To commence the statutory time period of appeals as of right (CPLR 5513[a]), you are advised to serve a copy of this order, with notice of entry, upon all parties.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER
COMMERCIAL DIVISION

Present: HON. ALAN D. SCHEINKMAN,
Justice.

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MBIA INSURANCE CORPORATION,

Plaintiff,

-against-

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

Defendant.

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Index No. 64676/2012
Motion Date: 1/17/14
Seq. # 2

DECISION & ORDER

Scheinkman, J:

INTRODUCTION

This is an action to recover damages for fraud brought by an insurer of a mortgage securitization transaction against the underwriter. There is evidence that the underwriter, knowing that a condition for issuing an insurance policy for the transaction was the submission of a due diligence report prepared by a third party and that such report showed that there were issues with the collateral pool, altered the report prepared by the third party and tendered the altered report to the insurer who then issued a financial guaranty insurance policy. There is also evidence that the alterations were done to make the collateral pool appear to be in closer conformity to loan-underwriting guidelines than was actually the case.

The insurer complains that it was fraudulently induced by the underwriter's conduct to issue the policy and alleges that it has sustained about $168 million in claims for delinquencies and charge-offs, a much higher amount, says the insurer, than it should have.[1] This record indicates that there is significant evidence that the underwriter engaged in an intentional misrepresentation of facts which may be found, at trial, to be material.

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[1]Defendant points out, in its memorandum of law (at 5), that the American residential real estate market "collapsed" not long after the transaction closed. Whether losses sustained by the insurer were due to fraud by the underwriter, due to changed economic conditions, or other causes is not an issue to be decided now.

The underwriter seeks to avoid a trial, moving for summary judgment upon the argument that the insurer's fraud claim must fail because the insurer cannot prove that any of its representatives even so much as perused the altered report before the transaction closed and, therefore, essential components of a fraud claim – *i.e.,* actual reliance, justifiable reliance and materiality – cannot be established as a matter of law. The Court agrees that there is no evidence that the insurer considered the altered report, sent to it a scant few hours before closing, before it proceeded to issue its policy.

The present Complaint contains a single cause of action for fraud which is firmly anchored to the assertions that the underwriter, through the submission of the altered due diligence information, intentionally misrepresented existing material facts and that the insurer relied on this misinformation to its detriment. While there is evidence to support the former assertion, there is no evidence to support the latter. Hence, Defendant has shown its entitlement to summary judgment dismissing the present Complaint.

Had the underwriter simply passed on the third-party due diligence information without alteration, the insurer would have only itself to blame for failing to review the information before issuing the policy. Likewise, had the third party merely sent on the unaltered due diligence information, the underwriter could have kept to itself its opinion of what that information revealed. But there is evidence that is not what happened.

There is evidence that shows that the underwriter realized that the due diligence results showed the loan pool was problematic. There is evidence from which it may be inferred that the underwriter perceived that, if the insurer was given the unaltered information (to which it was entitled), the insurer might balk at insuring the deal. There is evidence that the underwriter, in order to mask the problems with the collateral pool from the insurer, undertook to deliver the due diligence results to the insurer itself (rather than having them transmitted by the third party who performed the due diligence), delayed for nine days in providing the insurer with any information, used that time to massage the results, and then gave the altered results to the insurer at the last hours before the closing.

If this evidence is credited by the trier of facts, the underwriter may have breached a duty to disclose the true facts and, if the underwriter engaged in the active concealment of the truth, it may be held liable for its actions. Intentionally altering the due diligence results so as to disguise their true import and delivering them only at the last-minute and without disclosure of the underlying problems known to the underwriter and of the alterations made to the results by the underwriter may be found to have thwarted the insurer's ability to protect itself. The insurer had a contractually-based entitlement to access to a third-party due diligence report. The underwriter could not withhold the report for days, alter it, and then tender an altered report at the last minute, without at least disclosing to the insurer that the report had been altered or that there were problems with the collateral pool.

While there is evidence in this record that could support the imposition of liability upon the underwriter for fraudulent concealment, the insurer did not clearly plead such a theory. While the present Complaint contains at least one passing reference to the underwriter having a duty to speak, that reference appears in the portion of the Complaint that describes the nature of the action. The paragraphs of the pleaded cause of action do not contain a clear allegation of a duty to speak and, likewise, lack a clear allegation of reasonable reliance upon the absence of the information left unspoken. Stated more concisely, while the evidence on this record indicates that there may be triable issues of fact on a theory of fraudulent concealment, the insurer has not pleaded such a theory.

Accordingly, as will be addressed below in further detail, the Court concludes that the underwriter is entitled to summary judgment of dismissal of the present Complaint, but this determination is without prejudice to a motion by the insurer to interpose an Amended Complaint.

PROCEDURAL BACKGROUND

Defendant J.P.Morgan Securities LLC ("JPMorgan")[2] (f/k/a Bear, Stearns & Co., Inc.) ("Defendant" or "Bear Stearns") moves, pursuant to CPLR 3212, for an order granting Defendant summary judgment dismissing the Complaint of Plaintiff MBIA Insurance Corporation ("Plaintiff" or "MBIA"). Plaintiff opposes the motion.

"Securitization involves packaging numerous mortgage loans into a trust, issuing debt securities in the trust and selling those notes, known as residential mortgage-backed securities, to investors. The securities are backed by the mortgages, and the borrowers' payments of principal and interest on their mortgage loans are used to pay the investors who purchased the securities" (*MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD2d 287, 290 [1st Dept 2011]).

MBIA alleges that Bear Stearns fraudulently induced MBIA to issue a financial guaranty insurance policy (the "Policy")[3] in connection with the GMAC

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[2]JPMorgan merged with Bear Stearns on October 1, 2008 and it is undisputed that JPMorgan is the successor-in-interest to Bear Stearns. Nevertheless, because the events underlying this lawsuit occurred two years prior to the merger and it was Bear Stearns' actions that are in question, references to Defendant will be to Bear Stearns.

[3]It is alleged that the Insurance Agreement was entered into on September 27, 2006. The parties to the Policy were MBIA, GMACM, Walnut Grove, Home Equity Loan Trust 2006-HE4, RAMP, Wilmington Trust, and J.P. Morgan Chase Bank, N.A. (Complaint at ¶ 40).

Mortgage Corporation's ("GMACM") Home Equity Loan Trust 2006-HE4 (the "2006-HE4 Securitization"). GMACM served as the sponsor of the 2006-HE4 Securitization (Def's Rule 19-a Stmt at ¶ 3).

According to Plaintiff, the 2006-HE4 Securitization involved the creation by GMACM, as sponsor (the original owner of the mortgages), of a trust to which it sold a portfolio of mortgage loans. The trust in turn issued debt securities using the pool of loans as collateral (Complaint at ¶ 16). The securities issued by the trust were initially purchased by a number of securities underwriters, including Bear Stearns (*id.* at ¶ 17). Bear Stearns, in turn, offered and managed the sale of the securities to investors. The investors in those securities acquired rights to the income flowing from the mortgage pools. The income was generated by homeowners' payments of principal and interest on the mortgage loans held by the trust (Complaint at ¶ 16). MBIA entered into the Policy with GMACM whereby MBIA guaranteed the payments of interest and principal to the investors. Because any shortfalls in trust payments would be covered by MBIA, this allowed GMACM and Bear Stearns to market the securities based on a AAA credit rating rather than the lower credit rating the notes would have otherwise obtained.

It is alleged that Bear Stearns, as lead securities underwriter for the 2006-HE4 Securitization,[4] fraudulently manipulated a due diligence report it was obligated to provide to MBIA as a pre-condition to the release of the Policy and the closing of the 2006-HE4 Securitization.

This action was filed after MBIA learned through discovery in an action it brought against GMACM (*MBIA Ins. Co. v GMAC Mortgage LLC*, Index # 600837/2010 [Sup Ct, NY County] [the "GMACM Action"]) of evidence that Bear Stearns had manipulated the due diligence report that had been drafted by the third party due diligence provider – Mortgage Data Management Corp. ("MDMC"). MDMC had been hired by Bear Stearns to review a sample of the loans in the 2006-HE4 Securitization 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 GMACM and applicable laws and regulations when originating the loans (Complaint at ¶ 3).

In this action, MBIA alleges that, after MDMC concluded its due diligence review, MDMC reported to Bear Stearns and GMACM (but not MBIA) that approximately one third of the loans in the sample had not been originated in compliance with GMACM's loan-underwriting guidelines or with applicable laws (Complaint at ¶ 4). Plaintiff asserts, in essence, that Bear Stearns altered the MDMC report so as to remove columns of information indicating that there were problems with loans and passed the altered report along to Plaintiff who relied upon it in issuing the Policy (*id.* at ¶¶ 5-7). Plaintiff seeks recovery of: (1) damages totaling the current and future claims MBIA has had to pay under the Policy; (2) rescissory damages; (3) its

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[4]Bear Stearns status as the lead securities underwriter for this transaction is undisputed (Def's Rule 19-a Stmt at ¶ 3).

compensatory and consequential losses, including lost profits and business opportunities; (4) pre-judgment interest; and (5) punitive damages. MBIA also seeks 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.

Defendant, in response to the Complaint, filed a motion to dismiss, challenging Plaintiff's claim that it relied upon the altered information from Bear Stearns. However, after a conference held on October 18, 2012, counsel for Defendant agreed to withdraw the motion without prejudice. Discovery proceeded. A Trial Readiness Conference was held on October 9, 2013 at which the Court issued a Trial Readiness Order and directed Plaintiff to serve and file a Note of Issue, which Plaintiff did, the next day. This motion for summary judgment ensued.[5]

THE SECURITIZATION TRANSACTION

A. MBIA Bids

By early September, 2006, Bear Stearns, as lead underwriter, was orchestrating the 2006-HE4 Securitization, an offering of residential mortgage backed securities. As of September 8, 2006, matters being addressed included the dissemination of information to rating agencies and to monoline bond insurers as well as the performance of a due diligence review. The deal was targeted for closing on September 28, 2006. (Affirmation of Mark L. Greenwald, Esq. in Opposition to Defendant's Motion for Summary Judgment dated October 28, 2013 ["Greenwald Aff."] , Ex. 6).

On September 11, 2006, Bear Stearns sent a preliminary loan file to MBIA so that MBIA could prepare a bid (*id.*, Ex. 1). MBIA decided to bid on the deal even though the timing was tight (Affirmation of Anastasia A. Angelova, Esq. dated October 9, 2013 ["Angelova Aff."], Ex. E).

On September 19, 2006, MBIA issued a formal bid letter. The letter was addressed to GMACM but was emailed by MBIA's Lauren Desharnais to Robert Durden of Bear Stearns (Angelova Aff., Ex. I), who was serving as lead or primary transaction manager (Greenwald Aff., Ex. 8 at 22-27). The bid letter acknowledged MBIA's interest in considering the issuance of a financial guaranty insurance policy. The letter set forth the terms and conditions of the bid, noting that the actual issuance of a policy was subject to formal underwriting approval.

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[5]The Court expresses its appreciation to counsel for both parties for the high quality of their submissions. The Rule 19-a statements were of great assistance to the Court in navigating through the voluminous and complicated exhibits; the memoranda of law presented well-crafted arguments and helpful analyses of the law.

The Bid Letter contains two bullet points of consequence that should be noted:

> **Diligence Requirements:** GMAC Mortgage and Bear Stearns agree to share loan file diligence results with MBIA.
>
> * * * * * * * *
>
> **Pool Assumptions**: This bid is based on the accuracy of the data file provided to MBIA by Bear Stearns & Co. To the extent that the ultimate pool differs from this on and/or the due diligence results prove materially different collateral, our overcollateralization target and fee will change accordingly.

On the same day that the bid letter was sent, September 19, 2006, MBIA learned that it had won the bid (*id.*, Ex. J). The transaction closed on September 27, 2006 – only 8 days later (Def's Rule 19-a Stmt at ¶ 39).

