SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER

MBIA Insurance Corporation,

Plaintiff,

-against-

J.P. MORGAN SECURITIES LLC (formerly known as BEAR, STEARNS & CO. INC.),

Defendant.

Index No. 64676/2012
Commercial Division
Scheinkman, J.
Motion Sequence No. 2

PLAINTIFF'S MEMORANDUM OF LAW
IN OPPOSITION TO DEFENDANT'S MOTION FOR
SUMMARY JUDGMENT PURSUANT TO CPLR 3212

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Plaintiff MBIA Insurance Corporation ("MBIA") respectfully submits this memorandum of law in opposition to Defendant J.P. Morgan Securities LLC's ("JP Morgan" or "Bear") Motion for Summary Judgment. JP Morgan ignores the out-and-out fraud committed by Bear and makes no attempt to justify Bear's decision to intentionally remove material information from a due diligence report before providing it to MBIA. For the reasons below, JP Morgan's motion is without support on the facts or the law, and the motion should be denied.

PRELIMINARY STATEMENT

In late September 2006, Bear had a big problem. Bear used its reputation among RMBS issuers to get hired again and again on lucrative securitizations. GMAC Mortgage ("GMACM") had hired Bear to underwrite a large securitization, and Bear would earn large fees upon closing. One of Bear's jobs as underwriter was to hire a third party to perform due diligence on the loan pool. Bear was required to provide the third-party diligence report to MBIA—which Bear had solicited and selected as insurer on the deal—as a closing condition. Bear hired Mortgage Data Management Corp. ("MDMC"), which found a shockingly-high 50% failure rate. MDMC's findings hit like a bombshell at Bear just days before closing. But GMACM's instructions to Bear were explicit: we are closing on schedule and not changing the loan pool. Unbeknownst to MBIA, which was awaiting the report, Bear tried to pressure MDMC into changing its report and issuing a "clean" one, but two days before closing MDMC issued its final report that still showed more than one-third of the loans failing. Bear knew that MBIA would not issue a policy if it received MDMC's actual report, so Bear decided to cover it up. Unwilling to risk losing its fees, Bear created a doctored version of MDMC's report and passed it off as MDMC's work. This was plainly fraud.

Bear almost got away with it. MBIA's team was unaware that the document Bear provided was not MDMC's report and had been doctored by Bear. Thinking that Bear had satisfied its obligation to deliver the third-party report, MBIA provided insurance and has paid over $180 million in claims. Luckily for MBIA, and unfortunately for Bear, MBIA obtained a copy of the true MDMC report directly from MDMC as part of MBIA's lawsuit against GMACM. Only then did MBIA discover that it had been a victim of Bear's fraud. MBIA filed this lawsuit.

Bear's motion for summary judgment is an exercise in chutzpah. Bear ignores its own willful, uncontested deception and blames the victim for not catching the fraud in 2006. But the motion is wrong on the law and facts. Bear overlooks entirely the New York law governing fraud in procuring insurance and attempts to impose upon MBIA a reliance requirement that is absent from the statute and the caselaw. But even if such a requirement did exist, Bear ignores all contrary evidence that MBIA did rely on the fraudulent delivery of the diligence report and of Bear's own motives in perpetrating the fraud (which show beyond argument that it knew in 2006 that MBIA would rely on the document Bear provided and on Bear's representation that it had provided the third-party due diligence report).

First, Bear applies the wrong legal standard. New York law imposed on Bear the duty to not conceal, suppress, or misrepresent information that would have been material to MBIA's decision to provide insurance and provides for relief to MBIA when it does so. Under New York Law, Bear had to provide MBIA with all information that might be material to its decision to insure. Bear knew that a third-party diligence report and the true results of the due diligence were material to MBIA's decision to provide insurance, because MBIA directly told Bear how important the due diligence was. Indeed, Bear acknowledged internally that "MBIA needs" the third-party report, and that Bear "can't get [MBIA] to execute their agreement" without it. Bear's false representation that it was providing the MDMC report, its failure to provide the true report and adverse results, and its failure to advise MBIA that the document it delivered was created by Bear and not MDMC all were material to MBIA's decision to provide insurance. Bear's motion does not even discuss the Insurance Law, presumably because Bear knows MBIA can readily prove all the elements for relief.

Second, even without considering the Insurance Law, there remains a question of fact on MBIA's reliance on Bear's fraud. Bear twists the record to claim that MBIA did not review the due diligence results until a week after the close of the Securitization. In doing so, Bear ignores the testimony of both Lauren Desharnais and Theresa Murray, MBIA employees responsible for the Securitization, who testified that they would not have allowed the Securitization to close unless MBIA received and reviewed the due diligence results. Indeed, contrary to Bear's unsupported statement that evidence "confirms" that Ms. Desharnais did not review the report, ample evidence is available for a jury to determine that she did indeed review the report before closing. Ms. Desharnais was back in New York approximately three hours before closing, and she testified that she would have reviewed the report "before [she] would allow the deal to close." Even if MBIA needs to prove reliance, this testimony suffices.

Third, Bear ignores that it provided not only a doctored report, but also a fraudulent transmittal e-mail. MBIA relied independently on the e-mail, which evidence reflects was read before the closing. In that e-mail Bear represented that it was providing "the due diligence report for the [2006-HE4] deal." Of course, Bear did not disclose that the document it provided was not the third-party report but rather a doctored version created by Bear. By so doing, Bear misrepresented that it was delivering MDMC's report, not a doctored version created by Bear to hide the adverse results of MDMC's work, and that there were no issues with the due diligence review. Under industry practice at the time, it was the underwriter's responsibility to make interested parties aware of any issues arising in the due diligence review, and where an underwriter raised no issues with the due diligence, then an insurer was reasonable to conclude that no issues existed. By its silence, Bear represented that there were no issues. By its transmittal e-mail, Bear confirmed that no issues existed and failed to disclose the true facts. Bear's transmittal e-mail misrepresented material facts, including that an express requirement imposed by MBIA had been satisfied, and thereby misled MBIA.

Bear's attempt to avoid liability for its fraud is unavailing. Its motion for summary judgment should be denied.

FACTUAL BACKGROUND

A. The Transaction

Bear made false representations and omissions to induce MBIA to issue a financial-guaranty-insurance policy in connection with GMACM Corporation Home Equity Loan Trust 2006-HE4, an offering of residential mortgage backed securities. Ex. B ¶¶ 15, 19, 40; Ex. C ¶¶ 15, 19, 40.[1] The underlying collateral for the securities consisted of mortgage loans originated or acquired by GMACM. Ex. B ¶ 16; Ex. C ¶ 16. Bear was the lead underwriter, Ex. B ¶¶ 17-18; Ex. C ¶¶ 17-18, and was responsible for, among other things, soliciting and selecting a bond insurer, Exs. 1-4; Ex. 8, at 30:8-32:2; structuring the deal, Exs. 4-5; arranging for a third party to perform due diligence on the collateral, Exs. 6-7; and coordinating between the various deal parties to ensure the Securitization stayed on schedule, Ex. 8, at 24:19-26:4. Bear only received its fee if the Securitization closed, and failure to close on time could cause major problems for the Securitization. *Id.* at 39:7-43:13; 48:8-49:24. Delays would therefore endanger Bear's underwriting fee, as well as risk upsetting Bear's client GMACM.

