shortfall in that cash flow, and therefore the risk that MBIA will be

required to pay claims made by investors, is a function of the credit quality of the loans in the collateral pool. If, for instance, the lender that originated the mortgage loans employed substandard underwriting practices, risk increases. Among the factors that determine the interest rate of a loan are the degree to which the borrower is required to verify his or her income, the borrower's credit score and employment history, and the amount of equity the borrower has in the mortgaged property. For example, a borrower who is not required to verify income and has little or no equity in his or her home typically pays a higher interest rate. Likewise, the value of a pool of mortgage loans depends on the quality of the loans, because a pool in which there is a higher risk of delinquencies and charge-offs is deemed more likely to suffer impaired cash flows. Based on its assessment of the risk of impaired cash flows, an insurer may decide not to provide insurance on a particular transaction, ask that the transaction be structured to provide additional protection against losses, or increase premiums to reflect the risk.

22. Accordingly, the ability of the market, or of a potential financial guaranty insurer, to accurately assess risk depends on the information it has regarding the quality of the underlying mortgage loans and the standards used to originate those loans.

23. The most important information about the credit quality of the loans is contained in the "loan files" that the mortgage originators compile while assessing loan applications and securities underwriters have reviewed as part of their due diligence when structuring the transaction.

24. For residential mortgage loans, a loan file generally contains the borrower's application for the loan; documents relating to verification of the borrower's income, assets, and employment; references; credit reports on the borrower; an appraisal of the property that will secure the loan and provide the basis for measures of credit quality, such as loan-to-value ratios;

and a statement of the occupancy status of the property. The loan file also typically contains the record of the investigation by the loan originator of the documents and information provided by the borrower, as well as detailed notes of the loan underwriter setting forth the rationale for the approval of each loan.

25. As Bear Stearns knew, MBIA had no contractual right to receive copies of these loan files before the 2006-HE4 Securitization closed, nor any meaningful opportunity to do so. The 2006-HE4 Securitization closed a matter of weeks after MBIA first learned of it through a solicitation by Bear Stearns to bid. Instead of re-underwriting the thousands of loans contributed to the pool, in accordance with the custom and practice of financial guaranty insurers at the time, MBIA relied on comprehensive representations and warranties by GMAC Mortgage and assurances by Bear Stearns regarding the quality of the underlying loans and the standards under which they had been originated as determined by the results of a due-diligence review of loan files associated with a sample of the loans within the collateral pool, which was performed by a third party and which indicated whether the collateral pool appeared consistent with the representations, warranties, and information about the collateral pool received by MBIA.

26. The collateral pool for the 2006-HE4 Securitization included thousands of loans—17,342 at the time of closing. The sponsor and underwriter were responsible for gathering, verifying, and presenting to investors and financial guaranty insurers accurate and complete information about the credit quality and characteristics of the loans that were deposited into the trust. Under standard industry practice at that time, it was the security underwriter's responsibility to make interested parties aware of any issues arising in the due diligence review. The security underwriter was also expected to use the results of the loan-file due diligence review as a basis for satisfying its own due diligence responsibilities under the federal securities

law with respect to the related mortgage loan pool. When an underwriter allows a securitization to close without raising any issues with the due diligence to the insurer—or without altering its disclosure, the collateral pool, or the structure of Securitization—it affirms to the insurer that no material issues with the collateral pool have been uncovered by the loan-file due diligence review.

27. The ability of the investor or MBIA to accurately assess the risks associated with the 2006-HE4 Securitization depended entirely on the truthfulness of the information provided to it about the quality of the loan pool and the underwriting standards used to assemble that pool. The investors and MBIA took responsibility for certain risks not within the sponsor's control, such as risks created by changes in interest rates. However, neither MBIA nor the investors are responsible for the risks hidden behind inaccurate representations about the securitized collateral. To the contrary, MBIA relied upon the information provided to it by Bear Stearns to assess those risks.

B. Bear Stearns Fraudulently Induced MBIA To Insure the 2006-HE4 Securitization

1. MBIA Relied on Bear Stearns to Alert It to Any Issues with the Due-Diligence Results

28. To induce MBIA to write financial guaranty insurance for the 2006-HE4 Securitization, Bear Stearns provided to MBIA information about loans within the collateral pool. Among other things, Bear Stearns provided MBIA with two key categories of information: (1) information about the conformity of those loans with GMAC Mortgage's loan underwriting guidelines ("GMAC Mortgage's Underwriting Guidelines"); and (2) information about the compliance of those loans with applicable laws and regulations.

