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. ________________ **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 provide MBIA the results of a due-diligence review designed to test the accuracy of the representations and warranties that GMAC Mortgage made to MBIA. 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.

4. When MDMC reviewed the loan files for the sample of the loans in the 2006 HE-4 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 altered these spreadsheets to fraudulently conceal the problems that MDMC 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 the report that it received, which had been altered by Bear Stearns, in deciding to issue its financial-guaranty 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 March 2012, approximately $168 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 and will make in the future.

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, 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 trust at issue 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) working with GMAC Mortgage to structure the transactions; (b) taking the lead in coordinating the flow of documents and information among the parties and persons involved in the transactions; and (c) 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 2006-HE4 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. 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.

21. 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.

22. 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.

23. 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.

24. 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 information provided by Bear Stearns about the quality of the underlying loans and the standards under which they had been originated. Information provided by Bear Stearns included 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.

25. The collateral pool for the 2006-HE4 Securitization included thousands of loans—17,342 at the time of closing. The sponsor and underwriter are 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 are deposited into the trust.

26. 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 Due-Diligence Results Provided by Bear Stearns To Assess the Bona Fides of the Transaction

27. 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.

28. 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.

29. 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.

30. 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).

31. 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.

32. The Prospectus Supplements provided to MBIA expressly state that all mortgage loans contributed to the pool were underwritten generally in accordance with GMAC Mortgage's underwriting standards.

33. 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.

34. 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 the results of a third-party due-diligence review of the loan files relating to the loans in the pool with MBIA.

35. 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.

36. 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.

37. For the 2006-HE4 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.

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

39. Bear Stearns was well aware that MBIA would rely on the results of the third-party due-diligence review in deciding whether to enter into the Insurance Agreements and that MBIA would not agree to provide financial guaranty insurance if the results revealed 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 MDMC's due-diligence review to ensure that risks in the loan files were known and fully disclosed and that MBIA would not face additional hidden risks.

40. Based on the due-diligence results that it received, MBIA decided to provide financial guaranty insurance for the 2006-HE4 Securitization. Accordingly, on September 27, 2006, MBIA entered into the Insurance Agreement among MBIA, GMAC Mortgage, Walnut Grove, Home Equity Loan Trust 2006-HE4, RAMP, Wilmington Trust, and J.P. Morgan Chase Bank, N.A. (the "Insurance Agreement").[1] Pursuant to the Insurance Agreement, MBIA issued a financial-guaranty-insurance policy (the "Policy").

41. 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

42. Unbeknownst to MBIA at the time the transaction closed, the due-diligence 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 revealed that Bear Stearns had intentionally altered

[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.

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.

43. 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.)

44. In that case, MBIA obtained discovery related to MDMC's due-diligence review in connection with the 2006-HE4 Securitization. Documents produced by MDMC and GMAC Mortgage included correspondence among MDMC, GMAC Mortgage, and Bear Stearns about the results of its review. J.P. Morgan Securities was also subpoenaed, but to date has not produced any documents in that case. Among the documents produced by MDMC in a March 29, 2011 production 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.

45. 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 results from Bear Stearns.

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

46. MDMC had 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.

47. 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.

48. 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. This report was never shared with MBIA.

49. GMAC Mortgage chose 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, causing GMAC Mortgage to keep these loans on its balance sheet. 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."

50. The same day, MBIA submitted its bid letter to Bear Stearns. That letter expressly imposed as a condition of MBIA's provision of financial guaranty insurance that Bear Stearns share the results of MDMC's loan-file due-diligence review with MBIA.

51. Consistent with GMAC Mortgage's request, Bear Stearns did not seek to have any of the defective loans removed from the collateral pool. On September 25, 2006, MDMC sent its final due-diligence report to Bear Stearns. This report indicated that no loans had been removed from the sample. In addition, although MDMC informed Bear Stearns that it had been able to clear 33 of the loans of credit and compliance issues that had been previously reported, MDMC's report continued to identify 52 of the approximately 150 loans in the sample—or approximately one-third—as receiving failing credit or compliance grades of "3."

52. 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 altered the results that it received from MDMC on September 25 to conceal the information identifying those defects. 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.

53. Bear Stearns received the September 25 results from MDMC in the form of two electronic spreadsheets, 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.

54. 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 52 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.

55. Bear Stearns actively and intentionally concealed the adverse results of MDMC's due-diligence review from MBIA by removing each of these approximately 50 columns indicating serious credit or compliance problems from the version of the spreadsheet that it sent to MBIA. Bear Stearns combined the worksheets from the two electronic spreadsheets that it had received from MDMC into one; removed the 50 columns describing adverse results; and left intact the remainder of the spreadsheet.

56. Bear Stearns sent the electronic spreadsheet that contained the due-diligence results that it had altered to MBIA by email on September 27, 2006, hours before the closing of

the transaction, 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.

57. 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.

58. The purported due-diligence results received by MBIA and the information omitted from the reports were material to MBIA's decision to insure the 2006-HE4 Securitization. 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.