B. Bear Requested Bids for Insurance from Financial Guaranty Insurers and Selected MBIA

Bear sought out insurance from various monoline bond insurers, including MBIA. Exs. 1, 6. On September 11, Bear solicited MBIA to bid on insuring the Securitization, sending MBIA the preliminary loan tape so that MBIA could prepare its bid. Ex. 1. On September 18, Bear selected MBIA as the insurer. Ex. 4. The following day, MBIA sent Bear a formal bid letter presenting the conditions of MBIA's bid. Ex. I. Included in this bid letter as the second bullet point was the clear requirement that Bear and GMACM share loan file due diligence with MBIA. *Id.* Robert Durden, Bear's transaction manager for the Securitization, forwarded the bid letter to GMACM and discussed it with them. Ex. 9-11. Neither GMACM nor Bear took issue

[1] Citations to lettered exhibits herein refer to the exhibits attached to the Affirmation of Anastasia A. Angelova, dated October 9, 2013. Citations to numbered exhibits herein refer to the exhibits attached to the Affirmation of Marc L. Greenwald, dated October 28, 2013.

with MBIA's requirement that it be given the due diligence results, and MBIA was approved as the insurer on the terms of a bid letter which included that requirement. *Id.*

C. The Importance of Due Diligence to MBIA

Bear was not surprised that MBIA's bid letter required that due diligence be shared with MBIA, because it knew that due diligence served a vital role in MBIA's securitization process. At MBIA, loan-file due diligence was used to confirm that the characterizations in the transaction documents regarding the collateral underlying the securitization—such as in the loan tapes or prospectus—accurately reflected the true nature of the collateral. Desharnais Aff. ¶ 8. John Mongelluzzo, Bear's due diligence manager, testified that due diligence is used "[t]o ensure that the loans that we were purchasing were in fact what we thought we were buying . . . [because] everybody wants to know what it is they're buying." Ex. 12, at 34:19-35:3. Without third-party due diligence, MBIA would have had to simply hope, without verifying, that the transaction documents accurately characterized the collateral. Desharnais Aff. ¶ 11; *see also* Ex. 13, at 9 ("Independent third-party due diligence gave insurers an additional level of comfort that the collateral was, in fact, underwritten in compliance with proper underwriting standards.").[2] Because of this, MBIA policy required that third-party due diligence be performed on every securitization that it insured, Ex. 14, at 4, and MBIA's approval of the Securitization was conditioned upon delivery of the due diligence results, Ex. L.

Since the due diligence results served essentially as a "check" on the collateral, it was not customary or even possible for MBIA to review the due diligence before formulating its bid or preliminarily deciding on insuring the Securitization. Desharnais Aff. ¶ 9. If MBIA received due diligence results that showed widespread issues with the collateral, it would have withdrawn from the Securitization. Desharnais Aff. ¶ 11; Ex. 15, at 112:11-115:7. And if MBIA did not receive any due diligence results at all, then it would not have insured the Securitization.

[2] James Aronoff is an expert in capital markets and RMBS with more than 30 years of experience in the RMBS industry. MBIA will be using his testimony about standard industry practice regarding loan-file due diligence during the 2004 to 2007 time period.

Desharnais Aff. ¶¶ 9, 11; Ex. 15, at 71:22-72:8, 115:11-15; Ex. 16, at 31:7-18, 44:6-45:3. Furthermore, under normal business practice, the underwriter would make the insurer aware of any issues arising in the due diligence review. Desharnais Aff. ¶ 9; Ex. 13, at 10. If the due diligence review had shown issues with the collateral, the underwriter would have been expected to make changes to the disclosure, the transaction structure, or the collateral pool. Ex. 13, at 10.

D. MDMC'S Due Diligence Review Uncovered Big Problems

On September 8, Bear's due diligence manager John Mongelluzzo hired MDMC to review a sample of 153 loans from the loan pool to confirm that they complied with both legal requirements (a "Compliance" review) and with GMACM's underwriting guidelines (a "Credit" review). Ex. 17. This review occurred on-site at GMACM and was scheduled to be completed by Friday, September 15. Ex. 7. By the following Monday, September 18, however, MDMC had still not completed its preliminary report, causing GMACM to register its concern in a stream of e-mails to Bear and MDMC. Exs. 18-19. Later that day, MDMC sent an initial report to Bear and GMACM. Ex. 20. This report showed massive problems with the loans, assigning "failing" grades to 85 of the 153 loans in the sample. MDMC's transmittal e-mail advised Bear that "[t]here are a large number of fails outstanding at this point." *Id.* MBIA was not made aware of any of these problems.

MDMC's report surprised GMACM. GMACM complained to Mr. Mongelluzzo about the timing of the report stating that "GMACM wants all loans to remain in the deal" and that GMACM desired to only "review the compliance fails." Ex. 21. A later e-mail from GMACM to Mr. Durden likewise expressed GMACM's "disappoint[ment]" with the report, and demanded to know what Bear intended to do about the loans reported as defective. Ex. 22. GMACM insisted that all of the loans remain in the pool and asked for "sign off from Bear that the pool is final." *Id.* Internally at Bear, Mr. Durden and Mr. Mongelluzzo were working to solve this "big issue with the [] due diligence," in order to keep the Securitization on schedule. Exs. 23-24. Bear's solution was to bow to GMACM's demands and ignore MDMC's findings. Exs. 25-26.

Bear knew it had a "big issue," and that it needed to keep MBIA in the dark. On the same day Mr. Durden was dealing with the big due diligence issue, he was discussing with MBIA its bid letter which explicitly demanded the results of the due diligence. Over the next week, Bear asked MDMC to continue to work on the report by clearing compliance issues, with the hope that MDMC could produce a "clean" due diligence report. Exs. 25, 27. As Bear knew, MBIA was asking for and "needed" the due diligence results, and Mr. Durden repeatedly pressured Mr. Mongelluzzo over the following week to provide a "clean" report that he could share with MBIA. Two days after MBIA's initial request for the diligence results, Mr. Durden asked Mr. Mongelluzzo whether he had "a clean dd report for the GMAC deal." Ex. 28. Mr. Mongelluzzo responded "not even close, why[?]" *Id.* Mr. Durden explained that "MBIA needs it, they are [] wrapping the deal." *Id.* On the following day, Mr. Durden again asked Mr. Mongelluzzo to "send the cleaned up dd report for GMAC 06-HE4, or tell us who to contact at MDMC for it." Ex. 29.