29. Bear Stearns provided MBIA with information about the adherence of the loans within the collateral pool to GMAC Mortgage's Underwriting Guidelines in a Preliminary

Prospectus Supplement dated September 21, 2006, and in a Final Prospectus Supplement dated September 25, 2006, that also would be filed with the SEC on or before the day the 2006-HE4 transaction closed. In the Prospectus Supplements, Bear Stearns makes specific representations describing GMAC Mortgage's underwriting standards, including the criteria set forth in GMAC Mortgage's Underwriting Guidelines applicable to the GMAC Mortgage Home Equity Program. According to the Prospectus Supplements, the Underwriting Guidelines set forth the types of documentation that borrowers must provide and should be included in the mortgage loan file, under each loan program. This documentation can include the loan application, verifications of income, assets, funds available to the borrower at closing, and mortgage payment histories. GMAC Mortgage's Underwriting Guidelines also require appraisals of the mortgaged property and an underwriter's assessment of whether the applicable thresholds for the borrower's debt-to-income ratio, or "DTI," and combined loan-to-value ratio, or "CLTV," are met.

30. For example, according to the Prospectus Supplements, the Underwriting Guidelines provide that to qualify for a "Standard" program loan—one requiring full documentation—a borrower applying for a loan mortgaged by his primary residence must fill out a detailed application providing pertinent credit information, including tax returns, pay stubs, or a W-2, and must provide authorization for GMAC Mortgage to obtain a credit report. The borrower is also required to provide an appraisal of the subject property, or collateral.

31. The Prospectus Supplements also state that an important variable in evaluating a loan under the GMAC Mortgage's Underwriting Guidelines is the level of documentation of a borrower's income and assets. According to the Prospectus Supplements, a borrower can apply for a loan through programs that require significantly less documentation from the borrower than that required under the "Standard" full documentation program. These reduced documentation

programs—which typically charge higher interest rates—include the "Stated Income," "Stated Value," and "No Income/No Appraisal" programs, among others. For these loan programs, and unlike the "Standard" full documentation program, GMAC Mortgage does not independently verify a borrower's income (in the case of "Stated Income" loans), the value of the collateral (in the case of "Stated Value" loans), or either income or collateral value (in the case of "No Income/No Appraisal" loans).

32. Critically, although income is not independently verified in Stated Income loans, such loans remain subject to the requirement that the borrower's income be reasonable in light of three main factors: employment, credit, and assets. For every program, GMAC Mortgage's Underwriting Guidelines, and prevailing mortgage origination industry standards, require an underwriter to determine, after receiving all applicable employment, credit, and property information, whether the borrower is able to meet his or her monthly loan payments and other expenses related to the home, such as taxes, insurance, and debt service on senior liens.

33. The Prospectus Supplements, prepared by Bear Stearns and provided to MBIA, expressly state that all mortgage loans contributed to the pool were underwritten generally in accordance with GMAC Mortgage's underwriting standards. Bear Stearns knew that this was untrue, because of the results of MDMC's due diligence review, but did nothing to change this statement or alert MBIA to the fact that the statement was untrue.

34. Bear Stearns also made no changes to the structure of the Securitization, to the collateral pool—either by removing or exchanging loans in the pool—or to its disclosure as security underwriter. As Bear Stearns knew, MBIA would have seen such changes as potential red flags regarding the quality of the collateral underlying the Securitization.

35. Additionally, Bear Stearns was aware that MBIA received a copy of the Mortgage Loan Purchase Agreement under which the loans were sold to the trust. This agreement states GMAC Mortgage's representation and warranty that to the best of GMAC Mortgage's knowledge, the loan agreements and mortgages at the time made complied in all material respects with applicable local, state, and federal laws, including, but not limited to, applicable predatory lending laws.

36. As a means of ensuring that the information it received from Bear Stearns and others about the loans in the collateral pool for the 2006-HE4 securitization was accurate, MBIA included within its bid to provide financial guaranty insurance a requirement that GMAC Mortgage and Bear Stearns share with MBIA the results of a third-party due-diligence review of the loan files relating to the loans in the pool.

37. In accordance with industry standards, this responsibility involves performing due diligence on a sample of the loan pool to ensure that the representations made to investors and insurers are accurate regarding the entire pool.

38. This review was routinely performed by a third-party accounting or underwriting firm. The results of the third-party due-diligence review were designed to identify the extent to which the origination practices applied to the loans in the collateral pool failed to comply with GMAC Mortgage's Underwriting Guidelines and applicable laws and regulations, and indicated whether the representations made to the insurer about the loan pool were accurate.