THE DUE DILIGENCE PROCESS

As noted above, MBIA prepared its bid using preliminary loan file information. According to Lauren Desharnais, the MBIA employee responsible for coordinating the due diligence review on this transaction, the conduct of due diligence involves a review of a sample of the underlying collateral so as to verify that the assumptions made by the insurer regarding the mortgage pool were correct (Affidavit of Lauren Desharnais, sworn to October 28, 2013 ["Desharnais Opp. Aff."] at ¶¶ 8-9). Similarly, John Mongelluzzo, a Managing Director of Bear Stearns' capital markets department who coordinated Bear Stearns' due diligence efforts on this deal (Greenwald Aff., Ex. 6, Ex. 17, Ex. 12 at 34), testified that due diligence is conducted "[t]o ensure that the loans that we were purchasing were in fact what we thought we were buying" (*id.*, Ex. 12 at 34-35).

The bid letter provided that Bear Stearns and GMACM would share loan file diligence results with MBIA, as opposed to MBIA undertaking its own due diligence. While Bear Stearns could have retained its own due diligence provider, that might have been impractical given the time constraints. Moreover, MBIA perceived that the "market standard" was for the underwriter to contract with a due diligence firm (Angelova Aff., Ex. D at 180-181).

There is evidence that on September 8, 2006, Bear Stearns commissioned the third party due diligence firm, MDMC (Greenwald Aff., Ex. 6; Ex. 7 at JPMS_GM06HE4_00093054; Ex. 17). Thus, it appears that Bear Stearns arranged for the due diligence provider before Bear Stearns sought insurance bids and, certainly, before MBIA put in its bid. This tends to support the view that the underwriter was to arrange for the due diligence provider with the insurer to receive the results.

MDMC performed its due-diligence review on site at GMACM's offices in Horsham, Pennsylvania between September 13–15, 2006 (*id.*, Ex. 7).

By early morning, Monday, September 18, 2006, GMACM was inquiring as to the status of the due diligence. An email from Kim Bornstein of MDMC to Becky Balistriere of MDMC at 8:31a.m. indicated that MDMC was having "technical issues" (*id.*, Ex.18). Balistriere asked Bornstein at 9:25 a.m. whether MDMC had been provided with "failed loans." And at 11:39 a.m., Bornstein told Balistriere that "[w]e are still in the process of clearing up the reports" and that "[a]fter further review we are able to cure a number of loans that originally had failed .... (*id.*, Ex. 21). Early that afternoon, Janet Marrone, from GMACM, emailed Mongelluzzo to advise him that "Bear wants the preliminary prospectus printed Wednesday" which meant that the pool would have to be finalized by Tuesday 10 a.m. Marrone pointed out that, as of 1 p.m. on Monday, GMACM had not gotten a Level 3 report from MDMC. Mongelluzzo responded that he was working on getting the reports (*id.*, Ex. 19).

MDMC's Becky Balistriere sent an email to Mongelluzzo of Bear Stearns on September 18, 2006 at 8:14 p.m. The email forwarded what Balistriere described as "final reports." She stated:

> There are a large number of fails outstanding at this point. GMAC had been provided with fails on a loan level basis while we were at the site last week. As of now no cures have been received in our office from them. Please review and advise of any exceptions you may want to make as well as any comments/changes needed to the upload (*id.*, Ex. 20).

According to Mongelluzzo, the next day, September 19, 2006, the phone calls and emails were coming "fast and furious" (*id.*, Ex. 25). At 12:49 that afternoon, Bornstein asked Mongelluzzo to call her, expressing her "many concerns with the lateness and accuracy" of the report and, in particular, the compliance fails. She wrote:

> We asked on Thursday for any compliance issues and were told by on-site lead that there weren't compliance issues. At this late stage, GMACM wants all loans to remain in the deal. We will review the compliance fails and if GMACM agrees, we will have these cured (*id.*, Ex. 20).

At 1:42 p.m., Janet Marrone of GMACM emailed Robert Durden of Bear Stearns that GMACM had advised Mongelluzzo that "GMACM considered the pool final with no drops." She added that it was unreasonable to have received such an extensive report from MDMC late in the previous day but that GMACM would review the report for valid exceptions and proceed within the normal course of business. She wrote further:

> We asked John to let us know if there were any particular loans of concern to him, but expect that much of the report is non-material. We haven't heard from John yet today, but I would like sign off from Bear that the pool is final so that our analysts can begin to run the collateral tables (*id.*, Ex. 22).

There is evidence that, on September 19, 2006, Mongelluzzo had told GMACM to "ignore the credit findings and to resolve the compliance issues" (*id.*, Ex. 25). Indeed, at 1 p.m. that day, Durden sent out an email in which he stated that "GMAC should have the compliance issues cleared up this afternoon, which is what John M. asked them to focus on" (*id.*, Ex. 26).

On Thursday, September 21, 2006, Victor Cascio of MDMC asked Mongelluzzo by email for the deadline on "getting this report cleaned up and back to you. Mongelluzzo replied, "End of day Monday", *i.e.*, September 25, 2006 (*id*, Ex. 27). That same afternoon, Durden asked Mongelluzzo by email: "Do you have a clean dd report for the GMAC deal." Mongelluzzo responded: "not even close, why" (*id.*, Ex. 28). In reply to the question, Durden stated: "MBIA needs it, they are wrapping the deal" (*id.*, Ex. 28).

On Friday, September 22, 2006, Durden emailed Mongelluzzo: "Mongo, please send the cleaned up dd report for GMAC 06-HE4, or tell us who to contact at MDMC for it, thanks" (*id.,* Ex. 29).

On Monday, September 25, 2006, Cascio of MDMC sent Mongelluzzo "updated reports." He advised "were able to clear an additional 23 loans from the previous report, if you find other items that you decided to waive, please let me know and I will make the corrections" (*id.*, Ex. 30). The attached reports consisted of two Excel spreadsheets, each with several worksheets, and each worksheet containing numerous rows of data about the loan characteristics and the due diligence results (*id.* at Ex. 30; Ex. 12 at 178-179, 191-194). MBIA contends that, notwithstanding the clearing of additional loans, there were still 53 loans – over one-third of the sample – that failed for a variety of fundamental reasons 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 (Pltf's Opp. Mem. at 7, *citing* Ex. 30; *see* Desharnais Opp. Aff. at ¶16).

On this record, there is no evidence that Mongelluzzo sent these updated reports to anyone, whether it be anyone else at Bear Stearns, anyone at MBIA, or anyone at all. Indeed, on September 26, 2006, the day after Mongelluzzo received the updated reports from MDMC, Durden emailed Mongelluzzo again: "Mongo, please send the due diligence report for this deal. We close Wednesday morning and can't get the insurer to execute their agreement if we don't have a due diligence report" (Greenwald Aff., Ex. 32).

On September 27, 2006 – just a few hours before the closing – Mongelluzzo sent two Excel spreadsheets to Durden via email. The text of the email states: "I got these cleaned up as best I could. Still some data that is missing but most of the holes have been filled in." The files were named "GMAC HE-4 MDMC DD Data File 092506 II.xls" and GMAC "HE-4 MDMC DD Issues 092506 II.xls."

It is undisputed that the two spreadsheets that Mongelluzzo sent to Durden did not contain certain information that was included in the spreadsheets that MDMC had sent to Mongelluzzo, such as, *inter alia*, columns identifying "compliance issues," "underwriting issues," "underwriter comments," the overall loan grades, and information relating to what remedy was required to "fix the issues on certain loans" (Def's Resp. to Pltf's Stmt of Additional Facts at ¶ 22; Greenwald Aff., Ex. 12 at 187-188, 195-197, 199-204).

These changes are claimed by MBIA to include the following:

-- Modifying several cells in the "Compliance" column of the "Data Report" worksheet. These cells originally showed that MDMC had marked certain loans "Unacceptable Compliance" but were modified to show that they were "Acceptable";

-- 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

-- 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 loan (Pltf's Opp. Mem. at 8).

Mongelluzzo, at his deposition, testified that he did not recall making any deletions (Greenwald Aff., Ex. 12 at 191).

On September 27, 2006, about an hour after receiving the email from Mongelluzzo, Durden sent an email to Carl Webb and Lauren Desharnais of MBIA. Desharnais was a Director in the New Business Group at MBIA and Webb was her supervisor. The email was not sent directly to Theresa Murray, who was a director at MBIA responsible for credit risk and chairing the Underwriting Committee for the 2006-HE4 Securitization (Def's Rule 19-a Stmt at ¶ 9).

The email was headed: "GMAC 2006-HE 4 DUE DIL REPORT." The text of the email reads:

> Attached is the due diligence report for the above deal, let me know if you have any questions.

Attached to the email was one Excel spreadsheet: "GMAC HE4-2006 MDMC DD Data File 092506 II.xls.[6] It is not disputed that Durden combined the two spreadsheets he had obtained from Mongelluzzo into one.[7]

Plaintiff argues that Durden did not simply pass along Mongelluzzo's email of September 27 because that would have revealed that Mongelluzzo had "cleaned up" MDMC's spreadsheets. The Court notes that someone who actually looked at the email could plausibly have perceived that the forwarded spreadsheet was MDMC's work product given the reference to "MDMC DD Data File" in the name of the document, along with the absence of any reference to any alteration by Bear Stearns. Additionally, it could be inferred that, by combining the "Data File" spreadsheet with the "HE-4 MDMC DD Issues 092506 II.xls" spreadsheet, Bear Stearns was seeking to mask the fact that there had been "issues" with the due diligence review.

There is no dispute that Mongelluzzo, who had the MDMC spreadsheets, did not send them to MBIA. There is also no dispute that Durden sent MBIA only one spreadsheet that he had prepared from the two spreadsheets that Mongelluzzo had altered from the ones he had gotten from MDMC.

BEAR STEARNS' CONTENTIONS REGARDING MBIA'S LACK OF RELIANCE ON THE DUE DILIGENCE INFORMATION

Defendant portrays MBIA as a reckless insurer, interested only in competing to "win" the business,[8] and in so doing, willing to allow certain things to occur

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[6]The email header also refers to an attachment of "Disclaimer.txt" but since the parties make no issue of this, the Court will not attach any significance to it either.

[7]Defendant's Rule 19-a Statement asserts that Durden combined the spreadsheets (¶ 27). Plaintiff's Rule 19-a Statement of Affirmative Facts (¶ 24) states that Durden combined the spreadsheets. While Defendant asserts that the evidence cited by Plaintiff does not support the assertion, Defendant then refers the Court to its prior statement that Durden combined the spreadsheets.

[8]MBIA's bid for the 2006-HE4 Securitization was based on a premium of 12 basis points and MBIA's bid on "similar" transactions was based on a premium of 13 basis points (Def's Rule 19-a Stmt at ¶ 8).

post closing,[9] such as reviewing the results of the due diligence performed. While there was some testimony to the effect that MBIA would allow deals to close prior to receiving the final due diligence reports given the pressure from MBIA's new business unit to close transactions (*see* Def's Mem. at 12, *citing* Ex. O at 52, 54-55, 117-120; Ex. V; Ex. DD at 79-81; Ex. G at 19-22, 24-25), the testimony of the MBIA witnesses (*i.e.,*Desharnais and Murray) was consistent that to the extent deals closed prior to receiving the final due diligence,[10] MBIA had been receiving information as to the progress of the due diligence that had been performed and had been made comfortable as to the results uncovered such that it would allow the deal to close prior to the receipt of such final due diligence reports. Hence, this contention by Defendant will not carry the day on summary judgment.