E. Bear's Receipt of MDMC'S Final Due Diligence and Fraudulent Alteration

Bear received MDMC's final report on September 25, two days before closing. Ex. 30. This report comprised two excel documents titled "GMAC HE4-2006 MDMC DD Data File 092506.xls" and "GMAC HE4-2006 MDMC DD Issues 092506.xls," each with several worksheets, and with each worksheet containing many rows of data about the loan characteristics and due diligence results. *Id.*; Greenwald Aff. ¶ 30. This was not the "clean" report that Bear desired, however. Although MDMC was able to "clear" 32 loans from its initial report, there were still 53 loans—over a third of the entire sample—that "failed" for a variety of fundamental issues regarding the quality of the loans, such as credit scores that were below the level required by GMACM's underwriting guidelines or excessive debt-to-income ratios. Ex. 30.

Bear did not send this report to MBIA as they were obligated to do. Instead, realizing how MBIA would react to the report, Bear decided to conceal MDMC's results. The next day, September 26, Bear had a weekly Mortgage Finance Department meeting, at which a topic of discussion was the "MDMC DD Issue," with both Mr. Durden and Mr. Mongelluzzo listed as attendees. Ex. 31. Later that day, Mr. Durden again asked Mr. Mongelluzzo for the report, telling him that he needed it because Bear "can't get [MBIA] to execute their agreement if we don't have a due diligence report." Ex. 32.

On the following day, about three and a half hours before closing, Mr. Mongelluzzo finally sent Mr. Durden the "clean" due diligence report he had been asking for. Ex. R. But this "clean" report was not MDMC's report. *Id.* Instead, it was a sanitized version of MDMC's final report, carefully modified so as to remove information that Bear plainly believed would alert MBIA to the issues present in the pool. *Id.* The document that Mr. Mongelluzzo created comprised two excels, titled "GMAC HE4-2006 MDMC DD Data File 092506 II.xls" and "GMAC HE4-2006 MDMC DD Issues 092506 II.xls." *Id.* Within these excels, he made wide-spread changes to MDMC's results, altering the contents of several cells and deleting fifty columns. *Id.* Among these changes were:

- 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 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. These cells originally showed MDMC's determination that certain loans had "Unacceptable Compliance," but Bear altered the contents of them to show that they were "Acceptable."

Compare id. with Ex. 30. Mr. Mongelluzzo told Mr. Durden 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." Ex. R. Mr. Durden did not simply forward Mr. Mongelluzzo's message on to MBIA, however, because doing so would have alerted MBIA to the fact that this was not MDMC's report but one cleaned by Bear and that there had been an excel listing "DD Issues." *Compare id. with* Ex. P. Instead, he combined the contents of the two excels into the excel 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, while falsely presenting the report as MDMC's work. *Compare* Ex. R *with* Ex. P. This was a blatant, intentional fraud perpetrated, and Bear has not attempted to contest or explain these facts, choosing instead to simply ignore them.

F. In Reliance on the "Cleaned" Due Diligence Report, MBIA Allowed the Securitization to Close

At 9:59 a.m., Mr. Durden sent this "cleaned" due diligence report to Ms. Desharnais and Carl Webb. Ex. P. In his transmittal e-mail, titled "GMAC 2006-HE4 DUE DIL REPORT," Mr. Durden did not state that there had been issues with the due diligence, that Bear and GMACM had agreed to ignore MDMC's findings, or that the attachment was a doctored version of the MDMC report. He instead represented that he was attaching "the due diligence report for the [2006-HE4] deal." *Id.* When asked whether he knowingly provided information he believed was inaccurate, Mr. Durden was unable to say that he did not. Ex. 8, at 108:5-9 ("Q. In the 2006-HE4 transaction, did you ever knowingly provide MBIA with any data that you did not believe was accurate? A. I don't know."); *see also id* 105:13-23 (Q. I[f] you had known that any of the information was inaccurate, would you have provided that to MBIA as part of their developing their bid to insure this transaction? . . . A. I can't be certain. I'm not certain what I would have done given various, you know, conditions or other information, you know." (objection omitted)).

Ms. Desharnais returned to New York approximately three hours before the closing. Exs. Z, AA. At 10:36 a.m., she arrived at the gate at LaGuardia Airport, and went from there to her home in New Rochelle. *Id.*; Ex. 41. This Court can likely take judicial notice that the drive from LaGuardia to New Rochelle takes as little as 20 minutes. And the drive from New Rochelle to MBIA's headquarters in Armonk, New York also takes about 20 minutes. Although the many years between the relevant date of closing and today deprive her of specific recall, Ms. Desharnais has stated that she would not have allowed the Securitization to close without reviewing the due diligence results, that she would have had the opportunity to do so upon her return, and that she would have found the altered report to be acceptable. Desharnais Aff ¶¶ 11-13; Ex. 15, at 89:5-92:10. Although the report did not possess the "1, 2, or 3" loan grades that several other due diligence firms used at that time, Ms. Desharnais explained that she was not "married to the loan grades" and that the important thing for her was to be able to understand the substance of the due diligence firm's evaluation and observations regarding the quality of the collateral. Ex. 15, at 89:5-19.[3] The document that Bear passed off as the MDMC report was sufficient for Ms. Desharnais to determine what was purported to be the outcome of MDMC's due diligence review, stating that it showed that essentially all of the loans had been deemed acceptable, according to the column "Compliance," and that the loans files had been compared to the electronic loan tape. *Id.* at 91:20-92:10. In reliance upon the document and Mr. Durden's e-mail transmitting it, MBIA allowed the Securitization to close. Had MBIA known the true results of the due diligence, that Bear had passed off its own document as MDMC's report, or that Bear had unilaterally altered the third-party due diligence report to omit MDMC's negative findings, MBIA would have not entered into the Securitization. Desharnais Aff. ¶¶ 11, 15.

Despite having no facts to support such a proposition, Bear argues that Ms. Desharnais allowed the Securitization to close without reviewing the altered report, instead electing to review it only after closing. In support of this, Bear relies wholly upon the fact that Ms. Desharnais e-mailed a pricing memorandum to MBIA's pricing group on October 3, after closing. Def's Memo 10, 12, 16. The pricing memorandum is irrelevant. Unlike receipt of the due diligence results, which was an explicit pre-closing condition of the underwriting committee, the pricing memorandum was not required to be completed before closing. Ex. L.[4] Therefore,

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[3] Although the "1, 2, or 3" grades were used by several due diligence firms at the time, it was not universally accepted. *See* Ex. 33, at MBIA00117955 (using a 1-6 scale). Indeed, Bear internally used a 1-4 scale for its due diligence. *See* Ex. 34, at 65:14-66:23.