39. For the Securitization, Bear Stearns retained the third-party underwriter MDMC to perform this due-diligence review. To complete its review, MDMC examined each of the loan files included within a random sample, selected by Bear Stearns, of the loans within the collateral pool. MDMC reviewed each loan file in the areas of "credit," which refers to the

loan's adherence to GMAC Mortgage's Underwriting Guidelines, and "compliance," which refers to the loan's compliance with applicable laws and regulations. MDMC then graded each loan in each of these two areas. Each loan received a grade of 1–3 in the "credit" category. Within that category, a grade of "1" indicated that the loan adhered strictly to GMAC Mortgage's Underwriting Guidelines; a grade of "2" indicated that the loan failed to adhere to those guidelines, but compensating factors made the loan an acceptable risk; and a grade of "3" indicated that the loan origination failed to adhere to the guidelines and represented a large, possibly unacceptable risk. Each loan also received a grade of "1" to "3" for "compliance" with federal and state laws and regulations. A grade of "1" indicated that the loan was fully compliant; a grade of "2" indicated that infractions existed, but they were immaterial; and a grade of "3" indicated that the loan represented an unacceptable, serious compliance violation.

40. On September 27, 2006—only hours prior to the closing—Bear Stearns provided to MBIA what it described as "the due diligence report" for the 2006-HE4 transaction.

41. As Bear Stearns was well aware, "MBIA need[ed]" to know the results of the due diligence, because "they are wrapping the deal," and that MBIA would not "execute their agreement if [Bear Stearns didn't] have [the] due diligence [results]." In particular, Bear Stearns knew that MBIA would not agree to provide financial guaranty insurance if the results of the due diligence review revealed any significant credit or compliance violations. MBIA had no contractual right to review loan-origination files before the 2006-HE4 Securitization closed, nor any meaningful opportunity to do so. Accordingly, MBIA relied on Bear Stearns to inform it if MDMC's due-diligence review revealed any risks in the loan files, to ensure that those risks were known and fully disclosed and that MBIA would not face additional hidden risks.

42. Based on the belief that the due-diligence results did not show any issues with the underlying collateral, MBIA agreed to provide financial guaranty insurance for the 2006-HE4 Securitization. Accordingly, on September 27, 2006, MBIA—along with the other parties to the Securitization—proceeded to close on the Securitization. In doing so, MBIA and Bear Stearns entered into various agreements, including (1) the Insurance Agreement between MBIA, GMAC Mortgage, Walnut Grove, Home Equity Loan Trust 2006-HE4, Residential Asset Mortgage Products, Inc. ("RAMP"), Wilmington Trust, and J.P. Morgan Chase Bank, N.A. (the "Insurance Agreement"), which conditions the issuance of the policy on, among other things, the satisfaction of conditions of Bear Stearns's Underwriting Agreement, and the receipt of an indemnification letter or agreement from Bear Stearns; (2) the Underwriting Agreement between Bear Stearns, GMAC Mortgage, and RAMP (the "Underwriting Agreement"), which discusses the Insurance Agreement and attaches a letter from MBIA's corporate counsel; and (3) an Indemnification Agreement between MBIA, Bear Stearns, GMAC Mortgage, RAMP, and Residential Funding Securities, LLC.[1] Pursuant to the Insurance Agreement, MBIA issued a financial-guaranty-insurance policy (the "Policy").

43. MBIA insured the trust's payments to investors, and received in return an annual premium, based on a small, fixed percentage (tenths of one percent) of the aggregate principal balance of each loan pool. The existence of financial guaranty insurance enhanced the ability of Bear Stearns to market the securities issued as AAA, the highest possible investment grade.

2. Discovery Revealed Bear Stearns's Fraud

44. Unbeknownst to MBIA at the time the transaction closed, the results of the due-diligence review showed wide-spread issues with the underlying collateral in the Securitization

[1] Although the Insurance Agreement was dated as of September 1, 2006, the parties signed and executed the Insurance Agreement on September 27, 2006, the Closing Date.

and the report that MBIA received from Bear Stearns was not a complete and accurate set of the loan-file due diligence results that Bear Stearns had obtained from MDMC. Discovery in a case against GMAC Mortgage filed by MBIA in 2010, as well as discovery in this case, has revealed that Bear Stearns intentionally withheld MDMC's findings from MBIA and altered MDMC's report to conceal from MBIA that MDMC had found serious credit and compliance problems with respect to approximately one-third of the loans in the sample that it reviewed to make sure that MBIA would not refuse to close on the transaction.