Defendant's main point is that no one from MBIA actually read the altered spreadsheet received from Bear Stearns on that fateful morning of September 27, 2006, so MBIA cannot prove, by clear and convincing evidence, that it relied on that document in deciding to issue the Policy. Defendant submits evidence, which has not been refuted by Plaintiff, that the only two people to have received the spreadsheet directly from Durden, Bear Stearns' transaction manager, on September 27, 2006 were Webb and Desharnais; Murray did not receive it until October 3,[11] a week after the deal closed (Def's Mem. at 8, *citing* Ex. T Resp. to Interrog. No. 8; Ex. O at 76-77; 84; 117-120; Ex. P; Ex. U, Ex. V; Ex. G at 107-109; Ex. Q at 57- 63; 204-207; 219-220).

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[9]Defendant also tries to insinuate that MBIA may have been lax in its diligence with regard to this transaction based on its prior involvement with GMACM on another securitization that Defendant contends was similar to this one. Defendant does this by relying on the deposition testimony of Carl Webb, the Managing Director and head of the new business group for residential mortgages and secondary markets at the time of the 2006-HE4 Securitization, in which he testified 2006-HE4 Securitization involved a sizeable piece of business for MBIA and that at the time of the 2006-HE4 Securitization, MBIA regarded GMACM as a "very good originator" and "very strong counterparty" (Def's Rule 19-a Stmt at ¶ 7).

[10]Defendant relies heavily on Murray's deposition testimony in which she testified that it appeared that they were looking at the final due diligence after the deal closed in connection with the 2006-HE4 Securitization. However, as noted, this testimony was tempered by other testimony from Murray that MBIA would not have allowed the deal to close unless they had received some comfort as to the due diligence being performed (*id.* at 14, at Ex. G at 108-109).

[11]Plaintiff does not contest that the first time Theresa Murray saw the altered report was on October 3, 2006 when Lauren Desharnais sent her an email attaching the report and that Murray responded on October 4, 2006 in an email in which she stated that she and Desharnais should get together to discuss later that day after they had both had a chance to review (Def's Rule 19-a Stmt at ¶¶ 31, 34, 56).

A. Theresa Murray

According to Defendant, it was Murray who was responsible for reviewing the due diligence and "to confirm all closing conditions had been met, to sign off on the underwriting, and to determine whether the deal would go forward" (Def's Mem. at 8, *citing* Ex. D at 13-16; Ex. G at 12-15, 21-25; 65-67; Ex. L).[12] Defendant contends that she had "completed this responsibility two days earlier, September 25, when she released the insurance policy in MBIA's system before receiving the due diligence" (*id., citing* Ex. G at 68-70, 100-102, Ex. M).

It is undisputed that, on September 25, 2006, two days prior to closing, MBIA's Underwriting Committee voted its conditional approval to issue a policy for the 2006-HE4 Securitization (Def's Rule 19-a Stmt at ¶ 20). One of the closing conditions listed on the Underwriting Committee's Approval Memorandum is "Due Diligence Follow Up" (*id.* at ¶ 23). While Murray did release the policy in MBIA's system on September 25, 2006, she testified that releasing a policy in the system did not mean she was done with the deal. She testified that "if there were still pre-closing conditions, I would have to monitor it if I had signed off on it in MIDAS" , *i.e.*, MBIA's internal data system (Murray Tr. 68:15–76:7; Ex. M).

B. Carl Webb

It is undisputed that Webb testified that he could not recall if he had received the September 27 Durden email or reviewed the attached due diligence spreadsheet (Def's Rule 19-a Stmt at ¶ 33). Webb also testified that the "general practice" at MBIA was that it "would have received" the due diligence results prior to closing, and that the policy "would not have gone out if we didn't have the results" (*id.* Def's Rule 19-a Stmt at ¶ 59).

C. Lauren Desharnais

With Murray not having seen the report on September 27, 2006 and Webb not recalling if he had received it or reviewed it, the issue comes down to Desharnais.

Desharnais repeatedly testified that she had no direct memory of this transaction and no recollection of receiving the Durden email and spreadsheets, reviewing them, or discussing them with Murray on September 27, 2006 (Angelova Aff.,

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[12]Defendant also portrays Desharnais as not having the responsibility to review and sign off on the due diligence results as it was only Murray's responsibility as Chair of the Underwriting Committee and Desharnais had no voting authority on the Underwriting Committee (Def's Mem. at 9, *citing* Ex. O at 28-30; Ex. D at 14-16, 145-147).

Ex. O at 17-18, 54, 73, 85, 86, 93). She also testified that her practice at the time was to review third party due diligence results prior to closing (Ex. O, at 85-86). She further testified that she "would have" reviewed the due diligence report transmitted by Durden prior to closing because it was her general "practice" to review due diligence and to discuss it with Murray prior to closing, and because she "would not have let the deal close if those conditions weren't fulfilled" (*id.* at ¶ 39-40 115, 121,129). In addition, she claims that she would not have allowed the transaction to close if she had serious concerns with the information sent to her on September 27,2006 (*id.* at ¶ 112).[13]

Defendant points to evidence that Desharnais could not possibly have reviewed the information. It is undisputed that Durden sent the email to her at 9:59 a.m., the deal closed prior to 1:38 p.m. and from 8:00 a.m. to 10:37 a.m., Desharnais was on a flight from Minneapolis, Minnesota, to New York (Def's Rule 19-a Stmt and Pltf's Resp., ¶¶ 39, 41-43). Defendant also cites evidence that the handheld electronic device she may have had with her was not suitable to review the excel spreadsheet due diligence report (Def's Rule 19-a Stmt at ¶¶ 42-48; Def's Mem. at 9-10).

MBIA's network remote log on information indicated that Desharnais credentials were used to log into MBIA's system on the morning of September 27 at 10:20 a.m., and to log out at 10:22 a.m. EST (Def's Rule 19-a Stmt at ¶ 48). This would have been around the time that her flight to New York City was landing. There is no evidence, however, that Desharnais (or someone using her credentials) opened the Durden email or its attachment.

Defendant closes the loop by providing evidence that MBIA's witnesses (Desharnais, Webb and Murray) all admitted that "MBIA could have stopped the closing if it did not get all the information it was entitled to receive under the Bid Letter, and that they could have stopped the closing until they were satisfied with the due diligence" (Def's Mem. at 11, *citing* Ex. D at 36-37; Ex. O at 112-115; Ex G. at 29-31). Further, that Desharnais, when shown the altered report at her deposition, noticed (albeit after studying it for 19 minutes), that the loan grades were missing from the Excel spreadsheet (Def's Mem. at 10-11, *citing* Ex. O at 84-89).[14] Despite this, Defendant

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[13]Defendant points to speculative testimony from Desharnais that while she had no specific recollection of having reviewed the due diligence report prior to the closing, she "'doubt[ed]' she would have signed off and closed the deal without reviewing the results, based on what she 'would have' done in her general 'practice'" (Def's Mem. at 12, *citing* Ex. O at 70-72, 82-86, 121).

[14]Desharnais described herself as "very experienced" in reviewing due diligence reports, having reviewed them throughout the entire period of her 10- to 15-year career at MBIA as a team leader, and testified that she "knew what I wanted to find" when she reviewed due diligence results (Def's Rule 19-a Stmt at ¶ 50). MBIA does not dispute that Desharnais testified that she looked for loan grades, compliance issues, and

points out that "on September 27, Desharnais took no action whatsoever. Though she is the only MBIA employee who could possibly have reviewed the results prior to closing, and was demonstrably capable of spotting the missing loan grades and halting the closing, her contemporaneous emails reflect that she did nothing with the results until October 3 [when she forwarded the due diligence report to Murray], and even then merely remarked on the absence of 'the usual type of reporting[.]'" (Def's Mem. at 11, *citing* Ex. O at 117-121; Ex. V).

As its legal argument, Defendant contends that Plaintiff will not be able meet the higher (clear and convincing) standard of proof "with respect to any of the three elements at issue on this motion: actual reliance, justifiable reliance, or materiality. MBIA did not even look at the allegedly fraudulent due diligence results prior to closing on the 2006-HE4 Securitization,[15] could not have justifiably relied upon the results because the absence of information Bear Stearns supposedly 'concealed' was obvious, and did not consider the results at all material to its decision to proceed with issuing a financial guaranty policy" (Def's Mem. at 13). It is Defendant's position that Desharnais' total lack of recollection is fatal to Plaintiff's claim since fraud cannot be proven by clear and convincing evidence on "guesswork" or "'speculative' or 'conclusory' assertions of reliance ...." (*id.* at 15, *citing Vitolo v Mentor H/S Inc.*, 426 F Supp 2d 28, 37 [ED NY 2006], *affd* 213 Fed Appx 16 [2d Cir 2007], *cert denied* 552 US 815 [2007], *Schultz v Commercial Programming Unlimited, Inc.,* 1992 WL 396434 at *3 [SD NY 1992]; *Carter v Newsday, Inc.*, 528 F Supp 1187, 1191 [ED NY 1981]; *Callisto Pharmaceutical, Inc. v Picker,* 74 AD3d 545 [1st Dept 2010]).

To the extent Plaintiff is relying on Defendant's omission of material information, Defendant argues that "MBIA cannot meet its burden of proving that it actually relied upon Bear Stearns' purported omission of 'significant problems' from its transmittal of a report that MBIA received but never read, any more than it can prove actual reliance upon purported misrepresentations contained in the report. New York has 'repeatedly refused to import' a 'presumption of reliance for misleading omissions' into common law fraud claims ... MBIA 'must therefore show actual reliance for misrepresentations ***and*** omissions" (Def's Mem. at 17, *citing International Fund Mgmt. S.A. v Citigroup Inc.*, 822 F Supp 2d 368 [SD NY 2011]; *Lerner v Fleet Bank, N.A.*, 459 F3d 273 [2d Cir 2006]; *Eagle Comtronics, Inc. v Pico Prods., Inc.*, 270 AD2d 832 [4th

underwriting issues when reviewing due diligence reports, but also testified that she "wasn't married to the loan grades," but rather "was interested in the evaluation and the observations" in due diligence reports (*id.* at ¶¶ 49-50). After reviewing the due diligence spreadsheets at her deposition for 19 minutes, Desharnais confirmed that it "doesn't have the one, two, three coding that a lot of reports that I've seen do have" (*id.* at ¶ 52).

[15]According to Defendant, all of the evidence points to the fact that Desharnais and Murray did not review the due diligence report until October 3, 2006.

Dept 2000] [emphasis added]).

Defendant argues that Plaintiff cannot rely on Desharnais' claims that she would have reviewed the due diligence sent because it was her practice to do so because "'[e]vidence of a practice is admissible to prove conformity with that practice on a specific occasion only 'where the proof demonstrates a deliberate and repetitive practice by a person in complete control of the circumstances'" (Def's Mem. at 17-18, *quoting Rivera v Anilesh*, 8 NY3d 627, 633-34 [2007]) – *i.e.*, "there must be a specific protocol that the witness 'repeatedly and invariably used'" (*id.* at 18, *quoting Galetta v Galetta*, 21 NY3d 186, 198 [2013]). Because Desharnais "offere[ed] no description of a typical protocol that she 'repeatedly and invariably' followed in reviewing due diligence results" and instead "admitted that she reviewed due diligence reports ***after*** closing on a 'not infrequent' basis confirming that her supposed 'practice' was neither deliberate nor repetitive'" and, therefore, is inadmissible (*id.* [emphasis in original]).

Defendant contends that, even if there is a triable issue as to actual reliance, there is no triable issue as to whether such reliance would be justifiable. According to Defendant, because MBIA is a sophisticated party, and the "'facts represented are not matters peculiarly within the party's knowledge, and the other party has the means available to him of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation, he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations'" (Def's Mem. at 20, *quoting DDJ Mgmt., LLC v Rhone Group L.L.C.*, 15 NY3d 147, 154 [2010]). Defendant asserts that the duty to investigate also applies to cases in which the defendant has made a "'selective disclosure and partial withholding of information relevant to assessing the risks of the subject transactions'" (*id., quoting Societe Nationale D'Exploitation Industrielle Des Tabacs Et Allumettes v Salomon Bros. Intl., Ltd.*, 268 AD2d 373, 374-75 [1st Dept 2000], *lv denied* 95 NY2d 762 [2000]). Further, it is Defendant's position that "where a plaintiff voluntarily decides to proceed with a transaction despite knowing that it has not received full or complete information, its alleged reliance 'cannot be considered reasonable or justifiable'" (*id.*, at 20-21, *quoting KNK Enters., Inc. v Harriman Enters., Inc.*, 33 AD3d 872, 872 [2d Dept 2006], *lv denied* 8 NY3d 804 [2007]).