[4] Defendant also mischaracterizes an e-mail from Ms. Desharnais discussing her intent to have the pricing memo completed on September 27, 2006. Contrary to Defendant's mischaracterization that "she had originally committed to finish [the pricing memo] prior to closing," Def's Memo 10, 16, Ms. Desharnais nowhere states that she was going to have the

any equivalence would be a false one. Furthermore, the goal of the pricing memorandum was to have the premium approved by the pricing group. Ex. 15 at 50:12-51:22. As Ms. Desharnais explained in her deposition, the premium was approved on September 26—the day before closing—making the drafting of a pricing memorandum a purely administrative task. *Id.*; Ex. X. If anything, this timing supports MBIA's argument that Ms. Desharnais was concerned with making sure the important things were taken care of before closing, while allowing the purely administrative work to be completed after closing.

G. MBIA Takes a Closer Review of The Due Diligence Report Post-Closing

Six days after the closing, Ms. Desharnais sent the "report" provided by Bear to Ms. Murray. Ex. U. She asked Ms. Murray if they could go over it sometime, and advised Ms. Murray that although the reporting did not look "usual" it nevertheless "looked pretty benign." *Id.* As explained by Ms. Desharnais, the purpose of this post-closing review was likely to prepare for bids on later deals and to review the product of MDMC, since it was the first time MDMC had worked on one of MBIA's deals. Desharnais Aff. ¶ 14. Ms. Desharnais and Ms. Murray reviewed the final, altered report together the following day. Ex. V. Importantly, even without the pressure of an impending closing, MBIA's team did not detect that it had received a doctored report. Bear had gotten away with its fraud.[5]

ARGUMENT

Summary judgment is a "drastic remedy" and will be granted only where no material or triable issue of fact exists. *Jablonski v. Rapalje,* 14 A.D.3d 484, 486 (2d Dep't 2005); *Mandelos*

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pricing memo completed prior to closing, Ex. X. Instead, she simply said that she intended to complete the pricing memo on the 27th, which happened to be the same day as closing. *Id.*

[5] Bear's fraud went undiscovered until 2012. In April 2010, MBIA filed an action against GMACM. During discovery in that case, MBIA received documents from MDMC, including the final due diligence report that MDMC sent to Bear on September 25, 2006. Ex. B ¶ 44, Ex. 35, at 7. In or about January 2012, MBIA compared this report to the altered report originally received by MBIA and discovered for the first time that Bear altered MDMC's report before sending it to MBIA. Ex. B ¶ 45, Ex. 35, at 7.

v. Karavasidis, 86 N.Y.2d 767, 768-69 (1995). The movant must come forward with evidence "sufficien[t] to warrant the court as a matter of law in directing judgment." CPLR 3212(b); *see McCauley v. New York City Housing Authority*, 232 A.D.2d 614, 614 (2d Dep't 1996). If the movant offers such proof, "the opposing party must 'show facts sufficient to require a trial of any issue of fact.'" CPLR 3212(b); *see Zuckerman v. City of New York*, 49 N.Y.2d 557, 562 (1980). The Court should draw all reasonable inferences in favor of the non-movant (here, MBIA). *See, e.g.*, *Gitlin v. Chirinkin*, 98 A.D.3d 561, 561 (2d Dep't 2012). "A motion for summary judgment 'should not be granted where the facts are in dispute, where conflicting inferences may be drawn from the evidence, or where there are issues of credibility." *Lopez v. Beltre*, 59 A.D.3d 683, 685 (2d Dep't 2009). When an issue of fact is even arguable or debatable, summary judgment should be denied. *See Tech. Support Servs., Inc. v. Int'l Bus. Machs. Corp.*, No. 02891/2006, 2007 WL 4500382, at *17 (N.Y. Sup. Ct., Westchester Cnty. Dec. 3, 2007) (Scheinkman, J.). Furthermore, factual issues related to elements of a fraud claim should not be determined on summary judgment, but should be left to the jury to resolve. *See Brunetti v. Musallam*, 11 A.D.3d 280, 281 (1st Dep't 2004) ("[T]he motion court should not have resolved factual issues by determining, based on this record, that defendants established as a matter of law that plaintiff could not prove all the elements of his fraud claim[, because] . . . essential elements of a fraud claim[] are not subject to summary disposition."). As shown below, Defendant's motion should be denied under these standards.

A. Bear Concealed Material Information from MBIA to Induce MBIA into Entering into the Securitization

Much of Bear's motion rests on arguments about whether MBIA "actually" relied on the falsified and misrepresented due diligence report that Bear concededly provided. This argument gets Bear nowhere for a number of reasons, including that Bear had an affirmative duty to tell MBIA of the widespread problems identified in MDMC's due diligence review. Under New York law, an insurance company's claim of fraud arising in the context of an application for insurance is informed by New York Insurance Law § 3105. *See MBIA Ins. Corp. v. Countrywide*

Home Loans, Inc., 34 Misc. 3d 895 (Sup. Ct., N.Y. Cnty. 2012) (applying § 3105 to a common-law fraud claim); *Syncora Guarantee Inc. v. Countrywide Home Loans, Inc.*, 36 Misc. 3d 328, 341 (Sup. Ct., N.Y. Cnty. 2012) (same); *cf. Assured Guar. Mun. Corp. v. Flagstar Bank, FSB*, 892 F. Supp. 2d 596, 603 (S.D.N.Y. 2012) (applying § 3106 to a breach of contract claim). In New York, an insurer pursuing a fraud claim must merely show that a fact misrepresented by an applicant for insurance would have been *material* to the insurer's decision to insure:

> (a) A representation is a statement as to past or present fact, made to the insurer by, or by the authority of, the applicant for insurance or the prospective insured, at or before the making of the insurance contract as an inducement to the making thereof. A misrepresentation is a false representation, and the facts misrepresented are those facts which make the representation false.
>
> (b)(1) No misrepresentation shall avoid any contract of insurance or defeat recovery thereunder unless such misrepresentation was material. No misrepresentation shall be deemed material unless knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such contract.

Therefore, pursuant to § 3105, the only question is whether information misrepresented by Bear, an applicant for insurance, was material to the decision to provide insurance for the Securitization—*i.e.*, whether "knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such contract." *Id.* § 3105(b)(1). Thus, all MBIA is required to show is that it would not have issued the policy on the same terms if it had known the true nature of the due diligence results.

1. Bear Was an Applicant for Insurance

Bear was the applicant for the insurance provided by MBIA. *See, e.g.*, *MBIA Ins. Corp.*, 34 Misc. 3d at 905 (applying § 3105 to defendants, despite not being the insured entity, because it "appl[ies] to statements made 'by . . . the applicant'" (ellipsis in original)); *Syncora Guarantee Inc.*, 36 Misc. 3d at 341 (same); *Syncora Guarantee Inc. v. Alinda Capital Partners LLC*, No. 651258/2012, 2013 WL 3477133, at *1, 14-16 (N.Y. Sup. Ct., N.Y. Cnty. 2013) (applying § 3105 to advisory services company serving as sponsor of public infrastructure project insured by plaintiff). Likewise, the courts have held that a broker, as an agent of the applicant, may be held responsible for damages under the Insurance Law. *See, e.g.*, *Seneca Ins. Co. v. Wilcock*, No. 01 Civ. 7620(WHP), 2002 WL 1067828, at *5 (S.D.N.Y. May 28, 2002) (applying the Insurance Law to insurer's claim for indemnification against applicant's brokers); *Equitable Life Assur. Society of U.S. v. Werner*, 286 A.D.2d 632, 632-33 (1st Dep't 2001) *Panepinto v. Allstate Ins. Co.*, 108 Misc. 2d 1079, 1081 (Sup. Ct., Monroe Cnty. Mar. 20, 1981); *Liberty Mut. Ins. Co. v. Grand Transp., Inc.*, No. 06 CV 3433(JG), 2007 WL 764542, at *3 (E.D.N.Y. Mar. 12, 2007).