45. After a review of a number of the delinquent and charged-off loans in transactions—including the 2006-HE4 Securitization—revealed that an overwhelming number of those loans were in breach of representations and warranties made by GMAC Mortgage, MBIA brought fraud and breach of contract claims against GMAC Mortgage in a complaint filed in April of 2010. *MBIA Ins. Corp. v. GMAC Mortgage, LLC*, Index No. 10/600837 (N.Y. Sup. Ct., N.Y. Cnty.)

46. In that case, MBIA obtained discovery related to MDMC's due-diligence review in connection with the 2006-HE4 Securitization. Among the documents produced was the final report that MDMC sent to Bear Stearns on September 25, 2006, of the results of its due-diligence review, in the form of two spreadsheets.

47. When MBIA compared the two spreadsheets that MDMC had provided Bear Stearns on September 25, 2006, with the single spreadsheet that Bear Stearns had provided to MBIA on September 27, 2006, MBIA discovered that the results reported by MDMC were very different from those reported by Bear Stearns. In particular, Bear Stearns had removed approximately 50 columns of information from the spreadsheets it received from MDMC, and left the rest of the data intact, combining it into a single spreadsheet before sending it to MBIA.

Critically, the approximately 50 columns that Bear Stearns removed from MDMC's spreadsheets were results indicating that approximately one-third of the loans in the collateral pool had not been underwritten generally in compliance with GMAC Mortgage's underwriting standards or in compliance with applicable laws. MBIA never received those true results from Bear Stearns.

3. Bear Stearns Fraudulently Concealed the Results of MDMC's Review

48. On September 8, 2006, John Mongelluzzo, the due diligence coordinator at Bear Stearns selected MDMC as the third-party due diligence firm for the Securitization. MDMC performed its due-diligence review on site at GMAC Mortgage's offices in Horsham, Pennsylvania between September 13–15, 2006. During this three-day review, an underwriting team from MDMC undertook a comprehensive review of each loan file within a sample of approximately 150 loans. MDMC's review checked for critical data deficiencies, deficiencies in legal documentation, adherence to GMAC Mortgage's Underwriting Guidelines, and compliance with federal, state, and local laws.

49. The approximately 150 loans reviewed by MDMC were chosen by Bear Stearns as a random sample of the more than 17,000 loans that constituted the collateral for the 2006-HE4 Securitization. The sample was random by design so that the results could be extrapolated to the entire collateral pool.

50. Following its review of the sample, on September 18, 2006, MDMC sent to both GMAC Mortgage and Bear Stearns a voluminous report that identified 85 of the approximately 150 loans within the reviewed sample as receiving a credit or compliance decision of "fails" or "unacceptable." The report identified each of these 85 loans as having been assigned credit or compliance grades of "3," indicating that the loans failed to conform to GMAC Mortgage's Underwriting Guidelines or to comply with applicable laws and regulations. MDMC noted in its

transmittal e-mail to Mr. Mongelluzzo that "[t]here are a large number of fails outstanding at this point." Bear Stearns did not share MDMC's September 18 findings with MBIA.

51. After receiving MDMC's report—unbeknownst to MBIA—GMAC Mortgage and Bear Stearns exchanged numerous calls and e-mails regarding how to deal with the results that showed so many failing loans. GMAC Mortgage told Bear Stearns that it intended to ignore MDMC's findings, even though MDMC's report indicated that more than half of the loans in the sample and, consequently, more than half of the loans in the collateral pool, suffered from serious credit or compliance defects. It did so because the transaction would not have otherwise been able to close, which would have meant that GMAC Mortgage would have continued to own these faulty loans, rather than selling them to the 2006-HE4 Trust. Additionally, without a closing, Bear Stearns would not be entitled to its considerable underwriting fee. On September 19, 2006, GMAC Mortgage informed Bear Stearns by email that it had received the 173-page report that MDMC had sent the day before, and that "[t]o receive such an extensive report at this late stage seems unreasonable." GMAC Mortgage nevertheless informed Bear Stearns that it "considered the pool final with no drops," and further stated that it "would like sign off from Bear that the pool is final so [GMAC Mortgage's] analysts can begin to run the collateral tables."