According to Defendant, the evidence "shows that Desharnais either did not undertake a reasonable review and investigation of the due diligence results when they were made available to her, or she noted the omissions and elected to proceed anyway. In either event, MBIA's reliance was not justifiable" (*id.*).[16]

As a secondary argument, Defendant asserts that MBIA's judicial admissions made in the related action are contrary to the allegations contained in the present Complaint and, therefore, this action must fail. Defendant points out that the Complaint filed in the related action makes no mention of Bear Stearns, the due diligence report or any reliance on it and instead is replete with allegations concerning Plaintiff's reliance on "loan tapes and data, loan schedules and statistics, representations and warranties, and 'shadow ratings'" (*id.* at 22). As such, "MBIA cannot now change its theory of justifiable reliance simply because it wishes to pursue a new target after GMAC Mortgage's bankruptcy" (*id.* at 23).

Defendant contends that the due diligence results "were not material to MBIA's decision to issue a financial guaranty policy for the 2006-HE4 Securitization, and that Plaintiff would not have acted differently if Bear Stearns had provided other versions of the MDMC spreadsheets. MBIA made the transaction a 'top priority' despite the 'very tight' time frame and 'tight' resources, and lowered its premium to improve the competitiveness of its bid, not because of Bear Stearns' involvement as lead underwriter, but because it viewed GMAC Mortgage a 'very good originator' and 'very strong counterparty'" (*id.*). In further support, Defendant relies on the fact that Murray testified that there was tremendous pressure because of the competitive business environment among monoline insurers and that MBIA was "'effectively committing at the business stage,' and never backed out of a transaction after approving it at the bidding stage, well before receiving the due diligence results" (*id.* at 24). To show MBIA acted accordingly on this transaction, Defendant argues the evidence shows that MBIA conditionally approved the transaction two days before closing without having seen the due diligence and without requiring a follow up vote. As further evidence of the inconsequential nature of Bear Stearns' involvement and the due diligence, Defendant relies on: (1) the Underwriting Committee Memorandum which did not include due diligence as a major analytical point and did not identify Bear Stearns as a key player; (2) the Bid letter itself which did not state that materially different due diligence results from that represented would result in MBIA's decision not to issue its policy, only that it could affect the "overcollateralization target and fee" (*id.*). Defendant relies on the fact that Webb, Murray and Desharnais did not even review the results prior to closing and "[t]hese facts preclude any triable issue on the element of materiality, as MBIA has not offered and cannot offer any evidence that it would have acted differently had Bear Stearns disclosed MDMC's due diligence spreadsheets in their entirety" (*id.* at 25).

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[16]In support, Defendant relies on two other cases (one of which involved MBIA) where the courts dismissed fraud claims because the plaintiff had hints of falsity yet failed to investigate or insert protective language in contract despite its heightened duty to investigate (Def's Mem. at 21, *citing MBIA Ins. Corp. v Credit Suisse Sec. (USA), LLC*, 32 Misc 3d 758 [Sup Ct, NY County 2011]; *ACA Fin. Guar. Corp. v Goldman Sachs & Co.*, 106 AD3d 494 [1st Dept 2013], *lv dismissed* 22 NY3d 909 [2013]).

PLAINTIFF'S CONTENTIONS IN OPPOSITION

Plaintiff submits an affidavit from Desharnais. In it, she admits that, due to both the passage of years and the number of transactions she was a part of in 2006, she does not have a specific recollection of how the events unfolded with regard to the 2006-HE4 Securitization. She adds, however, that she has reviewed the documents and can "describe the circumstances surrounding the days leading up to and subsequent to the closing with a reasonable level of reliability based on those documents and [her] general practices at the time" (Affidavit in Opposition of Lauren Desharnais, sworn to October 28, 2013 ["Desharnais Opp. Aff."] at ¶ 6). She avers that she was "the primary point of contact between MBIA and the other parties to the transaction, including the underwriter, Bear Stearns. As part of this role, [she] was responsible for receiving and evaluating the results of the third-party due diligence review conducted ... by [MDMC]" (Desharnais Opp. Aff. at ¶ 4).

With regard to the requirement in the bid letter that Bear Stearns and GMACM share the results of the third party due diligence, Desharnais explains that neither GMACM nor Bear Stearns objected to the provision of these results and if either had refused to share such results, MBIA "would not have agreed to insure the securitization" (*id.* at ¶ 7) since it was the only way for MBIA to confirm that the loans were accurately reflected by the issuer (*id.* at ¶ 9). According to Desharnais, "MBIA relied upon the loan tape, the prospectus, and the loan purchasing agreement to decide whether to bid ... and to determine what fee MBIA should charge and what losses were likely" and since the third party due diligence served as a check on the collateral, it was not necessary to have the third party due diligence results before "formulating its bid or making its preliminary determination to enter into the securitization" and the results only needed to be made available prior to closing (*id.* at ¶ 9).

Desharnais explains that it "was standard practice at the time, for the underwriter to alert [her] to any issues they were finding in the due diligence. If the underwriter did not raise any issues with the due diligence either orally or through preliminary reports, then that meant that they had not seen any material issues with regards to the due diligence results" (*id.*). She admits that on occasion MBIA would allow the deal to close prior to receipt of a final due diligence report provided it had been able to receive and evaluate a preliminary report and were given assurances from the underwriter that all issues in the preliminary report would be addressed (*id.*).

She describes the email she received from Durden on September 27, 2008 and states that she would have taken Durden's statement that he was attaching the due diligence report for the 2006-HE4 deal as meaning that he was providing the report Bear Stearns received from MDMC. She confirms that if Durden had stated that what he was providing a document created by Bear Stearns that omitted important parts of MDMC's due diligence report, she would have never allowed the deal to close. She avers that in her experience, the "transmission of this report by the underwriter signaled that it was ready to close the transaction as it was, meaning that, in the underwriter's view, the collateral was generally consistent with the representations in the transaction documents" (*id.* at ¶ 10). Thus, Durden's email signaled to her that the "due diligence review had been completed and, because he raised no issues concerning the results, also advised [Desharnais] that the results were consistent with [MBIA's] assumptions concerning the collateral" (*id.* at ¶ 11). She further confirms that it is her recollection that she reviewed the due diligence results prior to closing on all of the deals in which she served as securitization team leader including this transaction (*id.*).

Desharnais asserts that it was her "practice" to review the due diligence results individually and to pass her thoughts to Murray and that while Murray would usually want to review the results herself before closing, "when faced with a short deadline, [Desharnais'] review of the due diligence would usually provide sufficient comfort to Ms. Murray" (*id.*). With regard to this transaction, Desharnais states that, based on documents she reviewed, she has no reason to believe she deviated from her standard practice (*id.* at ¶12).

She avers that she returned from her trip to Minneapolis on September 27, 2006 at 10:38 a.m. and that, while she cannot specifically recall the events that day, there are emails which show that she did not have a laptop with her and that she took a car service back to her house in New Rochelle (*id.* at ¶ 13). She adds that she is "reasonably confident" that from there she would have gone to MBIA's office in Armonk, which was only 15-20 minutes away (*id.*)

Desharnais emphasizes that if she had not received the results prior to closing or did not have adequate time to evaluate them, she would not have allowed the deal to close (*id.* at ¶ 11).

With regard to the actual, unaltered MDMC due diligence report, Desharnais asserts that it shows that over a third of the loans had been graded Level 3 (a failing grade) and the credit and compliance issues outlined in the report evidence "very serious issues in the collateral, such as credit scores or debt-to-income ratios not conforming to GMAC Mortgage's acceptable guidelines, files missing verification of important information like income or employment, and loans not conforming to legal requirements" (*id.* at ¶ 16). She avers that if she been provided the unaltered report, she would not have allowed the deal to close unless and until the issues had been addressed (*id.* at ¶ 16).

With regard to her email to Murray on October 3, 2006, she attests that it confirms that she had previously read the report and that she found that while the report was not the usual format she had seen in the past, the results looked benign (*id.* at ¶ 14). Further, that she and Murray arranged to meet the following day to go over the report in order to examine the format of the report and to get a better understanding of

GMACM's collateral so as to be better informed on future deals with these parties.

Desharnais avers that if she had been given the true due diligence results after the closing, she would have immediately alerted senior management at MBIA to make sure they did everything to ensure that they did not suffer losses (*id.* at ¶ 17).

Plaintiff also submits an expert report from James H. Aronoff, Managing Partner of MTGX, LLC and Managing Director at Duff & Phelps where he is "a senior member of the firm's Dispute and Legal Management Consulting practice"[17] (Greenwald Aff. , Ex. 13). On the issue of whether Bear Stearns' "alterations would have played a significant factor in a financial guaranty insurer's decision to issue a financial guaranty insurance policy for the Securitization," Aronoff opines that the alterations made by Bear Stearns to MDMC's due diligence report "were significant and that a reasonable monoline insurer would have been misled by a report containing such alterations" (Ex. 13 at 2). Further, he opines that had the true facts been known, "a reasonable monoline insurer either would have refused to insure the related security or would have availed itself of all remedies available to it under the law and the transaction documents to avoid the risks concealed by the altered report" (*id.*). Aronoff confirms that the changes made were "not apparent on the face of the report sent to MBIA ...." (*id.* at 16, 19).

Aronoff explains that the insurance MBIA provides is "an unconditional and irrevocable guaranty to bondholders that they would receive interest and principal payments with respect to a security, when due, in the event that the related issuer or trust fails to make such payments" (*id.* at 5). Further, "[a] security insured, or 'wrapped,' by a financial guaranty insurer would receive the same rating as that insurer's claims paying rating, which during the relevant time period was Triple-A, the highest rating issued by the rating agencies" which made such wrapped securities more marketable and attractive to the issuers and underwriters (*id.*).

Aronoff states that it was typical for securitizations to occur within a three to four week time frame and that it was not customary for the insurer to select a loan sample and conduct a review of the loan files (*id.* at 5). "Rather, the prevailing practice ... was that loan file reviews were conducted on a sample of the loan pool by independent third-party due diligence firms, which were retained by the securities underwriter. In turn, the securities underwriter would then share the results of this

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[17]Aronoff lists his educational background (Yale undergrad and Cornell Law School) and work experience (attorney in Mortgage Backed Securities Department at Thacher Proffitt & Wood until 1987 and various other positions in the Residential Mortgage Backed Securities area). He testified as an expert in the *MBIA Ins. Corp. v Countrywide Home Loans* case (Index No. 602825/2008) (Bransten, J.) (Sup Ct, NY County) (Greenwald Aff., Ex. 13).

independent review with prospective insurers" (*id.* at 6). This would provide the necessary assurance to the securities underwriters and insurers that the mortgage pool was as it was represented to be and that it "was underwritten in compliance with proper underwriting standards" (*id.* at 9). He explains the efficiencies in terms of both cost and time for the due diligence review to occur this way since if the due diligence review did not occur until the insurer's bid was accepted, the securitization process would be significantly delayed (*id.* at 6-7). He asserts that "it was common for insurers to include in their conditions necessary to insure the transaction a requirement that the securities underwriters send them the results of that loan file review prior to closing such transaction," which is what occurred here (*id.* at 7).