Bear was responsible for soliciting and selecting the insurers, and in fact, was the party that initiated contact with MBIA. Ex. 1. Bear also provided MBIA with the information regarding the deal before MBIA agreed to provide insurance. Exs. 1, 38-40. Additionally, Bear, together with GMACM, ultimately chose MBIA as the insurer. Ex. 2 ("we should tell MBIA and FGIC ***we will decide*** around 6:30 pm" (emphasis added)); Ex. 3 (e-mail from Bear's counsel asking "Has GMACM and Bear picked the insurer?"); Ex. 4 (internal Bear e-mail from Lieberman to other Bear employees naming "MBIA as Wrapper"). Under these circumstances, Bear was an applicant for insurance under the Insurance Law. *See, e.g.*, *Seneca Ins. Co.*, 2002 WL 1067828, at *5 (applying the Insurance Law to claim against applicant's brokers).

2. Bear's Own E-Mails Show the Due Diligence Results Were Material to MBIA's Decision to Insure the Securitization

Under § 3105, an insurer is entitled to rescind an insurance policy or recover payments made under that policy if an insured or applicant for insurance, while applying for insurance, makes a material misrepresentation. *See* Insurance Law § 3105; *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 105 A.D.3d 412, 412 (1st Dep't 2013) (explaining that insurer can recover payments made under insurance policy without rescinding because § 3105 contemplates "defeating recovery thereunder" in addition to rescission). "A misrepresentation is material if the insurer would not have issued the policy had it known the facts misrepresented." *See Varshavskaya v. Metropolitan Life Ins. Co.*, 68 A.D.3d 855, 856 (2d Dep't 2009). Materiality is generally a question of fact and only when the evidence is clear and uncontroverted may the court decide the issue as a matter of law. *See Zilkha v. Mutual Life Ins. Co. of New York*, 287 A.D.2d 713, 714 (2d Dep't 2001).

Bear's misrepresentations were material. Two different MBIA employees have testified to the materiality of MDMC's report, saying that a due diligence report was an important part of all deals, including the Securitization, and that they would not have closed a deal without it. Desharnais Aff. ¶¶ 9, 11; Ex. 15, at 71:22-72:8, 115:11-15; Ex. 16, at 31:7-18, 44:6-45:3. Furthermore, Bear was required to provide MDMC's report as a condition of the MBIA bid letter, Ex. I, and review of the due diligence results was listed in the memo approving the deal, Ex. L. Bear was well aware that the due diligence results were important to MBIA. Its own internal e-mails recognized that MBIA "need[ed]" the MDMC's report, Ex. 28, and that MBIA would not "execute their agreement if [they] don't have a due diligence report," Ex. 32. As explained by Mr. Mongelluzzo: "[E]verybody wants to know what it is they're buying." Ex. 12, at 34:19-35:3. If Bear truly believed that the actual MDMC report was immaterial to MBIA's decision, there was no reason for Bear to withhold the report from MBIA for eight days or to significantly alter MDMC's report before sending it to MBIA.

Bear's attempts to diminish the materiality of the due diligence report by arguing that MBIA's bid letter somehow limits the ways in which MBIA could use the results is likewise unavailing. First, although the bid letter discusses that MBIA might have used the due diligence report to change its fee or over-collateralization levels, it does not state or imply that this was the only way MBIA could use the report results. Ex. I. Indeed, as explained by Ms. Desharnais, if MBIA was not satisfied with the report, it would have been free to withdraw from the Securitization. Ex. 15, at 112:11-115:15. Second, even if MBIA's only remedy was to change its fee or over-collateralization target, Bear would still be liable for fraud. It is irrelevant whether an insurer might have issued the policy under different terms; instead, the inquiry is whether the insurer would have entered the deal under the ***exact*** same terms. *See McLaughlin v. Nationwide Mut. Fire Ins. Co.*, 8 A.D.3d 739, 740-41 (3d Dep't 2004) (finding misrepresentation material where insurer "would have refused to issue the ***exact same policy*** had it known of such facts" (emphasis added)).

3. Bear Withheld and Concealed MDMC's Report

Under New York law, a material misrepresentation is also made when a party withholds material information from the insurer. As explained by the Court of Appeals:

> [W]here an applicant for insurance has notice that before the insurance company will act upon the application, it demands that specified information shall be furnished for the purpose of enabling it to determine whether the risk should be accepted, ***any untrue representation***, however innocent, which either by affirmation of an untruth ***or suppression of the truth***, substantially thwarts the purpose for which the information is demanded and induces action which the insurance company might otherwise not have taken, is material as matter of law. The question in such case is not whether the insurance company might perhaps have decided to issue the policy even if it had been apprised of the truth, the question is ***whether failure to state the truth where there was duty to speak prevented the insurance company from exercising its choice of whether to accept or reject the application upon a disclosure of all the facts which might reasonably affect its choice***.

Geer v. Union Mutual Life Ins. Co., 273 N.Y. 261, 266 (1937) (emphasis added).[6] Likewise, the Second Department has recognized that an applicant for insurance "cannot remain silent while cognizant that his insurance application contains misleading or incorrect information," and that the applicant "must notify his insurance company of [material information] which the company probably would consider relevant when deciding whether to issue a policy." *See Meagher v. Executive Life Ins. Co. of New York*, 200 A.D.2d 720, 720-21 (2d Dep't 1994); *see also L. Smirlock Realty Corp. v. Title Guarantee Co.*, 70 A.D.2d 455, 462 (2d Dep't 1979) ("[T]he issue to be decided is whether the suppression deprived the insurer of its freedom of choice in determining whether to accept or reject the risk upon full disclosure of all the facts which might reasonably affect that choice." (citing *Geer*, 273 N.Y. 261).

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[6] *Geer* and other Court of Appeals decisions from this time are "representative of the common law principles that the legislature sought to codify through Section 3105 and its predecessor statute, Section 149." *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, No. 602825/08, 2013 WL 1845588, at *4 (N.Y. Sup. Ct., N.Y. Cnty. Apr. 29, 2013).