52. At this same time, MBIA was bidding on insuring the Securitization and negotiating the terms of its bid letter with Bear Stearns and GMAC Mortgage. On September 11, 2006, MBIA received from Bear Stearns a preliminary loan file so that MBIA could prepare a bid. Over the following week, MBIA discussed the Securitization with Bear Stearns, finally submitting its preliminary bid on September 18, 2006. Later that day, Bear Stearns informed MBIA that Bear Stearns had decided on MBIA as the insurer. The following day, September 19, 2006, MBIA submitted a formal bid letter directly to Bear Stearns's lead transaction manager on

the Securitization, Robert Durden. In MBIA's bid letter, MBIA included as a condition of its provision of financial guaranty insurance that Bear Stearns and GMAC Mortgage share the results of MDMC's loan-file due-diligence review with MBIA and noted that its bid was "based upon the accuracy of the data file provided to MBIA by Bear Stearns." Bear Stearns discussed the bid letter with MBIA, but neither Bear Stearns nor GMAC Mortgage commented on this particular requirement.

53. Although Bear Stearns recognized the "big issue with the [] due diligence," it decided to not try to fix the underlying errors in the collateral pool—or even replace the faulty loans. Instead, Bear Stearns's solution was to agree to GMAC Mortgage's demands and tell GMAC Mortgage and MDMC to "ignore the credit findings" and only attempt to resolve "compliance issues." MDMC continued working over the next week, sending revised reports on September 19 and September 20. Over this week, Mr. Durden—the primary contact between MBIA and Bear Stearns—made several internal requests to John Mongelluzzo, the due diligence coordinator at Bear Stearns, asking for the due diligence results, noting that "MBIA needs [the results], they are wrapping the deal." On September 25, 2006, MDMC sent its final due-diligence report to Mr. Mongelluzzo. This report indicated that no faulty loans had been removed from the sample. In addition, although MDMC informed Bear Stearns that it had been able to clear some of the loans of credit and compliance issues that had been previously reported, MDMC's report continued to identify 53 of the approximately 150 loans in the sample—or approximately one-third—as receiving failing credit or compliance grades of "3."

54. Recognizing that MBIA would not agree to issue an insurance policy if it learned of the credit and compliance defects that MDMC had found in the sample, and that it stood to lose millions of dollars in commissions and fees as a result, Bear Stearns fraudulently withheld

from MBIA the results that it received from MDMC on September 18, 19, 20, and 25 to conceal the defects that MDMC had found. Bear Stearns knew that MBIA would understand the true results of MDMC's review to indicate that a significant percentage of the collateral pool suffered from serious credit or compliance defects and, therefore, that the securitization was far riskier than one that MBIA would be willing to insure.

4. Bear Stearns Covered Up Its Fraud by Sending MBIA an Altered Due Diligence Report

55. Not only did Bear Stearns fraudulently withhold the adverse results of MDMC's due-diligence review from MBIA, but it also actively and intentionally concealed and altered the results to ensure that MBIA did not discover MDMC's true results until too late. Bear Stearns knew that the due diligence report was a problem. On the day after receiving MDMC's final report, September 26, Bear Stearns's Mortgage Finance Department held its weekly meeting. At this meeting they discussed the "MDMC DD Issue" along with the fact that the closing date was set for the next day, September 27. After the meeting, Mr. Durden e-mailed Mr. Mongelluzzo, telling him that he need the due diligence report for the deal, because the Securitization's closing was set for the following morning, and Bear Stearns "can't get [MBIA] to execute their agreement if [Bear Stearns] doesn't have a due diligence report."

56. Bear Stearns received the September 25 results from MDMC in the form of two electronic spreadsheets—titled "GMAC HE4-2006 MDMC DD Data File 092506 II.xls" and "GMAC HE4-2006 MDMC DD Issues 092506 II.xls"—each of which contained three different "worksheets," or tabs, containing information about each of the loans within the sample. Columns within each worksheet recorded data or information about each loan: the name of each borrower, the address and location of the property securing the borrower's loan, and information about the loan amount, interest rate, and originator.

57. Approximately 50 columns within the spreadsheets contained information about the defects that MDMC found among loans within the sample. The spreadsheets contained, for example, 10 different columns that indicated a Credit Event Grade, a Compliance Event Grade, or an Overall Grade of 1, 2, or 3, including the failing grades of "3" that MDMC had assigned to 53 loans within the sample. Other columns described the underwriting issues found by MDMC, comments by MDMC underwriters, and information about compensating factors or potential remedies.