According to Aronoff, underwriters such as Bear Stearns knew that the insurers relied on the underwriters "to transmit to them the results of the loan file review conducted by the independent, third-party due diligence firm" and that the "insurers would not agree to insure a transaction until they received the due diligence report, or were otherwise informed about and satisfied with the progress and results of the due diligence process" (*id.* at 9). Aronoff references the evidence in this case showing that Bear Stearns knew that MBIA would not close without the due diligence report (Greenwald Aff., Ex. 13 "MBIA needs [the due diligence report], they are [] wrapping up the deal"; Ex. 19 "Mongo, please send the due diligence report for this deal. We close Wednesday morning and can't get the insurer to execute their agreement if we don't have a due diligence report"; Durden Tr. at 194) (*id.* at 9-10).

Aronoff asserts that Bear Stearns was motivated to alter the report and remove the unfavorable results because if MBIA had seen the MDMC report in its unaltered form, it would have not have agreed to insure the deal without significant changes to the transaction that would have necessitated "substantial additional work by the issuer and Bear Stearns and made it impossible to close the transaction on the date promised by Bear Stearns to GMAC Mortgage" (*id.* at 20).

Aronoff avers

> [t]he parties' expectations were that the securities underwriter would provide the insurer with information regarding the due diligence review and alert the insurer as to any significant problems before the transaction closed, whether through interim verbal communications, preliminary reports, or, if available, the final due diligence report. It was reasonable for the insurer to assume that the final due diligence report would be delivered as soon as it was completed, and it was not uncommon for the final report to be transmitted to the insurer the same day as the transaction's closing. In such cases, the insurer was reasonable to regard the transmittal of the final report,

> coupled with the securities underwriter's intent to close the transaction without any material changes to the disclosure, the transaction structure, or the collateral pool, as confirmation by the securities underwriter that the mortgage loans supporting the RMBS were what the parties expected them to be. This was a reasonable inference given that the securities underwriter used the results of the same due diligence review as the basis for satisfying their own due diligence responsibilities under the federal securities law with respect to the related mortgage loan pool. When the final report was not available prior to closing, it was expected by the insurer that such final report would be delivered as soon as possible after the transaction closed (*id.* at 10).

Aronoff contends that, in his experience, "it was unheard of for a securities underwriter to make substantive alterations of the kind Bear Stearns made to the MDMC report" (*id.* at 19). He asserts that the altered report left nothing that would have led MBIA to believe there was anything out of the ordinary with the due diligence results. Moreover, according to Aronoff, it was reasonable for MBIA "to infer that the due diligence results were satisfactory ... based simply on the fact that Bear Stearns delivered the final report to MBIA without identifying any problems in the due diligence and then moved forward to close the Securitization without any changes in its disclosure, terms, or collateral pool" (*id.* at 19).

In its memorandum of law, Plaintiff argues that based on New York's Insurance Law § 3105, all that it must show is that a fact misrepresented by an applicant for insurance would have been material to the insurer's decision to insure. According to MBIA, Bear Stearns had the affirmative duty, as an applicant for insurance,[18] to tell MBIA of problems found in MDMC's due diligence review since these results were material to MBIA's issuance of insurance. It is Plaintiff's contention that Bear Stearns' "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" (Pltf's Opp. Mem. at 2) – *i.e.,* MBIA would not have issued the policy on the same terms if it had known the true nature of the due diligence results (*id.* at 13). MBIA argues that "[m]ateriality 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" (*id.* at 15). Nevertheless, it contends that it has established that the misrepresentations were material since two MBIA employees have testified to the

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[18]Plaintiff argues that Bear Stearns was an applicant for insurance since it solicited and selected the insurer (MBIA), provided MBIA with the information to make its bid, and Bear Stearns together with GMACM chose MBIA (Pltf's Opp. Mem. at 13).

materiality of the due diligence report (*id.*). Moreover, "[i]f 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 nine days or to significantly alter MDMC's report before sending it to MBIA" (*id.*). In this regard, Plaintiff refutes Bear Stearns' reliance on the words in the bid letter to the effect that if the due diligence results were not as expected, MBIA could change its fee or over-collateralization levels, by pointing out that there is nothing in the letter to suggest that these were the only remedies MBIA had. Instead, Desharnais testified that if MBIA had received results it was not satisfied with, it would have been free to withdraw from the Securitization. Further, it is argued, even if a change in its fee or over-collateralization target were its only remedies, Bear Stearns would still be liable for fraud since the inquiry is whether MBIA would have entered the deal under the exact same terms.

Moreover, says MBIA, because under the Insurance Law, a material misrepresentation is also made when a party withholds material information (*i.e.*, there is a duty to disclose material information even if not explicitly requested by the insurer), even if there was no disputed issue of fact over whether MBIA reviewed the altered report (which MBIA contends there is), it would be irrelevant since Bear Stearns suppressed facts that would have affected MBIA's decision to enter into the transaction and did so with fraudulent intent (*id.* at 17-18).

MBIA argues that even if the Insurance Law does not apply, "there is ample evidence that MBIA actually relied on Mr. Durden's email and the information provided, and therefore summary judgment cannot be granted" (*id.* at 18). MBIA contends that the evidence demonstrates that Desharnais had a full two hours to get to MBIA's headquarters in Armonk to confirm that the due diligence had been received and that it showed no issues. Further, it points to the testimony of Desharnais and Murray that the deal would not have closed without the due diligence results. MBIA contests that the cases on which Defendant relies for the admissibility of evidence concerning a person's practice apply here since those cases involved negligence or due care and the habit evidence "borders too closely on character evidence, which is inadmissible in civil cases" (*id.* at 20). Plaintiff asserts that in cases involving fraud, "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., quoting Soltis v State,* 188 AD2d 201, 203 [3d Dept 1993]).

Alternatively, Plaintiff argues that even if Defendant's stricter standard applies, Desharnais' assertions are admissible as there is "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[19] ... Her testimony is supported by Ms. Murray ... Their testimony has not been 'equivocal,' but rather consistently shows that MBIA would not close without the due diligence results. MBIA's bid letter, internal policies, and underwriting approval memo all support this testimony ... 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 closing ... 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" (Pltf's Opp. Mem. at 21-22).

MBIA argues that even if the Court does not consider Desharnais' assertions as to her practices, there are still triable issues of fact over MBIA's fraud because "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'" but instead Bear provided a materially altered report and had MBIA known this, it would not have provided insurance. Furthermore, relying on the Aronoff report, Plaintiff contends "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 the 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 Durden's fraudulent e-mail, understandably inferring that no issues had been found" (*id.* at 23).

Responding to Defendant's contentions that Plaintiff's fraud claim fails because Plaintiff cannot show justifiable reliance, MBIA first argues that justifiable reliance is not an element required for fraud claims under New York's Insurance Law (*id.* at 23, *citing MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 2013 NY Slip Op 50677 [U], 39 Misc 3d 1220 [A] at *4 [Sup Ct, NY County 2013]; *Aguilar v U.S. Life Ins. Co. in City of N.Y.*, 162 AD2d 209, 210-211 [1st Dept 1990]). As its second argument, Plaintiff asserts that even if it was required to show justifiable reliance, there are triable issues of fact. While Desharnais noticed, at her deposition, that the altered report was missing certain coding, she also testified that she wasn't married to loan grades and instead was interested in the evaluations and observations. Further, after she reviewed the report at her deposition, she testified that she believed that MBIA had received the actual outcome of due diligence with the altered MDMC report based on the column

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[19]Plaintiff responds to Defendant's contention that MBIA occasionally did not review due diligence until after the closing by asserting that the relevant testimony was that while, in some instances, the final due diligence reports were not received prior to closing but the deal was closed because MBIA had been provided preliminary due diligence results and assurances that the final report would show no issues (Pltf's Opp. Mem. at 22, n11).

that represented the loans as acceptable along with a worksheet that listed a comparison between the actual data and the electric tape comparison (*id.* at 24). Further, that "[s]ince 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" (*id.*). In this regard, Plaintiff points out that even Bear Stearns used a 1 to 4 scale rather than the 1,2,3 coding system. Plaintiff argues that the Desharnais email to Murray on October 3 in which Desharnais states that although the report did not look usual, it nevertheless looked pretty benign, is further evidence that while MBIA noticed the reporting was different, it viewed the report as the actual final report and not an altered report by Bear Stearns.

Plaintiff refutes Defendant's contention that it is somehow barred from suing Bear Stearns because its **prior** complaint against GMACM is at odds with its allegations against Bear Stearns in this case since: (1) at the time it sued GMACM, it had no idea that Bear Stearns had altered the MDMC report; and (2) MBIA's allegations of fraud against GMACM are based on entirely different representations than the misrepresentation asserted against Bear Stearns in this case. As such, there was no affirmative allegation made in the GMACM case that is directly at odds with the claims made here.

DEFENDANT'S REPLY

In reply, Defendant requests that the Court disregard the Desharnais affidavit as based on speculation and conjecture as to what she would have done. In this regard, Defendant points out that while MBIA produced remote log-in records reflecting Desharnais log-in for less than two minutes on September 27, 2006 when she was traveling (which Defendant argues would not have been sufficient time for her to review the due diligence report), "MBIA has failed to produce a single record of Desharnais' office login activity (if any) for the same day to prove MBIA's purely hypothetical narrative" (Def's Reply at 4, n.4, *citing* Reply Affirmation of Anastasia A. Angelova, Esq. dated November 4, 2013, Exs. EE, FF).

Defendant also asserts that Desharnais' affidavit contradicts her prior deposition testimony wherein she repeatedly stated (76 times) that she had no recollection of receiving, reviewing or discussing the due diligence results prior to closing (Def's Reply at 2-4). And Defendant contends that Desharnais' averment in her affidavit that her review of the due diligence results would "usually provide sufficient comfort to Ms. Murray" (Desharnais Aff. ¶ 11), contradicts her deposition testimony that she was "a hundred percent" sure that she "would have discussed [the due diligence results] with Ms. Murray" before allowing the deal to close (Def's Reply at 4-5, *citing* Desharnais Tr. at 79).

Defendant argues that MBIA cannot raise theories for liability not alleged in its complaint as a means to avoid summary judgment. These new theories are: (1) that reliance is irrelevant because the fraud claim is governed by New York's Insurance Law as Bear Stearns was an applicant for insurance; (2) Bear Stearns had the obligation to disclose the due diligence information regardless of whether MBIA reviewed the report; and (3) MBIA relied on the transmittal email of the report which was a separate misrepresentation. Defendant also contends that each of these theories is without proper basis in fact and law.

THE SUMMARY JUDGMENT STANDARD

The proponent of a motion for summary judgment carries the initial burden of production of evidence as well as the burden of persuasion (*Alvarez v Prospect Hosp.*, 68 NY2d 320 [1986]). The moving party must tender sufficient evidence to demonstrate as a matter of law the absence of a material issue of fact.[20] Failure to make that initial showing requires denial of the motion, regardless of the sufficiency of the opposing papers (*Winegrad v New York University Med. Center*, 64 NY2d 851, 643-644 [1985]; *St. Luke's-Roosevelt Hosp. v American Tr. Ins. Co.*, 274 AD2d 511 [2d Dept 2000]; *Greenberg v Manlon Realty, Inc.*, 43 AD2d 968 [2d Dept 1974]). Once the moving party has made *a prima facie* showing of entitlement of summary judgment, the burden of production shifts to the opponent, who must now go forward and produce sufficient evidence in admissible form to establish the existence of a triable issue of fact or demonstrate an acceptable excuse for failing to do so (*Zuckerman v City of New York*, 49 NY2d 557, 562 [1980]; *Tillem v Cablevision Sys. Corp.*, 38 AD3d 878 [2d Dept 2007]).