This duty to disclose material information extends even to information not explicitly requested by the insurer. As recognized by the Second Department, "[a] policy of insurance will be voided where it is proved that in applying for the insurance coverage the insured fraudulently concealed a material fact." *Sun Ins. Co. of New York v. Hercules Securities Unlimited, Inc.*, 195 A.D.2d 24, 30 (2d Dep't 1993). Whenever an applicant withholds disclosure of a fact with fraudulent intent, the insurer may act to void the policy under the Insurance Law. *See id.*; *see also Sebring v. Fidelity-Phenix Fire Ins. Co. of New York*, 255 N.Y. 382, 386-87 (1931) ("Concealment is the designed and intentional withholding of any fact material to the risk which the assured in honesty and good faith ought to communicate to the [insurer and] . . . [i]f the applicant is aware of the existence of some circumstance which he knows would influence the insurer in acting upon his application, good faith requires him to disclose that circumstance . . . ."). To be considered a fraudulent concealment, "there must be a willful intent to defraud and not a mere mistake or oversight." *Sun Ins. Co. of New York*, 195 A.D.2d at 30.

Bear argues that MBIA did not review the contents of the doctored due diligence report, but even if that were relevant and there were no dispute of fact on that issue (and there clearly is), Bear is independently liable for fraud because it suppressed facts that would have affected MBIA's decision to enter into the Securitization. Starting on September 18, Bear knew that there were widespread issues with the sample of loans reviewed by MDMC. Ex. 20. Instead of making MBIA aware of these issues, Bear elected to cover up MDMC's adverse results to make sure that MBIA did not withdraw from the Securitization. Over the next nine days, Bear withheld the results from MBIA, despite pressure from MBIA for the results. Ex. I; Exs. 28-29, 31. That Bear did this with a fraudulent intent is readily apparent, and apparently undisputed for purposes of this motion.

Bear received MDMC's final report two days before the closing, but sat on the results while it tried to figure out internally how to deal with the "MDMC DD Issue." Ex. 32. Finally on the day of closing, Mr. Mongelluzzo "cleaned" the due diligence report—effectively creating his own report rather than providing MDMC's—in order to conceal MDMC's true results, while at the same time providing a document that looked like a third-party report and avoiding the obvious red flags that would be raised by a candid disclosure that the third party report had produced unacceptable adverse results. Ex. R. He sent this "cleaned" report (essentially a fabrication created by Bear) to Mr. Durden, along with the explanation that there were still holes in the report. *Id.* Mr. Durden, in turn, furthered the fraud by further altering the documents provided by Mr. Mongelluzzo to remove the reference to "DD Issues," and then sent the doctored "report" to MBIA in a new e-mail, making sure not to forward on Mr. Mongelluzzo's e-mail advising him that there were "holes" in the report. Ex. P. Instead, he innocuously (and falsely) advised MBIA, "Attached is the due diligence report for the above deal, let me know if you have any questions," as if nothing out of the ordinary had happened. *Id.* Under standard industry practice, it was reasonable for MBIA to believe, based on Mr. Durden's e-mail and all the relevant facts and circumstances, that no issues had arisen in the due diligence review, and that the deal should be permitted to close. Desharnais Aff. ¶ 9; Ex. 13, at 10.

Bear intentionally and fraudulently concealed and misrepresented information in order to mislead MBIA into believing that it was providing a third-party diligence report and that the third party's due diligence review had produced acceptable results. Since materiality is generally a question of fact for the jury and there is strong evidence that the information Bear concealed from MBIA was material, summary judgment should be denied.

B. Evidence Shows That MBIA Actually Relied on the Due Diligence Results in Its Decision to Allow the Securitization to Close

Even without applying the Insurance Law, summary judgment should be denied. At the summary judgment stage, the "essential elements of a fraud claim[] are not subject to summary disposition." *Brunetti*, 11 A.D.3d at 281. Rather, these questions should be saved for the jury. *Id.*[7] There is ample evidence that MBIA actually relied on Mr. Durden's e-mail and the information it provided, and therefore summary judgment cannot be granted.

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[7] The cases cited by Defendant regarding MBIA's reliance are unavailing. These cases found actual reliance impossible because either (i) the misrepresentation occurred after the possible

1. Ms. Desharnais Reviewed the Altered Due Diligence Results and Allowed the Deal to Close

Bear argues that MBIA did not actually rely before closing on the sanitized report created by Bear for the purpose of hiding the true results of MDMC's due diligence. Even if it mattered whether MBIA reviewed the report before or after closing (which it does not),[8] there is more than enough evidence for a jury to conclude that MBIA was fooled by Bear's false report before MBIA allowed the deal to close and issued its insurance policy. Bear's motion concedes that Ms. Desharnais returned to New York about three hours before the closing and took a car service to her home in New Rochelle. Even if it took Ms. Desharnais an hour to get home, she would have had two hours to make the short drive to MBIA's headquarters in Armonk to confirm before closing that the due diligence had been received and showed no issues. Both Ms. Desharnais and Ms. Murray repeatedly testified that the Securitization would not have closed without the due diligence results. Ex. 15, at 70:18-76:8, 78:7-12, 79:4-18, 83:21-84:20, 85:24-86:4, 90:7-13, 115:11-15, 129:13-18; Ex. 16, at 30:8-31:18, 44:3-45:3, 66:24-68:5; Desharnais Aff. ¶¶ 9, 11. This testimony is unequivocal and under well-established New York law, suffices to sustain MBIA's burden at trial and to defeat Defendant's motion for summary judgment.

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reliance could happen, *see Singer Co. v. Stott & Davis Motor Express*, 79 A.D.2d 227, 233 (4th Dep't 1981); *Gabriel Capital, L.P. v. NatWest Finance, Inc.*, 177 F. Supp. 2d 169, 174 (S.D.N.Y. 2001), (ii) the plaintiff never learned of defendant's misrepresentation, *Securities Inv. Protection Corp. v. BDO Seidman*, 95 N.Y.2d 702, 709 (2001), or (iii) simply ***no*** evidence of reliance, *Albion Alliance Mezzanine Fund, L.P. v. State Street Bank and Trust Co.*, 8 Misc. 3d 264, 270-71 (Sup. Ct., N.Y. Cnty. 2003); *Vitolo v. Mentor H/S, Inc.*, 426 F. Supp. 2d 28, 37 (E.D.N.Y. 2006). Here, there is ample evidence for a jury to determine that MBIA relied on the results preclosing.

8 Bear does not contest the fact that MBIA reviewed the results after closing. If MBIA had had the true results, MBIA would have had contractual and legal remedies to ensure that it suffered no losses. For example, after closing, MBIA had the contractual right to review every loan in the pool and force GMACM to replace any that did not correspond to its underwriting guidelines. Ex. 42, § 2.05(m); Ex. 43, § 2.03. Additionally, since a third of the loans in the review were deemed deficient, in October 2006 MBIA would have been able to seek indemnification or other relief from GMACM because of GMACM's material misrepresentations regarding the quality of its loans. *See* Insurance Law § 3105; Argument § A, *supra*.