58. Bear Stearns actively and intentionally concealed and altered the adverse results of MDMC's due-diligence review from MBIA by, among other things: deleting an entire worksheet entitled "Lender Response Required," which included credit and compliance grades, as well as comments from MDMC detailing the specific credit and compliance issues with each loans; deleting numerous columns showing MDMC's comments and the credit and compliance grades from the "Loan Summary Report" worksheet, the "Fees Report" worksheet, the "PPP Data" worksheet, and the "Data Report" worksheet; and modifying several cells in the "Compliance" column of the "Data Report" worksheet, which originally showed MDMC's determination that certain loans had "Unacceptable Compliance," but which Bear Stearns altered to say that they were "Acceptable." Bear Stearns combined the remaining information from the two electronic spreadsheets that it had received from MDMC into one spreadsheet entitled "GMAC HE4-2006 MDMC DD Data File 092506 II.xls," thereby hiding the existence of an excel listing "Issues" with the due diligence review. With these changes made internally at Bear Stearns, on September 27, 2006, approximately three-and-one-half hours before the closing of the Securitization, Mr. Mongelluzzo sent the altered report to Mr. Durden, telling him that he

"got these cleaned up as best I could. Still some data that is missing but most of the holes have been filled in."

59. Mr. Durden sent the electronic spreadsheet that contained the due-diligence results that it had altered to MBIA by email on September 27, 2006, only a few hours before the closing of the transaction. Mr. Durden did not simply forward Mr. Mongelluzzo's e-mail, which noted that Bear Stearns had "cleaned" the report, that "some data [was] missing" from the report, and that Bear Stearns had "filled in" holes in the report. Instead, Mr. Durden sent to MBIA an e-mail with the subject "GMAC 2006 HE-4 DUE DIL REPORT," which stated: "Attached is the due diligence report for the above deal, let me know if you have any questions." Bear Stearns did not disclose that it had altered the results, give any indication to MBIA that it had omitted any information that it had received from MDMC, or otherwise suggest the existence of results or information from MDMC's due-diligence review other than the spreadsheet that Bear Stearns sent to MBIA on September 27.

60. The purported due-diligence results and accompanying email sent by Bear Stearns to MBIA on September 27 were false and misleading. The attached spreadsheet appeared to be a complete and accurate set of the results of the due-diligence review performed by MDMC that concluded all of the loans within the sample as having been originated generally in compliance with GMAC Mortgage's Underwriting Guidelines and with applicable laws. In fact, the spreadsheet was incomplete and inaccurate. For Bear Stearns to delete the information showing that approximately one-third of the loans in the sample received failing grades from MDMC rendered the purported due-diligence results that Bear Stearns provided to MBIA misleading.

61. Withholding the true results of MDMC's review from MBIA—as well as providing an altered report that Bear Stearns represented to MBIA was the actual due diligence

report from MDMC—was material to MBIA's decision to insure the 2006-HE4 Securitization and to not take steps after closing of the Securitization to fix the widespread issues with the collateral pool. Because the payment streams from loan borrowers ultimately fund the return to investors, and MBIA insured investors against a shortfall in that return, MBIA would be required to pay claims by investors if enough loans in the pool were to default. Any information bearing on the riskiness of the underlying mortgage loans was thus highly material, including information about the extent to which those loans were originated in conformity with GMAC Mortgage's Underwriting Guidelines and applicable laws.

62. MBIA reviewed the spreadsheet that it received from Bear Stearns, which MBIA understood to be the complete, unaltered results of MDMC's due-diligence review. In light of Bear Stearns not alerting MBIA to the issues uncovered by MDMC's due-diligence review, and providing to MBIA a spreadsheet that purported to be the due-diligence results, MBIA concluded that the due-diligence review had uncovered no significant defects in the loan pool, and therefore there existed no significant obstacle to closing the transaction. MBIA reasonably believed that the results of MDMC's due diligence confirmed that the collateral for the 2006-HE4 Securitization had in fact been underwritten generally in compliance with GMAC Mortgage's underwriting standards and applicable laws.

63. In entering into the Insurance Agreement, MBIA justifiably relied on Bear Stearns's silence regarding the issues in the due diligence review as well as Bear Stearns's false and misleading statements and omissions of material facts, including the altered spreadsheet that purportedly contained the results of MDMC's due-diligence review. MBIA reasonably believed that the results of MDMC's due diligence confirmed that the collateral for the 2006-HE4 Securitization had in fact been underwritten generally in compliance with GMAC Mortgage's

underwriting standards and applicable laws; that Bear Stearns, as underwriter, would tell MBIA about any issues found in the due diligence review; and that Bear Stearns would make adjustments to Bear Stearns's disclosure, to the Securitization's structure, or to the Securitization's collateral pool, if the due diligence review showed issues with the collateral. MBIA also reasonably believed that the spreadsheet that it received from Bear Stearns contained a complete and accurate set of results from MDMC's due-diligence review and that those results did not identify any loans as having serious credit or compliance defects or receiving grades of "3." MBIA would not have entered into the Insurance Agreement had all of the information that Bear Stearns received from MDMC in their September 18, 19, 20, and 25 reports been provided to MBIA.