The court's main function on a motion for summary judgment is issue finding rather than issue determination (*Sillman v Twentieth Century-Fox Film Corp.*, 3 NY2d 395 [1957]). Since summary judgment is a drastic remedy, it should not be granted where there is any doubt as to the existence of a triable issue (*Rotuba Extruders, Inc. v Ceppos*, 46 NY2d 223 [1978]). Thus, when the existence of an issue of fact is even arguable or debatable, summary judgment should be denied (*Stone v Goodson*, 8 NY2d 8 [1960]; *Sillman v Twentieth Century Fox Film Corp., supra*). In reviewing a motion for summary judgment, the Court must accept as true the evidence presented by the nonmoving party and must deny the motion if there is "even arguably any doubt as to the existence of a triable issue" (*Baker v Briarcliff School Dist.*, 205 AD2d 652, 661-662 [2d Dept 1994]).

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[20]There is no requirement that proof be submitted in the form of an affidavit, as opposed to other acceptable forms, such as deposition testimony (*Muniz v Bacchus*, 282 AD2d 387 [1st Dept 2001]).

THERE ARE TRIABLE ISSUES OF FACT AS TO MATERIALITY

The Court does not agree with Defendant's contention that, as a matter of law, the due diligence results were not material to Plaintiff's decision to enter into the Policy relating to the 2006-HE4 Securitization.

While Defendant has presented evidence establishing *prima facie*, that Plaintiff was willing to enter into some mortgage securitization transactions without due diligence results in hand prior to closing and that Plaintiff indeed did not consider the report ultimately transmitted to it, in opposition, Plaintiff has presented evidence that due diligence results were material to its entry into the transaction and that, in those instances where due diligence results were not in hand prior to closing, Plaintiff had received preliminary reports showing no issue or had received assurances from the underwriter that the final report would show no issues. Moreover, the Bid Letter specifically conditioned MBIA's commitment to insure on the receipt of due diligence results. Defendant's own internal emails make clear that, in this deal, Defendant was getting pressure from MBIA for the results and that MBIA was asserting that it would not close if it did not have those results in hand. Moreover, the evidence upon which Defendant relies to suggest that Murray had already released the Policy two days before the closing and therefore, the receipt of the due diligence report was not a pre-condition to closing is refuted by the evidence presented by Plaintiff that the receipt of the due diligence results was a pre-condition to closing.

Since the Court cannot hold that the due diligence results were immaterial as a matter of law, it follows that, for purposes of the balance of the legal analysis, the Court must assume that the due diligence results were material. Likewise, the Court assumes, without deciding, that the changes made by Bear Stearns in the due diligence data prepared by MDMC materially changed the import of that information.

PLAINTIFF CANNOT ESTABLISH THAT IT ACTUALLY RELIED UPON THE CONTENT OF THE ALTERED DUE DILIGENCE REPORT AND THE COVER EMAIL FOR PURPOSES OF ITS CLAIM OF FRAUDULENT MISREPRESENTATION

The Court has little difficulty in disposing of any contention on MBIA's part that it actually relied upon the substantive content of the spreadsheet provided by Durden to Webb and Desharnais by email on September 27, 2006.

To establish a claim for fraudulent misrepresentation, a plaintiff must establish that there was an affirmative misrepresentation which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury (*Mandarin Trading Ltd. v Wildenstein*, 16 NY3d 173, 178 [2011]; *Lama Holding*

Co. v Smith Barney Inc., 88 NY2d 413, 421 [1996]; *MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 293 [1st Dept 2011]; *Orlando v Kukielka*, 40 AD3d 829, 831 [2d Dept 2007]; *see also Banque Arabe et Internationale D'Investissement v Md. Natl. Bank,* 57 F3d 146, 153 [2d Cir 1995]). The reliance element, which is the element at issue here, is two pronged: "the plaintiff must have relied on the representation and such reliance must have been justifiable" (*Royal Am. Mgrs., Inc. v IRC Holding Corp.,* 885 F2d 1011, 1016 [2d Cir 1989]; *see also Fidelity Funding of California, Inc. v Reinhold,* 79 F Supp 2d 110, 120-121 [ED NY 1997]).

Each element of a fraud claim must be proved by clear and convincing evidence (*Orbit Holding Corp. v Anthony Hotel Corp.,* 121 AD2d 311, 314 [1st Dept 1986]; PJI 3:20; *accord, Colavito v N.Y. Organ Donor Network, Inc.,* 438 F3d 214, 222 [2d Cir 2006]).

Here, it is obvious that MBIA cannot sustain a claim for fraudulent misrepresentation based on the content of the spreadsheet provided by Durden to MBIA for the simple reason that there is absolutely no evidence that anyone at MBIA as much as glanced at the content of the spreadsheet.

Defendant has met its burden of demonstrating *prima facie* that there is no evidence upon which Plaintiff can predicate a claim of reliance on the claimed fraudulent misrepresentations contained in Durden email and spreadsheet. Defendant has shown that there are only three possible persons at MBIA who could have received the Durden email and its attached spreadsheet. Durden actually directed the email and spreadsheet to Webb and Desharnais; neither can actually testify to having reviewed the document and having relied upon its substantive content in permitting the transaction to proceed. Likewise, it is undisputed that Murray did not see the document prior to closing.

In response to this showing by Defendant, Plaintiff has failed to raise a triable issue of fact.

To the extent that Desharnais now avers in her affidavit that her practice was to review due diligence results and not to allow a transaction to close without such review, the Court concludes that such testimony is not sufficient to raise a triable issue of fact as to whether she followed that practice on this particular occasion. On this point, the decision of the Court of Appeals in *Galetta v Galetta* (21 NY3d 186 [2013]) is controlling.

In *Galetta,* the proponent of a marital agreement sought to cure a defect in the husband's' acknowledgment of the agreement by showing that the notary public had, in fact, confirmed the husband's identity and that the husband was the person described in the agreement. The notary, in an affidavit submitted to the court, did not state that he actually recalled having acknowledged the husband's signature nor that he knew the husband prior to acknowledging the signature. Rather, he averred only that he recognized his own signature, had been employed at a bank at the time, and that it was his "custom and practice" to ask and confirm that the signer was the same person named in the document, and that he was "confident" that he had done so on this occasion. These averments, which are quite similar in nature and character to those of Desharnais, were found insufficient by the Court of Appeals. It said:

> We have held that a party can rely on custom and practice evidence to fill in evidentiary gaps "where the proof demonstrates a deliberate and repetitive practice by a person in complete control of the circumstances" .... thereby creating a triable question of fact as to whether the practice was followed on the relevant occasion. But the averments presented by the notary public in this case are too conclusory to fall into this category.
>
> Custom and practice evidence draws its probative value from the repetition and unvarying uniformity of the procedure involved as it depends on the inference that a person who regularly follows a strict routine in relation to a particular repetitive practice is likely to have followed that same strict routine at a specific date or time relevant to the litigation. For example, in *Rivera* [*v Anilesh,* 8 NY3d 627 (2007)] , a dentist who did not recall the procedure that allegedly gave rise to plaintiffs dental malpractice action—a second injection of anesthesia—was able to avoid summary judgment in plaintiff's favor by supplying a detailed description of the multistep protocol she always followed when administering such injections, coupled with proof that this protocol, if followed, comported with generally accepted medical standards.
>
> In contrast, the affidavit by the notary public in this case merely paraphrased the requirement of the statute—he stated it was his practice to "ask and confirm" the identity of the signer—without detailing any specific procedure that he routinely followed to fulfill that requirement. There are any number of methods a notary might use to confirm the identity of a signer he or she did not already know, such as requiring that the signer display at least one current form of photo identification (a driver's license or passport). It is also possible that a notary might not employ any regular strategy but vary his or her procedure for confirming identity depending on the circumstances (for example, a notary who

> works in a bank, law firm or other similar institution might occasionally rely on another employee who knew the signer to vouch for the signer's identity). If the notary actually remembered having acknowledged defendant's signature, he might have been able to fill in the gap in the certificate by averring that he recalled having confirmed defendant's identity, without specifying how. **But since he understandably had no recollection of an event that occurred more than a decade ago, and instead attempted to proffer custom and practice evidence, it was crucial that the affidavit describe a specific protocol that the notary repeatedly and invariably used—and proof of that type is absent here** (*Galetta,* 21 NY3d at 197-198 [emphasis added] [citation omitted]).

In this case, Desharnais has failed to describe a specific protocol that she repeatedly and invariably used to read and review due diligence results. There is nothing to indicate that she regularly followed a strict routine in relation to the allegedly repetitive practice. As in *Galetta*, here, there is nothing more than the bare assertion by Desharnais that she can describe the circumstances with a "reasonable level of reliability" based on the documents she has since reviewed and her "general practices" at the time (Desharnais Opp. Aff., at ¶ 7).

As in *Galetta*, there are a number of plausible practices that a person assigned to due diligence review might regularly follow. For example, a person who was assigned to review particular documents might have a practice of doing so within a certain time of receipt or might do so at a certain time of day or at a certain location. The person might have a practice or habit of making a note or entry on a computer or document indicating that he or she had reviewed a document. The person might keep a list of due diligence results he or she reviewed. The person might send an email to someone else reporting that the due diligence can be reviewed; the person might make a telephone call and keep a note of the person called (if not the content of the call). Given the proliferation of emails on this deal and in the business generally, the Court finds it peculiar that no email has been identified which would indicate that Desharnais or anyone at MBIA had reviewed the Durden email.[21]

Any possibility of a regular practice having been employed in this instance

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[21]There is no email from Desharnais to the effect that she had completed the due diligence review. There is no email from anyone at MBIA, anyone at Bear Stearns, or anyone at GMACM to the effect that the deal could proceed because the due diligence was done. While it is plausible that this information could have been communicated orally, there is no testimony that this is what occurred.

is defeated by the evidence showing that Desharnais was out of the office and in transit on the day in question. Whatever her regular custom may have been of doing work in the office, there is nothing to indicate that any such practice was followed on a day when she was traveling. The evidence is undisputed that Desharnais was on an airplane flight from 9:59 a.m (when the Durden email was sent) to at least 10:37 a.m. when her plane arrived at LaGuardia Airport. There is no contention by Plaintiff that Desharnais reviewed the due diligence on the plane.

While there remain three hours during which it is possible that Desharnais could have reviewed the Durden spreadsheet, there is no evidence that she did so. The claim in Desharnais' affidavit that she is "reliably confident" that, after first going home, she "would have headed" to MBIA's office in Armonk "to ensure that the final due diligence results showed no major issues" (Desharnais Opp. Aff. at ¶ 13) is flatly contradicted by her own introductory clause to that statement – "I cannot specifically recall the events of that day," as well as by her repeated deposition testimony that she had no recollection of this transaction. This aspect of Desharnais' affidavit presents, at best, only a feigned issue of fact designed to avoid the consequences of her earlier deposition testimony that she has no recollection of the matters at issue (*Wnetrzak v V.C. Vitanza Sons, Inc.*, 79 AD3d 939 [2d Dept 2010]; *Amplo v Milden Ave. Realty Assocs.*, 52 AD3d 750 [2d Dept 2008]; *Topal v Village of Pelham*, 304 AD2d 821 [2d Dept 2003]), given the absence of any explanation for any memory improvement (*see Telfeyan v City of New York*, 40 AD3d 372 [1st Dept 2007]).

The Court notes as well that, while there is some evidence that someone used Desharnais' credentials to log on to MBIA's computer system for two minutes at 10:20 a.m., there is nothing to indicate that Desharnais logged into the system later that day or that anyone saw her at the Armonk office or that her presence was noted on any logbook or entry record.

Nor is there any evidence that the Durden email was opened. In this computer age, it is common for email programs to record the date and time when a recipient of an email opened it. Such a record could be available on the computer or email system of both the sender and the recipient. No evidence has been offered by either party as to whether any such email record has been located.

Based on the submissions made on this record, the Court is compelled to conclude that there is not anyone at MBIA who reviewed, or gave any consideration to, the spreadsheets transmitted by Durden.

Similarly, the contention that Durden's email was itself a misrepresentation in that the email may be reasonably viewed as representing that the document that was forwarded was MDMC's work product when it was not, must fail – there is no evidence that anyone read or gave any consideration to Durden's email.