Defendant argues that New York imposes a requirement that MBIA must "demonstrate a deliberate and repetitive practice by a person in complete control of the circumstances" in order to bring into evidence a person's practice. This mischaracterizes the requirement for proving practice in fraud cases. Defendant's proposed requirement only applies in specific, inapplicable situations, such as cases dealing with negligence or due care. *E.g.*, *Soltis v. State*, 188 A.D.2d 201, 203-04 (3d Dep't 1993).[9] The basis for the narrower standard in those cases is that the habit evidence there borders too closely on character evidence, which is inadmissible in civil cases. *See, e.g.*, *id.* For fraud cases, however, New York follows the traditional rule which "permits proof of a business, professional or other institutional practice or custom to be introduced as probative evidence that the practice or custom was or would have been followed under the same set of circumstances on a specific occasion." *Id.* at 203; *see also Rigie v. Goldman*, 148 A.D.2d 23, 26 (2d Dep't 1989) (recognizing that in non-negligence case, "evidence of habitual behavior or custom is admissible as circumstantial proof that the habit was followed on the occasion in question"). In general, "the admissibility of business, professional or other institutional custom or practice is not limited to instances where the witness is to testify solely to a personal habit or custom and was in total control of the circumstances." *Soltis*, 188 A.D.2d at 204 There are many examples of the type of custom evidence allowable in the typical case, but the rule specifically allows testimony regarding a person's own practice. *See, e.g.*, *Beakes v. Da Cunha*, 81 Sickels 293, 298 (N.Y. 1891) (allowing practice evidence where witness testified that notice was mailed on certain day because witness had practice of being home on that day to transact

[9] Indeed, the New York cases cited by Defendant to support its position all relate to special situations, such as (i) medical malpractice, *Rivera v. Anilesh*, 8 N.Y.3d 627 (2007); *Ferrer v. Harris*, 55 N.Y.2d 285 (1982); *Gushlaw v. Roll*, 290 A.D.2d 667 (3d Dep't 2002); *Glusaskas v. John E. Hutchinson, III, M.D., P.C.*, 148 A.D.2d 203 (1st Dep't 1989), (ii) personal injury products liability, *Halloran v. Virginia Chems. Inc.*, 41 N.Y.2d 386 (1977), or (iii) strict compliance with particularities of a statute governing prenuptial agreements, *Galetta v. Galetta*, 221 N.Y.3d 186 (2013). There is no evidence that any of these decisions were intended to change the admissibility of business custom and practice evidence that New York has recognized as probative evidence for approximately 150 years.

such business); *In re Kellum*, 7 Sickels 517, 1873 WL 10295, at *2 (N.Y. 1873) (allowing practice evidence where experienced lawyer testified that his practice was to always execute wills according to statutory requirements); *Walentas v. Johnes*, 257 A.D.2d 352, (1st Dep't 1999) (in action for past rent, where "plaintiff offered uncontroverted evidence of his practice . . . such evidence is admissible to demonstrate compliance on the occasions specified"); *Peninsula Nat. Bank of Cedarhurst v. Hill,* 52 Misc. 2d 903, 903 (2d Dep't 1966) (allowing evidence of process server's custom of making substituted service); *Otero v. Cablevision of New York*, 186 Misc. 2d 651, 657 (Sup. Ct., Kings Cnty. 2000) (allowing testimony that practice of defendant was to obtain permission from building owners); *Man-Hung Lee v. Hartsdale Canine Cemetery, Inc.*, 28 Misc. 3d 234, 245 (N.Y. City Ct. 2010) (in contract case, finding as probative testimony "that it was customary for all [prospective customers] to receive" certain information despite witness being unable to testify whether he actually spoke to plaintiff).

In any event, even under Defendant's stricter standard, Ms. Desharnais's "practice" testimony would still be admissible. MBIA has produced uncontroverted evidence showing the deliberate, repetitive practice of a professional in complete control over her circumstances. Ms. Desharnais explained that she worked on numerous securitizations, and that on all of them, MBIA required due diligence results to be received and that she reviewed those results before closing. Ex. 15, at 36:2-22, 70:18-76:8, 78:7-12, 79:4-18, 83:21-84:20, 85:24-86:4, 90:7-13, 115:11-15, 129:13-18; Desharnais Aff. ¶¶ 9, 11. Her testimony is supported by Ms. Murray. Ex. 16, at 30:8-31:18, 44:3-45:3, 66:24-68:5. Their testimony has not been "equivocal," but rather consistently shows that MBIA would not close without due diligence results.[10] MBIA's bid letter, internal policies, and underwriting approval memo all support this testimony. Ex. I, L; Ex.

[10] Defendant's cherry-picked quote which it argues proves that Ms. Desharnais's practice was "equivocal" mischaracterizes her testimony. When asked whether MBIA's practice of holding signed policies in escrow before closing signified that MBIA had completely signed off, she in fact said: "I doubt it, because we didn't receive the due diligence results. This was common that you'd get everything signed and delivered and then held, it's not released yet." Ex. 15, at 72:4-8.

14. Internal Bear e-mails do as well: Mr. Durden repeatedly told Mr. Mongelluzzo that the due diligence report was "needed" or else MBIA's policy wouldn't be released, with Mr. Durden's final request coming the night before the scheduled closing. Exs. 28, 32. Bear plainly expected MBIA would review the results before allowing the deal to close, otherwise Mr. Durden would have had no reason to pressure Mr. Mongelluzzo for the report. Therefore, Ms. Desharnais's practice testimony is not simply "conclusory" but rather fully credible and supported by the testimony of Ms. Murray, MBIA's policies, and Defendant's internal e-mails.[11] Finally, to the extent that Defendant argues that Ms. Desharnais was not in control over the circumstances, they ignore the fact that she had three hours to go to MBIA's offices, which shows ample control of the circumstance.

No matter what standard is adopted, Ms. Desharnais's testimony regarding her practice is admissible as proof of MBIA's reliance on the fake report. *See, e.g.*, *Gould v. Winstar Comms., Inc.*, 692 F.3d 148, 161 (2d Cir. 2012) ("Although [witness] was unable to recall specifically that she reviewed GT's audit opinion letter, there was evidence that she actively reviewed such letters as a matter of practice in deciding whether to recommend certain stocks. At this stage of the proceedings, [her] testimony is enough; from that evidence, a jury reasonably could infer that she actually reviewed and relied on the relevant statements in the documents.").