64. Since closing, the 2006-HE4 Securitization has performed poorly. Delinquencies and charge-offs for mortgage loans in the loan pools have been much higher than would be expected for pools of loans that conformed to GMAC Mortgage's Underwriting Guidelines and complied with applicable laws, even taking into account the downturn in the housing market. By September 2014, for example, loans representing over 29% of the original pool balance in the 2006-HE4 Securitization had defaulted and been charged off. A total of at least $334 million has been lost from that original balance.

65. The losses experienced by the 2006-HE4 Securitization have caused MBIA to make approximately $188 million in net claims payments as of September 2014.

CAUSE OF ACTION NO. 1

(Fraudulent Concealment)

66. MBIA repeats and realleges, as if set forth herein, the allegations of all of the preceding paragraphs.

67. Defendant J.P. Morgan Securities is the successor-in-interest to Bear Stearns, pursuant to the October 1, 2008 merger. J.P. Morgan Securities is liable for Bear Stearns's wrongdoing, in its entirety, under common law, because Bear Stearns merged and consolidated with J. P. Morgan Securities, because J.P. Morgan Securities has expressly or impliedly assumed Bear Stearns's tort liabilities, and because J.P. Morgan Securities is a mere continuation of Bear Stearns. This action is thus brought against J.P. Morgan Securities both in its own capacity and as successor to Bear Stearns.

68. Bear Stearns fraudulently concealed from MBIA material facts before closing and while soliciting MBIA's participation in the 2006-HE4 Securitization. Bear Stearns knew as early as September 18, 2006 that MDMC's review had revealed widespread issues with the Securitization's collateral pool and that MDMC's final report on September 25, 2006 showed approximately one-third of the sample of loans reviewed as "failing." Bear Stearns likewise knew that MBIA needed to know whether the due diligence results showed any issues with the Securitization's collateral pool, and had included the receipt of those results as a condition to its insuring of the Securitization. Instead of sharing MDMC's September 18, 19, 20, or 25 reports, Bear Stearns withheld this information to ensure that MBIA would not withdraw from the Securitization.

69. The true MDMC due diligence results concealed by Bear Stearns would have been material to MBIA's decision to enter into the Insurance Agreement. Because the payment streams from loan borrowers ultimately fund the return to investors, and MBIA provided insurance to investors against a shortfall in that return, MBIA would be required to pay claims by investors if enough loans in the pool were to default. The information provided by MDMC that Bear Stearns concealed from MBIA demonstrated that the risk that the loans in the collateral

pool would default was significantly greater than it would have been if MDMC's due-diligence review had concluded that the sampled loans had been originated generally in accordance with GMAC Mortgage's Underwriting Guidelines or applicable laws. Had MBIA known about the contents of the September 18, 19, 20, or 25 reports, MBIA would not have insured the Securitization.

70. Bear Stearns withheld this information with the intent to defraud MBIA. Bear Stearns knew that MBIA "need[ed the results because] they are wrapping the deal." By withholding this information, Bear Stearns misled MBIA into insuring the Securitization. Bear Stearns did this so that it could sell securities backed by a collateral pool that was purportedly underwritten in accordance with GMAC Mortgage's Underwriting Guidelines and in compliance with applicable laws, and earn fees or commissions, while simultaneously passing the risks embedded in the non-compliant loans to MBIA and investors.

71. Bear Stearns's fraudulent intent is further evidenced by Bear Stearns's sending of the altered—and seemingly innocuous—due diligence report to MBIA on September 27, 2006, only hours before closing. This due diligence report, which Bear Stearns held out as being from MDMC, had 50 columns of information detailing the issues present with approximately one-third of the sample loans removed, and several additional cells altered to remove evidence of the problems with the loans. By sending this revised report, Bear Stearns ensured that MBIA would not discover Bear Stearns's fraudulent omissions.

