

undertake. Rather, in advance of the BSSLT Transaction, which closed on April 30, 2007, Bear Stearns disseminated to Ambac marketing decks that continued to tout its seller monitoring and quality control operations to induce Ambac's participation in the BSSLT Transaction.²⁶³

181. Bear Stearns thus rid its inventory of the very loans it knew represented a high risk of default or other material failing by passing them on to investors and insurers, such as Ambac, by means of its false and misleading representations. Bear Stearns knowingly funneled into the BSSLT Transaction large volumes of loans from originators that it previously had deemed as "high risk" sellers and that it had downgraded to "suspended" or "terminated" status with "F" or "D" ratings due to "material weakness in credit quality and/or collateral quality."²⁶⁴

182. Consistent with this conduct but contrary to its contemporaneous disclosures to Ambac, internally Bear Stearns employees more aptly characterized the BSSLT 2007-1 Transaction as a "going out of business sale."²⁶⁵ Another called it a "DOG."²⁶⁶ Both characterizations were correct, but neither was disclosed.

183. The Bear Stearns trading desk placed great pressure on the other departments to quickly purge its inventory of the loans that it knew represented greater likelihood of not performing due to serious defects in their origination. If the defective loans were not securitized,

²⁶³ Email from Soung Ho Park (Bear, Stearns & Co. Analyst, Mortgage Finance) to Hartmut Ott (Ambac Vice President, MBS Department of Structured Finance), dated March 22, 2007, ABK-EMC01555076-269, discussed in Section III.B.1, above.

²⁶⁴ Bear Stearns' Seller Monitoring Report as of January 7, 2008 reflects that Bear Stearns downgraded SouthStar as of April 2, 2007, but then pushed through nearly 1,500 loans into the BSSLT 2007-2 Transaction making SouthStar the third largest originator in that deal. *See* EMC-AMB 010909740 (also showing that Bear Stearns securitized over 208 and 158 loans in the BSSLT 2007-1 Transaction that it had acquired from Steward Financial Inc. and First Residential Mortgage Services Corporation, respectively, despite previously downgrading them to "F" ratings).

²⁶⁵ Email from Charles Mehl (Bear, Stearns & Co. Analyst, Mortgage Finance) to Keith Lind (Bear, Stearns & Co. Managing Director, Trading), dated April 5, 2007, EMC-AMB 002075468.

²⁶⁶ Email from John Tokarczyk (Bear, Stearns & Co. Associate Director) to Jeffrey Maggard (Bear, Stearns & Co. Managing Director and Deal Manager on the BSSLT 2007-1 Transaction), dated April 30, 2007, EMC-AMB 001469603-604.

the trading desk would become irate. For example, by March 2007, when Bear Stearns confirmed that it missed the opportunity to securitize \$73 million worth of loans in its inventory before they experienced an EPD – 74% of which did not comply with Bear Stearns’ then-current guidelines²⁶⁷ –Verschleiser demanded to know “why any of these positions were not securitized,” and did “not understand why they were dropped from deals and not securitized before their epd period.”²⁶⁸ Similarly, in May 2007, the same Managing Director in trading that had first conveyed the EPD policy-change in early 2006 demanded “to know why we are taking losses on 2nd lien loans from 2005 when they could have been securitized?????”²⁶⁹

D. EVEN AS IT REVIEWED BREACHING LOANS IN 2007, BEAR STEARNS CONTINUED TO CONCEAL ITS FRAUD AND FAILED TO GIVE “PROMPT NOTICE” OF THE SECURITIZATION BREACHES

184. Bear Stearns’ practices resulted in the blatant disregard of EMC’s contractual commitments to give “prompt written notice” to Ambac and other deal participants of breaching loans found in the securitizations, and cure, substitute or repurchase defective and breaching loans from the securitization trusts within 90 days.²⁷⁰

185. As advised by its outside auditors in mid-2006, and thereafter by its counsel, after identifying problems in the loans, Bear Stearns was and is obligated to promptly assess whether there is a breach affecting the loans in its securitizations. Contrary to that advice, Bear Stearns failed to establish the requisite policies and practices to review loans for securitization breaches until late 2007. Indeed, Bear Stearns did not even establish a formal “securitization breach

²⁶⁷ Email from John Mongelluzzo (Bear Stearns & Co. Vice President, Due Diligence) to Jeffrey Verschleiser, Baron Silverstein and Mary Haggerty, among others, dated March 21, 2007, EMC-AMB 006798661.

²⁶⁸ Email from Jeffrey Verschleiser to Baron Silverstein and Mary Haggerty, among others, dated March 1, 2007, EMC-AMB 006087607-609.

²⁶⁹ Email from Keith Lind (Bear, Stearns & Co. Managing Director, Trading), dated May 5, 2007, EMC-AMB 002283474 – 475.

²⁷⁰ See Section V.C, below.

team” until Spring 2007.²⁷¹ The securitization breach team began its tenure by immediately highlighting Bear Stearns’ failings with respect to its contractual obligations to timely review loans for securitization breaches.