59. 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 the light of the information contained in the "altered" spreadsheet, MBIA concluded that the due-diligence review had uncovered no significant defects in the loan pool that weighed against providing financial guaranty insurance. 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.

60. In entering into the Insurance Agreement, MBIA justifiably relied on 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 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 been included in the spreadsheet provided to MBIA.

61. 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 March 2012, for example, loans representing over 25% of the original pool balance in the 2006-HE4 Securitization had defaulted and been charged off. A total of at least $286 million has been lost from that original balance.

62. The losses experienced by the 2006-HE4 Securitization have caused MBIA to make approximately $168 million in net claims payments as of March 2012. MBIA has made a total of approximately $250 million in gross claims payments, and has received reimbursements of approximately $82 million from excess spread generated by the 2006-HE4 Securitization.

CAUSE OF ACTION

(Fraud)

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

64. 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.

65. Bear Stearns intentionally misrepresented existing material facts to induce MBIA to enter into the Insurance Agreement, in documentation provided to MBIA before the 2006-HE4 Securitization closed and the execution of the Insurance Agreement.

66. Bear Stearns intentionally misrepresented existing material facts, before closing and while soliciting MBIA's participation in the 2006-HE4 Securitization, in a materially false and misleading spreadsheet that Bear Stearns represented by email dated September 27, 2006, to be the report prepared by MDMC of its due-diligence review of a sample of the collateral pool.

67. The September 27, 2006, email from Bear Stearns was false and misleading because the attached spreadsheet appeared to be a complete and accurate set of the results of the

due-diligence review performed by MDMC that identified all of the loans within the sample as having been originated generally in compliance with GMAC Mortgage's Underwriting Guidelines and applicable laws. In fact, the spreadsheet was incomplete and inaccurate. In their original form, the spreadsheets that Bear Stearns received from MDMC contained information indicating that approximately one-third of the sample had received failing grades from MDMC. Bear Stearns actively concealed from MBIA approximately 50 columns of data, including these failing grades, by removing these columns and omitting them from the spreadsheet that it sent to MBIA on September 27. The omission of that information rendered the purported due-diligence results that Bear Stearns provided to MBIA misleading because, in the absence of that information, the report indicated that MDMC had concluded that all of the loans in the sample had been underwritten generally in accordance with GMAC Mortgage's Underwriting Guidelines and in compliance with applicable laws, when, in fact, MDMC had concluded otherwise.

68. Bear Stearns knew that the September 27, 2006, email and attached spreadsheet that it sent to MBIA was false and misleading at the time that it was sent. Bear Stearns had received spreadsheets from MDMC fully detailing the results of its due-diligence review on September 25, 2006. Those spreadsheets contained, among other things, information identifying 52 loans, approximately one-third of the sample, as failing to conform to GMAC Mortgage's Underwriting Guidelines and applicable laws. Bear Stearns intentionally altered those spreadsheets to conceal this information by removing 50 columns of information from the report related to the results of MDMC's review, including all of the data MDMC provided to Bear Stearns indicating that 52 loans had received a grade of "3." Bear Stearns also placed the remaining information into a single spreadsheet. Bear Stearns knew that the single spreadsheet

that it sent to MBIA on September 27, 2006, was not a complete and accurate set of results from MDMC's due-diligence review and that the information that Bear Stearns had intentionally deleted was material.

69. The misrepresentations and omissions of Bear Stearns in its September 27, 2006, email were 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.

70. In entering into the Insurance Agreement, MBIA justifiably relied to its detriment on 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. As Bear Stearns knew, MBIA did not have a contractual right to review loan-origination files before closing, nor any meaningful opportunity to do so. Accordingly, MBIA relied on the results of MDMC's review of the files of the loans in the sample for information about the contents of the loan files. Bear Stearns also knew from MBIA's bid letter, among other things, that MBIA would rely on the results of MDMC's due-diligence review in deciding whether to enter into the Insurance Agreement. MBIA 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 no loans had been designated "grade 3." But for Bear Stearns's providing this misleading

spreadsheet to MBIA, MBIA would not have entered into the Insurance Agreement. Furthermore, had all of the information that Bear Stearns received from MDMC been included in the spreadsheet provided to MBIA, MBIA would not have entered into the Insurance Agreement.

71. As a result of the knowing misrepresentations it made to MBIA, Bear Stearns intentionally defrauded MBIA into issuing the Policy for the 2006-HE4 Securitization. Bear Stearns defrauded MBIA 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.

72. As a direct result of, and in reliance upon, Bear Stearns's misrepresentations, MBIA issued the Policy, requiring MBIA to pay, to its substantial detriment, insurance claims in an amount in excess of $168 million. MBIA is exposed to further liabilities because delinquencies and charge-offs continue to occur in the loan pools.

73. Due to Bear Stearns's fraud, MBIA has incurred, and will continue to incur, 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 payments on current and future claims under the Policy;

ii. Rescissory damages;

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

iv. Punitive damages; and

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

b. For a declaratory judgment that Defendant is required to reimburse MBIA for all claims payments made to date and all future claims payments under the Policy.

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

DATED: New York, New York
September 14, 2012

QUINN EMANUEL URQUHART &
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By: ______________________
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