Since the Court is concluding that there is no evidence that Plaintiff actually relied upon the Durden email and spreadsheet, the Court need not reach the issue as to whether any such reliance would have been justifiable.[22]

THE COURT MAY GIVE SOME CONSIDERATION TO THE ADDITIONAL THEORIES OF LIABILITY WHICH WERE NOT PLEADED IN DETAIL IN THE COMPLAINT

The Complaint in this action contains five principal sections: (1) an introductory section headed "Nature of the Action" containing eight paragraphs; (2) a description of the parties consisting of four paragraphs; (3) a two paragraph section pertaining to jurisdiction and venue; (4) a section headed "Factual Allegations" which consists of 48 paragraphs; and (5) a section headed "Cause of Action (Fraud)" which contains ten paragraphs, one of which incorporates by reference all preceding paragraphs.

A review of the "Cause of Action" section makes plain the gravamen of the cause of action for fraud is intentional misrepresentation predicated upon the email of September 27, 2006. As set forth previously, this Court determines that such claim must fail, as a matter of law, due to lack of reliance. Perhaps in recognition of the vulnerability of its pleaded claim, Plaintiff asserts two other liability theories, which Defendant characterizes as new. Defendant asserts that courts "'should not consider the merits of a new theory of recovery, raised for the first time in opposition to a motion

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[22] "An investor may not justifiably rely on a misrepresentation if, through minimal diligence, the investor should have discovered the truth" (*Brown v E.F. Hutton Group, Inc.*, 991 F2d 1020, 1032 [2d Cir 1993]). "'New York takes a "contextual view" in deciding whether reliance was reasonable,' looking at the parties' sophistication and the information that was available.' Courts consider factors including: '(1) [t]he sophistication and expertise of the plaintiff in financial and securities matters; (2) the existence of longstanding business or personal relationships; (3) access to the relevant information; (4) the existence of a fiduciary relationship; (5) concealment of the fraud; (6) the opportunity to detect the fraud; (7) whether the plaintiff initiated the stock transaction or sought to expedite the transaction; and (8) the generality or specificity of the misrepresentations'" (*Sawabeh Info. Serv. Co. v Brody*, 832 F Supp 2d 280, 297 [SD NY 2011] *quoting Ashland, Inc. v Morgan Stanley & Co.*, 652 F3d 333, 338 [2d Cir 2011]). "A party may be found to have reasonably relied on another party's written representations, if the documents would not, on their face, have alerted the party to potential fraud ... [W]hether justifiable reliance exists presents an issue of fact" (*Bank Hapoalim (Switzerland), Ltd. v Banca Intesa S.p.A.*, 2008 NY Slip Op 52598 [U], 22 Misc 3d 1104 [A] at *4 [Sup Ct, NY County 2008]; *see also MBIA Ins. Co. v GMAC Mtge. LLC*, 30 Misc 3d 856, 861 [Sup Ct, NY County 2010] ["Reasonable reliance is a fact intensive inquiry, which should be reserved for a trier of fact"]).

for summary judgment, that was not pleaded in the complaint'" (Def's Reply Br. at 7, *quoting Mezger v Wyndham Homes, Inc.*, 81 AD3d 795, 796 [2d Dept 2011]).

Whether a court may properly consider an unpleaded theory of liability in opposition to a motion for summary judgment is itself an involved issue. Defendant properly relies upon a line of cases, typified by *Mezger*, which plainly hold that "[a] court should not consider the merits of a new theory of recovery, raised for the first time in opposition to a motion for summary judgment, that was not pleaded in the complaint" (*Mezger, supra*, 81 AD3d at 796; *accord, Golubov v Wolfson*, 22 AD3d 635 [2d Dept 2005]). However, this rule is not absolute and has not been universally applied.

In *Alvord and Swift v Stewart M. Muller Constr. Co., Inc.* (46 NY2d 276 [1978]), Chief Judge Breitel explained that unpleaded causes of action may be given consideration in opposition to summary judgment:

> [B]ecause this case involves summary judgment, not sufficiency of the complaint, failure to state a tort cause of action in pleadings would not be sufficient to permit unconditional summary judgment in favor of defendant, as a matter of law, if plaintiff's submissions provided evidentiary facts making out a cause of action....
>
> Long before enactment of the CPLR, on motion for summary judgment courts looked beyond the pleadings to discover the nature of the case .... Even when deficiencies in the plaintiff's complaint have induced courts to grant summary judgment in favor of defendant, amendment of the complaint has frequently been permitted or directed, even by appellate courts .... It has only been the dead hand of a criticized case that influenced courts to grant summary judgment for defendant when a plaintiff's submissions, but not its pleadings, made out a cause of action .... With the advent of the modern principles underlying the CPLR, application of the archaic rule is no longer merited. It must be admitted, of course, that the archaic rule, although theoretically unsound, produces no pernicious harm so long as plaintiff may in a proper case be permitted to amend its complaint to allege the cause of action proved in its submissions, the applicable Statute of Limitations not barring the late amendment (*Alvord and Swift,* 46 NY2d at 281 [citations omitted]).

In *Gold Connection Discount Jewelers, Inc. v American Dist. Tel. Co.* (212 AD2d 577 [2d Dept 1995]), the Second Department held it was proper to deny a motion for summary judgment where the opposition papers raised triable issues of fact, even though doing so required the court to "look beyond the allegations of the complaint" (*Gold Connection Discount Jewelers, Inc.*, 212 AD2d at 578). In *Noller v Peralta* (94 AD3d 833 [2d Dept 2012]), the trial court had declined on summary judgment to consider a claim not raised in the pleadings but, upon reargument, considered that claim and granted leave to amend the bill of particulars to assert that claim, determinations upheld by the Appellate Division. Although the court in *Comsewogue Union Free School Dist. v Allied-Trent Roofing Sys., Inc.* (15 AD3d 523 [2d Dept 2005]) ruled that plaintiff's inexcusable delay of six years in presenting an alternative cause of action warranted rejection of it, the court confirmed the view that "modern practice permits a plaintiff to successfully oppose a motion for summary judgment by relying upon on unpleaded cause of action which is supported by plaintiff's submissions" (*Comsewogue Union Free School Dist.*, 15 AD3d at 524; *see also Pludeman v Northern Leasing Sys., Inc.*, 106 AD3d 612 [1st Dept 2013]). There have even been instances where a party has been granted summary judgment in its favor on an unpleaded cause of action. The relevant factors are whether the proof supports the unpleaded cause of action and whether the opposing party has been misled to its prejudice; as with a trial, the court may deem the pleadings amended to conform to the proof (*Weinstock v Handler*, 254 AD2d 165, 166 [1st Dept 1998]).

The Court therefore believes it may properly give some consideration to the additional theories now asserted by MBIA.

INSURANCE LAW SECTION 3105

MBIA seeks to avoid the issue of reliance by invoking Section 3105 of the Insurance Law which, according to MBIA, requires an insurer pursuing a fraud claim to show only that a fact misrepresented by an applicant for insurance would have been material to the decision to insure. The statute applies, by its own terms, only to statements made to the insurer "by, or under the authority of, the applicant for insurance or the prospective insured."

It is not disputed that the insured, both prospectively and actually, was GMACM. MBIA argues that Bear Stearns may be viewed as being the applicant for insurance; Bear Stearns argues that it was not.

In two decisions of note, Justice Eileen Bransten has viewed "insurance brokers" as applicants for insurance for purposes of Insurance Law Section 3105 *(MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 34 Misc 3d 895, 904 [Sup Ct, NY County 2012] [Bransten, J], *modified on other grounds*, 105 AD3d 412 [1st Dept 2013]; *see also Syncora Guar. Inc. v Countrywide Home Loans, Inc.*, 36 Misc 3d 328 [Sup Ct, NY County 2012] [Bransten, J]). This construction springs from the established common law rule that an agent or broker who acts as a salesperson has a duty to supply correct information to the insurer and to make full disclosure of the nature of the risk whether or not the agent or broker is technically an agent of the insurer (*Panepinto v Allstate Ins. Co.*, 108 Misc 2d 1079, 1081 [Sup Ct, Monroe County 1981]).

Bear Stearns cites to *Financial Guar. Ins. Co. v Putnam Advisory Co.*, (2013 WL 5230818 [SD NY 2013] [Sweet, J]), involving a circumstance where the defendant who was involved in marketing a collateralized debt obligation based upon a mixture of actual and synthetic residential mortgage-backed securities was accused of having misrepresented the collateral to an insurer who provided insurance for a swap transaction. While it is unclear whether the defendant was acting in a role akin to an underwriter and it is equally unclear whether plaintiff was asserting a claim under Insurance Law Section 3105, the federal court did remark, in the context of distinguishing *MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, *supra*, that the defendant in the case before it did not apply for any insurance and did not enter into any sort of contract—insurance-related or otherwise—with the insurer.

The Court does not believe that it must give a decisive answer to whether Insurance Law Section 3105 applies in this context. A claim predicated upon Section 3105 was not presented in the present Complaint and, therefore, it is understandable that this issue was not addressed in Defendant's principal moving papers. The issue was raised in Plaintiff's opposition and responded to in Defendant's reply.

The Court cannot locate within the voluminous papers submitted anything that could be fairly characterized as an application for insurance. The Policy itself is not submitted. There is some evidence in this record that would suggest that, assuming GMACM was the only "applicant" for insurance, GMACM may have given "authority" to Bear Stearns to make statements on its behalf such that any statements made by Bear Stearns to MBIA were made "under the authority of" the insurance applicant. There is also evidence from which Bear Stearns may potentially be viewed as having been an agent for a disclosed principal and such an agent may be held liable for its own fraud (*see, e.g., Weinstein v Natalie Weinstein Design Assocs., Inc.*, 86 AD3d 641 [2d Dept 2011]). Moreover, here it also may be that Bear Stearns did enter into a contractual relationship with MBIA, *i.e.*, accepted the offer of MBIA to provide insurance on condition that Bear Stearns (along with GMACM) provide access to due diligence information.

If MBIA had moved to amend its complaint to include a cause of action under Section 3105, the Court's examination of the merits of such a claim would be confined to determining whether the proposed claim is palpably insufficient or patently devoid of merit on its face (*see, e.g., Rosicki, Rosicki and Assocs., P.C. v Cochems*, 59 AD3d 512 [2d Dept 2009]).

Because there is at least some evidence in this record that would support a claim based on Section 3105, the Court will grant Plaintiff leave to move to amend its Complaint so as to assert such a cause of action.

ACTIVE FRAUDULENT CONCEALMENT OF MATERIAL FACTS

Since MBIA cannot succeed in showing that it relied on Bear Stearns' affirmative representations as set forth in Durden's email and spreadsheet, it remains to consider whether MBIA can assert a claim based on Bear Stearns' failure to disclose what it knew to MBIA, *i.e.*, that the initial due diligence results showed that there were significant problems with the collateral pool, that GMACM was insisting on including all of the pool in the deal, and that both MDMC and Bear Stearns had been engaging in a process of attempting to sanitize the due diligence results, with the consequence that the due diligence results were delivered at the last minute to MBIA, who was unaware of the problems and the efforts to sanitize them.

It is well established that "'[t]he mere nondisclosure of a material fact, **unaccompanied by some deceptive act,** does not constitute fraud absent a confidential or fiduciary relationship" (*Sanford/Kissena Owners Corp. v Daral Props., LLC*, 84 AD3d 1210, 1211 [2d Dept 2011], *quoting First Keystone Consultants, Inc. v DDR Constr. Servs.*, 74 AD3d 1135, 1138 [2d Dept 2010] [emphasis added]). As the qualifying language in the quotation implies, while mere nondisclosure, standing alone, is not generally actionable, if the defendant does more than just stay silent and engages in deceptive acts, there are circumstances under which liability may be imposed. "In business [transactions], an affirmative duty to disclose material information may arise from the need to complete or clarify one party's partial or ambiguous statement .... or from a fiduciary or confidential relationship between the parties ....Such a duty may also arise .... where: (1) one party has superior knowledge of certain information; (2) that information is not readily available to the other party; and (3) the first party knows that the second party is acting on the basis of mistaken knowledge" (*Banque Arabe et Internationale D'Investissement v Maryland Natl. Bank*, 57 F3d 146, 155 [2d Cir 1995]).