186. In May 2007, the Bear Stearns manager responsible for its newly created securitization breach team reiterated the very failings that PWC had identified in 2006, including that (i) Bear Stearns’ “Claims [department] is only addressing repurchase/settlement from the original Seller and the time frames provided to the Seller and Claims exhausts the time frames allowed for Securitization review/buyout,” (ii) “Securitization review/buyout must be completed within 90 days of the Breach being identified,” but is not being done within that time frame, and (iii) “Missing compliance with the Securitization time frames creates Reg. AB issues and violations.”²⁷² The manager’s findings are consistent with the August 15, 2007 version of Bear Stearns’ policy governing the review and repurchase of loans from securitizations, which states that “*No loan(s) will be added to the Conduit Buy out Log . . . without confirmation of repurchase funds received or a firm commitment from the seller to repurchase or the funding of a down-bid.*”²⁷³ (The Conduit Buy-out Log is the file Bear Stearns used to track loans that were to be repurchased from a securitization under its repurchase commitments.) As late as mid-August 2007, therefore, Bear Stearns was directing its employees that the repurchase of loans

²⁷¹ 4/26/2010 Golden Deposition Tr. at 60-61; Email from Fernando Serrano, dated April 24, 2007, EMC-AMB 010726553-556 at 554 (noting that quality control department “[i]mplemented and established the Securitization Breach Department” in the first quarter of 2007).

²⁷² Email from Amy Adame (EMC Mortgage Corp., Quality Control Supervisor, Securitization Breach Team) to Fernando Serrano (EMC Mortgage Corp., Quality Control Manager), dated May 31, 2007, EMC-AMB 010814501-502.

²⁷³ EMC-AMB 002571130-132 at 131 (emphasis added). A separate internal Bear Stearns policy manual from August 10, 2007 sets out a similar procedure and explains that the Repurchase Log manual explains that, like the “Conduit Buy Out Log,” the Repurchase Log is maintained to facilitate the buy-out of loans in securities, but that this process beings only “[w]hen a Seller commits to repurchasing a loan[.]” EMC-AMB1 000001343-1346.

from a securitization was not even to be considered unless and until there was a recovery by EMC relating to the loans from the entity from which it purchased the loans.

187. It was not until September 2007 that Bear Stearns revised its “process flow for determining security breach of loans.” As the securitization breach manager explained, “[r]ather than the current process which occurs when the claim results in a repurchase by the Seller or a settlement by the Seller, it will now happen in the front end. . . This will happened [sic] potentially even before you file a claim with the Seller.”²⁷⁴ Four days later, Bear Stearns for the first time “implemented the policy of *fully honoring our obligations* to pro-actively review defective loans for potential PSA breach.”²⁷⁵ The new policy stated that “going forward all defective loans are reviewed for a securitization breach concurrent with the QC review.”²⁷⁶

188. At about the same time it formed the securitization breach team in early 2007, Bear Stearns also for the first time directed its outside vendor Adfitech to start conducting limited “securitization breach reviews” on an “as requested” basis.²⁷⁷ Reflecting its bad faith and duplicitous approach to its contractual obligations, however, it instructed Adfitech to conduct a very limited review of loans submitted by Bear Stearns for review. In particular, Bear Stearns directed Adfitech *not* to undertake any reasonable underwriting efforts to verify the information in the loan file, stating (i) “Effective immediately, in addition to not ordering occupancy

²⁷⁴ Email from Fernando Serrano (EMC Mortgage Corp., Quality Control Manager) dated September 10, 2007, EMC-AMB 010725797-799 (discussing the “9/5/07 QC Minutes/Overview”).

²⁷⁵ Email from Leslie Rodriguez (EMC Residential Mortgage Managing Director), dated September 14, 2007, EMC-AMB 006870106-110 at 108, 107 (emphasis added) (acknowledging that “further discussion as to how Reps and Warrants, Conduit QC and Security Breach QC interact in this manner may definitely be warranted.”).

²⁷⁶ EMC-AMB 011688248-249, “Securitization Breach Quality Control Review.”

²⁷⁷ Email from Sherrie Dobbins (EMC Mortgage Corporation Assistant Manager, Quality Control Underwriting and Vendor Management) to Greg Anderson (Adfitech quality control manager), dated April 5, 2007, ADFITECH_3112_00005402; *see also* Email from Sherrie Dobbins (EMC Mortgage Corporation Assistant Manager, Quality Control Underwriting and Vendor Management) to Greg Anderson (Adfitech quality control manager), dated July 6, 2007, EMC-AMB 006955548.

inspections and review appraisals, DO NOT PERFORM REVERIFICATIONS OR RETRIEVE CREDIT REPORTS ON THE SECURITIZATION BREACH AUDITS,” (ii) not “make phone calls on employment,” and (iii) gave the blanket instruction that “occupancy misrep is not a securitization breach.”²⁷⁸ The head of the securitization breach team testified that he did not share that restrictive view of an appropriate securitization breach review.²⁷⁹ Notwithstanding Bear Stearns’ improper and divergent limitations, Adfitech still found securitization breaches in **42.9%** of the loans it reviewed from the Transactions.