72. Bear Stearns had a duty to disclose the true results of MDMC's due diligence review to MBIA, because of the contractual relationship between Bear Stearns and MBIA. Bear Stearns was responsible—along with GMAC Mortgage—for selecting MBIA as insurer for the Securitization. In selecting MBIA as insurer, Bear Stearns agreed to MBIA's requirement in its

September 19, 2006 bid letter that Bear Stearns share MDMC's loan-file due diligence results with MBIA. Instead of sharing all of MDMC's findings—as contained with MDMC's September 18, 19, 20, or 25 reports—Bear Stearns shared with MBIA an altered and falsified version of the results only hours before the closing of the Securitization. Additionally, Bear Stearns, as lead underwriter, served as the intermediary on the Securitization between MBIA and every other party and was responsible for providing MBIA with the documents and information required by MBIA in order for MBIA to decide whether to pursue the Securitization—including the preliminary loan file.

73. Bear Stearns also had a duty to disclose the results of MDMC's due diligence review to MBIA because Bear Stearns possessed superior knowledge regarding the Securitization's collateral pool that was not available to MBIA. As lead underwriter, Bear Stearns was responsible for arranging the third-party due diligence, and because of this, knew as early as September 18, 2006 that widespread issues were present in the sample of the collateral pool reviewed by MDMC. MBIA did not have access to the loan files to independently verify the collateral pool and relied upon Bear Stearns to provide it with the results of the due diligence. Bear Stearns knew that by withholding the true results of the due diligence review, MBIA would enter into the Securitization, believing that no widespread issues were present in the collateral pool.

74. Bear Stearns also had a duty to disclose the results of MDMC's due diligence review to MBIA because Bear Stearns—by providing MBIA with the preliminary and final loan tapes as well as the Prospectus Supplement—made a misleading partial disclosure regarding the collateral pool, that it knew to be untrue when it received MDMC's September 18, 19, 20, and 25 reports.

75. Bear Stearns also had a duty to disclose the results of MDMC's due diligence review to MBIA because Bear Stearns actively concealed the MDMC's due diligence reports from MBIA. Bear Stearns did not send MDMC's due diligence reports to MBIA when Bear Stearns received them on September 18, 19, 20, and 25, despite MBIA's requests for the results during that time, but rather Bear Stearns concealed the fact that it had due diligence results showing widespread issues with the sample of the collateral pool. Bear Stearns's efforts to conceal the true due diligence results were furthered by their sending of an altered version of MDMC's September 25 report alteration to MBIA on September 27, 2006 that removed references to the issues uncovered by MDMC's due diligence review.

76. In entering into the Insurance Agreement, MBIA justifiably relied to its detriment on Bear Stearns's omissions of material facts. Because Bear Stearns had agreed to share the due diligence results with MBIA, MBIA justifiably believed that Bear Stearns would not withhold the actual results of MDMC's due diligence review if the review uncovered serious issues with the collateral pool. Furthermore, because under standard industry practice at that time, it was the security underwriter's responsibility to make interested parties aware of any issues arising in the due diligence review, MBIA reasonably believed that Bear Stearns would share with MBIA the results of MDMC's due diligence review if MDMC had found any serious issues. Additionally, because Bear Stearns made no changes to the Securitization's structure, the contents of the collateral pool, the closing date, or to its own disclosure, MBIA therefore justifiably believed that the due diligence review uncovered no serious issues with the collateral pool. As a result of these omissions, MBIA justifiably believed that no serious issues existed within the collateral pool of the Securitization and justifiably relied upon Bear Stearns's silence when it agreed to insure the Securitization.

77. Because of Bear Stearns's fraudulent concealment, MBIA issued the Policy, requiring MBIA to pay insurance claims of approximately $188 million.

78. Due to Bear Stearns's fraud, MBIA has incurred damages in an amount to be determined at trial. Further, MBIA is entitled to recover punitive damages, because Bear Stearns committed its fraudulent acts maliciously, wantonly, and oppressively, and with knowledge that the consequences of its conduct would affect the general public.

PRAYER FOR RELIEF

WHEREFORE MBIA prays for relief as follows:

a. For an award of damages against Defendant in an amount to be proven at trial, but including at a minimum:

i. MBIA's compensatory and consequential losses, including lost profits and business opportunities;

ii. Punitive damages; and

iii. Pre-judgment interest at the maximum legal rate.

b. For such other and further relief as the Court may deem just and proper.

DATED: New York, New York
September 29, 2014

QUINN EMANUEL URQUHART &
SULLIVAN, LLP

By: ______________________

Peter E. Calamari
Richard I. Werder, Jr.
Marc L. Greenwald

51 Madison Avenue, 22nd Floor
New York, New York 10010-1601
(212) 849-7000
petercalamari@quinnemanuel.com
rickwerder@quinnemanuel.com
marcgreenwald@quinnemanuel.com

Attorneys for MBIA Insurance Corporation