An active concealment is substantively the same as an affirmative misrepresentation (60 NY Jur 2d, Fraud and Deceit § 88). Active concealment implies purposeful misrepresentation, *i.e.,* the Defendant's affirmative attempt to hide something (*London v Courduff*, 141 AD2d 803 [1st Dept 1988], *lv dismissed* 73 NY2d 809 [1988]). When there has been an active fraudulent concealment, a duty to speak arises even in the absence of a confidential, fiduciary or contractual relationship (*Clement v Delaney Realty Corp.*, 83 AD3d 881 [2d Dept 2011]; *Haberman v Greenspan*, 82 Misc 2d 263 [Sup Ct, Richmond County 1975]).

The elements for a cause of action of fraudulent concealment are: (1) an omission of a material fact; (2) intent to defraud; (3) duty to disclose, (4) reasonable reliance on the omission, and (5) damages suffered (*Mandarin Trading Ltd. v Wildenstein*, 16 NY3d 173, 178 [2011]). The elements of fraudulent concealment are the same as the elements required for fraudulent misrepresentation with one addition – it must be shown that "the defendant had a duty to disclose material information and that it failed to do so" (*P.T. Bank Central Asia v ABN Amro Bank, N.V.*, 301 AD2d 373, 373 [1st Dept 2003]). As with fraudulent misrepresentation, fraudulent concealment must be established by clear and convincing evidence (*Banque Arabe et Internationale D'Investissement v Maryland Natl. Bank*, *supra*, 57 F3d at 153).

Here, as previously discussed, the Complaint asserts a single cause of action based on affirmative misrepresentations, principally, if not exclusively, the content of the Durden email of September 27, 2006.[23] While the Complaint contains extensive allegations regarding the due diligence process, it contains only glancing references to a claimed duty to disclose on the part of Bear Stearns (*see* Complaint, ¶5 ["[r]ather than share the actual results with MBIA, as was its obligation"...]). There is no allegation in the present Complaint to the effect that Bear Stearns was required to disclose what it was finding out, and what it was doing, during the due diligence process. Likewise, there is no allegation in the present Complaint that MBIA relied upon Bear Stearns' failure to speak out during the course of the due diligence process.

There is evidence in this record that may support the imposition of a duty on the part of Bear Stearns to speak as well as that would support a claim on the part of MBIA that it relied on Bear Stearns' silence.

The general rule is that, "[i]n the absence of a contractual relationship or a confidential or fiduciary relationship, a party may not recover for fraudulent concealment of fact, since absent such a relationship, there is no duty to disclose" (*900 Unlimited, Inc. v MCI Telecom. Corp.*, 215 AD2d 227, 227 [1995]). While the relationship between MBIA and Bear Stearns cannot conceivably be characterized as confidential or fiduciary, it may be potentially characterized as contractual. MBIA transmitted a Bid Letter, essentially an offer to provide insurance on specified terms, to both Bear Stearns and GMACM. The MBIA offer called for Bear Stearns and GMACM to share certain information – the loan file diligence results – with MBIA. There is evidence that this offer was accepted by both GMACM and Bear Stearns; Bear Stearns embarked on a due diligence process and ultimately shared information with MBIA. Indeed, if the "loan file diligence results" mean the results developed by the third party due diligence firm (MDMC), then it is arguable that, by providing altered results, Bear Stearns failed in a contractual duty owing to MBIA.

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[23]Paragraphs 66 through 69 of the Complaint refer exclusively to the September 27, 2006 email and do not mention any other claimed representations. However, in Paragraph 70 there is a slightly more generic reference to "false and misleading statements and omissions of material facts, including the altered spreadsheet...." Likewise, Paragraphs 71 and 72 refer to Bear Stearns' "misrepresentations" without specifying whether the misrepresentations referred to are exclusively those made in the subject email and its contents.

In addition, there may be a duty to disclose, which is not limited to parties in privity of contract, when nondisclosure would lead the person to whom it was or should have been made to forego action that might otherwise have been taken for the protection of that person (*Strasser v Prudential Sec., Inc.*, 218 AD2d 526 [1st Dept 1995]). Here, a potential viable fraud claim may be predicated either upon the theory that Bear Stearns had special knowledge not available to MBIA or that Bear Stearns' responses to MBIA's requests for delivery of the due diligence information were misleading in that they failed to disclose the problems known to Bear Stearns and/or failed to disclose that the delivery was being delayed by Bear Stearns' effort to alter the results (*see Williams v Sidley Austin Brown & Wood, L.L.P.*, 38 AD3d 219 [1]st Dept 2007).

Under the "special facts" doctrine, a duty to disclose arises "when one party's superior knowledge of essential facts renders a transaction without disclosure inherently unfair" (*Pramer S.C.A. v Abaplus Intl. Corp.*, 76 AD3d 89, 99 [1st Dept 2010]; *Swersky v Dreyer and Traub*, 219 AD2d 321 [1st Dept 1996]. In *Jana L. v West 129th Street Realty Corp.* (22 AD3d 274 [1st Dept 2005]), the court ruled that the "special facts" doctrine is subject to qualification:

> [This] doctrine requires satisfaction of a two-prong test: that the material fact was information "peculiarly within the knowledge" of [defendant], and that the information was not such that could have been discovered by [plaintiff] through the "'exercise of ordinary intelligence'" (*Black v. Chittenden*, 69 N.Y.2d 665, 669, 511 N.Y.S.2d 833, 503 N.E.2d 1370 [1986], *quoting Schumaker v. Mather*, 133 N.Y. 590, 596, 30 N.E. 755 [1892] ["if the other party has the means available to him of knowing ... he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentation"] (*Jana L.,* 22 AD3d at 278).

Here, there is evidence that would suggest considerable merit to Plaintiff's unpleaded claim that Bear Stearns had a duty to disclose which it breached, giving rise to a claim for fraudulent concealment.[24]

Bear Stearns agreed to provide the due diligence results to Plaintiff and it may be inferred that it was obligated to do so within a reasonable time of receipt of the results from the third party due diligence firm. However, instead of forwarding those

[24]There is also the possibility that as a result an active fraudulent concealment, a duty to speak arose (*Clement v Delaney Realty Corp.*, 83 AD3d 881 [2d Dept 2011]; *Haberman v Greenspan*, 82 Misc 2d 263 [Sup Ct, Richmond County 1975]).

results when they first came in from MDMC some 9 days before the closing, Bear Stearns withheld them from MBIA, delayed providing them despite requests for them from MBIA, used the time to make alterations to the results, and then sent the altered results to MBIA at the last minute. While Bear Stearns may not have known that Desharnais was traveling, it may be that the last minute nature of the transmission was intended to prevent MBIA from having a meaningful opportunity to review the results.

Of course, it can be said that MBIA could have avoided the circumstance it now finds itself in had it attempted to delay the closing in order to review the results or if it had reviewed the spreadsheets that Durden had sent. As to this latter point, it would seem to be a question of fact as to whether a person in Desharnais' position would have, in the use of reasonable care, observed that there was missing or incomplete information in the spreadsheets that Durden sent or that the spreadsheets were not in the form that would have been expected had they come directly from a third party due diligence firm. On the other hand, there is force to the notion that a party should not be held to have investigated where it was induced not to investigate:

> The fact that the party to whom the misrepresentations are made may have discovered the truth by investigation is immaterial where he or she is fraudulently induced to forgo making an investigation or inquiries which otherwise would have been made as where the representations are of such a character, or are made in such a way, as to disarm that party's vigilance, lull his or her suspicions, and induce him or her to refrain from making an examination or inquiries, or where, by trick or artifice, he or she is diverted by the other party from making an examination (60A NY Jur 2d, Fraud and Deceit § 170 [footnotes omitted].

Accordingly, the Court will grant Plaintiff leave to move to amend its Complaint so as to interpose a cause of action based on fraudulent concealment.

THE RELATED ACTION

The Court does not agree with Defendant's contention that Plaintiff, by suing only GMACM in the related action, is somehow precluded from suing Defendant in this action. It is not disputed that Plaintiff only learned through the discovery in the related action that it may have a basis to pursue a fraud claim against Bear Stears. Second, Bear Stearns has not pointed to any specific allegation in the prior complaint that is destructive of any allegation in this action.

CONCLUSION

The Court has considered the following papers:

(1) Notice of Motion dated October 9, 2013; Affirmation of Anastasia A. Angelova, Esq. dated October 9, 2013, together with the exhibits annexed thereto;

(2) Defendant's Memorandum in Law in Support of its Motion for Summary Judgment Pursuant to CPLR 3212 dated October 9, 2013;

(3) Defendant's Statement of Undisputed Material Facts dated October 9, 2013;

(4) Affidavit of Lauren Desharnais in Opposition to Defendant's Motion for Summary Judgment, sworn to October 28, 2013;

(5) Affirmation of Marc L Greenwald, Esq. dated October 28, 2013, together with the exhibits annexed thereto;[25]

(6) MBIA Insurance Corporation's Responses to Defendant's Rule 19-a Statement of Undisputed Facts in Support of its Motion for Summary Judgment dated October 28, 2013;

(7) Plaintiff's Memorandum of Law in Opposition to Defendant's Motion for Summary Judgment Pursuant to CPLR 3212 dated October 28, 2013;

(8) Second Affirmation of Anastasia A. Angelova, Esq. dated November 4, 2013 together with the exhibits annexed thereto;

(9) Defendant's Reply Memorandum of Law dated November 4, 2013; and

(10) Defendant's Response to MBIA Corporation's Statement of Additional Material Facts to be Tried Included in MBIA's Responses to Defendant's Rule 19-a Statement of Undisputed Facts in Support of its Motion for

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[25]Those exhibits include the report from Plaintiff's expert, James H. Aronoff. However, this report has only been considered to the extent that it suggests that there is a basis to allow Plaintiff the opportunity to move to amend its complaint to assert the two additional claims.

Summary Judgment dated January 17, 2014.[26]

Based on the foregoing papers and for the reasons stated, it is hereby

ORDERED that the motion by Defendant J.P.Morgan Securities LLC, f/k/a Bear, Stearns & Co., Inc. for summary judgment dismissing the Complaint of Plaintiff MBIA Insurance Corporation is granted and the Complaint is dismissed, provided, however, that said Plaintiff is granted leave to move, if it be so advised, within 20 days of the date hereof, to interpose an amended complaint asserting claims based upon Insurance Law Section 3105 and upon fraudulent concealment; and it is further

ORDERED that, should said Plaintiff move for leave to file an amended complaint as provided for hereinabove, counsel shall, within five (5) days of the service of said motion, contact Chambers for the purpose of scheduling a conference with the Court; and it is further

ORDERED that, in the event said Plaintiff fails to timely move to interpose an amended complaint as provided herein, then Defendant may, in accordance with 22 NYCRR §202.48(c), submit a proposed judgment, together with a bill of costs, if any.

The foregoing constitutes the Decision and Order of this Court.

Dated: White Plains, New York
May 6, 2014

E N T E R:

ALAN D. SCHEINKMAN
Justice of the Supreme Court

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[26]Pursuant to a conference call with Chambers following Defendant's submission of its Response to Plaintiff's Counterstatement, counsel was advised that the Court would not consider statements made in Defendant's Response to Statement No. 26 (or for that matter, either Plaintiff's or Defendant's Rule 19-a Statements) to the extent those statements provided argument and not uncontested facts.

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