2. MBIA Relied Separately on Mr. Durden's Transmittal E-mail Representing That the Due Diligence Report Was Attached

Even if this Court were to adopt Defendant's legal standard and ignore Ms. Desharnais's practice testimony, MBIA would still have a triable claim for fraud. This is because, in addition

[11] To the extent that defendant argues that MBIA occasionally did not review due diligence until after closing, this too is misleading. Contrary to Defendant's insinuation, Ms. Desharnais has never said that she would allow a deal to close without reviewing any due diligence, but rather that on occasion the due diligence ***process*** would not have been ***complete*** before closing. Ex. DD, at 81:5-10. As explained by both Ms. Murray and Ms. Desharnais, it was acceptable for MBIA to close on a deal pending receipt of ***final*** due diligence, so long as it was able to review preliminary due diligence results and was given assurances that the final due diligence report would show no issues. Ex. 16, at 44:3-46:19, 104:17-105:17; Desharnais Aff. ¶ 9.

to relying on the findings contained in the "report," MBIA also relied upon Mr. Durden's fraudulent transmittal e-mail, which represented that he was attaching "the due diligence report for the [2006-HE4] deal." Ex. P. It is undisputed that he did not attach the report, but instead provided a modified document prepared by Bear. *Id.* Had MBIA known that Bear had materially altered the report, MBIA would not have provided insurance. Desharnais Aff. ¶ 11.

Additionally, the delivery of what is represented as the true report serves as a representation by the underwriter that the due diligence review raised no issues. Under normal business practice at this time, it was the underwriter's responsibility to make the insurer aware of any issues arising in the due diligence review. Desharnais Aff. ¶ 9; Ex. 13, at 10. If the underwriter raised no issues, then the insurer would reasonably believe that the due diligence review had confirmed that the characteristics of the collateral were correct. Ex. 13, at 10. An insurer was reasonable in relying on this since the underwriter used the same results to satisfy their own due diligence responsibilities under the federal securities law, and if the due diligence review had shown issues with the collateral, then the underwriter would have been expected to delay or make changes to the securitization. *Id.* Therefore, whenever an underwriter (i) raised no issues with the insurer regarding the due diligence, (ii) made no changes to the disclosure, the structure, or the collateral pool, and (iii) did not flag any issues for the insurer when sending the final report, an insurer was reasonable in relying upon transmittal of a final report as evidence that the due diligence review showed no issues with the collateral. And, in fact, MBIA did rely upon Mr. Durden's fraudulent e-mail, understandably inferring that no issues had been found.

C. MBIA Was Justified in Relying on the Due Diligence Results It Received from Bear

As an initial matter, Defendant's argument that MBIA was not justified in relying upon the information provided by Bear fails because, under the Insurance Law, justifiable reliance is irrelevant. *See, e.g.*, *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 2013 WL 1845588, at *4 ("[T]he inquiry is not whether the insurer's reliance on the misrepresented information was justifiable but instead whether the insurer might have refused the application had it been aware of the truth of the misrepresentation."); *Aguilar v. U.S. Life Ins. Co.*, 162 A.D.2d 209, 210–11 (1st Dep't 1990) ("To demonstrate materiality as a matter of law, an insurer need only show that the misrepresentation substantially thwarts the purpose for which the information is demanded and induces action which the insurance company might otherwise not have taken.").

But even if MBIA is required to show justifiable reliance, multiple issues of fact preclude summary judgment. *Brunetti*, 11 A.D.3d at 281 (justifiable reliance is jury question).[12] Defendant's sole argument is essentially that because the altered due diligence report was so clearly fraudulent, MBIA could not possibly have justifiably relied upon it. This argument rests primarily on Ms. Desharnais's testimony at her deposition in this case that she noticed that the report "doesn't have the one, two, three coding that a lot of reports that I've seen do have." Ex. 15, at 89:5-6. Defendant conveniently fails to mention that Ms. Desharnais went on to testify that she "wasn't married to the loan grades," but "was interested in the evaluation and the observations." *Id.* at 89:18-19. Ms. Desharnais then reviewed the report at her deposition and pointed to the column that represented that the loans were "Acceptable" along with a worksheet that listed a comparison between the actual data and the electric tape comparison as reasons to believe that MBIA had received the actual "outcome of the due diligence." *Id.* at 91:20-92:10. Since this was the first time that MBIA had worked on a deal with MDMC, it was reasonable to conclude that MDMC used a different reporting system.[13] And, after the close of the deal, Ms. Desharnais sent her thoughts on the due diligence report to Ms. Murray, saying that although the

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[12] Bear argues that since "a similar fraud claim previously asserted by MBIA" against Credit Suisse was dismissed, that the Court should dismiss MBIA's fraud claim here. Bear's reliance on this case is curious, however. Although the court in *Credit Suisse* initially dismissed the fraud claim, it reinstated the claim a few months later, holding that the fraud claim should not be dismissed for reasonable reliance because "[t]he question of reasonable reliance is fact-intensive." *See MBIA Ins. Corp. v. Credit Suisse Secs. (USA) LLC*, No. 603751/09, 2011 WL 4865133, at *6, 15 (N.Y. Sup. Ct., N.Y. Cnty. Oct. 07, 2011). Furthermore, the fraud claims in *Credit Suisse* are completely different from the fraud claim here, in that they don't relate to an underwriter's fraudulent alterations to a third-party's due diligence report. *Id.* at *14.

[13] Although many due diligence firms at this time used a 1, 2, 3 coding system, not every due diligence firm used this format, Ex. 33, and Bear internally used a 1 through 4 scale, Ex. 34.

reporting did not look "usual" it nevertheless "looked pretty benign." Ex. U. Thus, it is clear that although MBIA noticed that the reporting was different, the report appeared to be the actual, final report.

D. MBIA's Lawsuit Based on Bear's Fraud Is Separate from Its Lawsuit Against GMACM Based on GMACM's Fraud

As a last-ditch effort to get this case dismissed, Defendant argues that MBIA's allegations here are at odds with its allegations against GMACM. Nothing in the GMACM complaint contradicts the evidence of fraud by Bear in this case. In addition, as Bear is well aware, when it sued GMACM, MBIA did not yet know that Bear had doctored the due diligence report because it learned that only when MDMC supplied the true report in discovery. Ex. 35. And Bear cites no case, because there is none, that the clear evidence of fraud MBIA has mustered against Bear cannot be presented to a jury simply because MBIA had also filed an earlier claim against a different party for different misconduct.[14] MBIA's statements in the GMACM case in no way contradict its statements in this case.

CONCLUSION

For the reasons set forth above, this Court should deny JP Morgan's motion for Summary Judgment in its entirety.

[14] Bear's reliance on *Morgenthow & Latham v. Bank of New York Co.*, 305 A.D.2d 74 (1st Dep't 2003), is unhelpful. In *Morgenthow* plaintiff made an ***affirmative*** allegation in one case that flatly contradicted its allegation in another case. *Id.* at 75-76, 80-81. Here, MBIA in its GMACM complaint alleged fraud against GMACM based upon certain representations and then, in its Bear complaint, MBIA alleged fraud against Bear based upon a different representation. *See Matthews v. Schusheim*, 42 A.D.2d 217, 221 (2d Dep't 1973) ("[T]he representation [need not] have been the exclusive cause of plaintiff's action or non-action...."); *see also Rapaport v. Diamond Dealers Club, Inc.*, 95 A.D.2d 743, 744 (1st Dep't 1983) ("[C]omplaint [should] limit[] itself to allegations of fact clearly relevant to the causes of action sought to be pleaded.").

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Respectfully submitted,

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