189. Because Bear Stearns only had conducted a limited securitization breach review starting in 2007 – and had not been conducting securitization breach reviews when loans were deemed defective by its quality control department or subject to a settlement with a supplier of the loans – there was a growing backlog of securitized loans that had never been reviewed for a potential breach of EMC’s representations and warranties. By September 2007, Bear Stearns acknowledged having to conduct a securitization breach review of at least 1,800 loans included in a settlement prior to August 2, 2007, as well as a backlog of over “4,000 defective loans that came out of the QC dept in the last year.”²⁸⁰ Bear Stearns did not disclose to Ambac or investors in 2007 the changes in its securitization breach policies, the securitization breaches it identified, or the backlog in its securitization breach reviews.

²⁷⁸ *Id.*

²⁷⁹ 6/10/2010 Peacock Deposition Tr. at 182-93 (stating that the securitization breach team was directed to “whatever sources that were available,” including but not limited to (i) “findings made by quality control,” (ii) “reverifications or other information . . . that was provided by the QC group,” (iii) “third-party resources,” (iv) “phone calls to borrowers,” (v) “tax records of the borrower,” and (vi) “phone calls to the borrower’s employer” to verify employment). The same manager of the securitization breach team did not identify any instance where the team was “trying to limit our sources.” *Id.* at 187-88.

²⁸⁰ E-mail from Whitney Long (EMC Residential Mortgage, Vice President of Risk Management and Claims) to, among others, Stephen Golden (Bear, Stearns & Co. Managing Director, Warehouse and EMC Residential Mortgage President) and Leslie Rodriguez (EMC Residential Mortgage Managing Director), dated September 13, 2007, EMC-AMB 007176791-800 at 792.

190. But after September 2007, Bear Stearns' obligation to repurchase securitized defective loans still went unaddressed while the trusts suffered losses. Indeed, even as late as May 28, 2008, an internal audit of the representations and warranties department revealed that "loans identified as 'defective' (loans not conforming to contractual agreement) *were still not always being referred for a securitization breach review.*"²⁸¹ As of May 2008, Bear Stearns still faced a backlog of nearly 4,000 defective securitized loans *dating back to 2000* that had never been reviewed for a potential breach of EMC's representations and warranties.²⁸² In the meantime, the "vast majority" of these defective loans fell into delinquency and defaulted to the detriment of the securitizations.²⁸³ In 2008, as mortgage originators fell into insolvency and went out of business, many of the defective loans on the backlog for securitization breach review remained subject to outstanding repurchase claims by Bear Stearns against those loan sellers. As an EMC witness described them, these were "sellers who are in distress"²⁸⁴ that were "close to going out of business."²⁸⁵ Rather than review, albeit belatedly, all defective loans on the securitization breach review backlog – as its outside auditors and counsel had advised and its new policies purportedly dictated – Bear Stearns improperly *removed* from the backlog, without ever performing the requisite review, loans subject to repurchase claims against out-of-business

²⁸¹ "Bear Stearns Internal Audit Report – EMC Mortgage Corporation ('EMC') Limited Review of Representations and Warrants Department," EMC-AMB 010858511-515.

²⁸² E-mail from Alan Lu (J.P. Morgan Securities Inc. Claims Analyst) to Ashley Poole (EMC Mortgage Corporation Analyst, Representations and Warranties Department), dated May 13, 2008, and attached report of "Security Breach Review Back Log Delinquency Information," EMC-AMB 009103232-233 (emphasis added).

²⁸³ See 9/25/10 Lu Deposition Tr. at 190 (confirming that the "vast majority" of loans on the securitization breach review backlog were "delinquent 360 plus days"). E-mail from Alan Lu (J.P. Morgan Securities Inc. Claims Analyst) to Ashley Poole (EMC Mortgage Corporation Analyst, Representations and Warranties Department), dated May 13, 2008, and attached report of "Security Breach Review Back Log Delinquency Information," EMC-AMB 009103232-233.

²⁸⁴ 9/25/10 Lu Deposition Tr. at 204.

²⁸⁵ *Id.* at 205.

sellers and other “sellers in distress.”²⁸⁶ The same May 28, 2008 internal audit report also concluded that even in rare cases when Bear Stearns did perform securitization breach reviews and determined that the defective loans “should be repurchased from the deal,” “not all the loans had been repurchased.”²⁸⁷ These defective loans, which Bear Stearns itself found to breach securitization representations and warranties but failed to repurchase, include Mortgage Loans in the Transactions that have been charged off as losses to the Trusts.²⁸⁸

191. Without the benefit of disclosures regarding the true nature of Bear Stearns’ practices, it was not until late 2007 that Ambac started noticing that the performance of the Transactions was deteriorating. After realizing the Transactions were performing far worse than expected, Ambac began investigating whether the loans in the Transactions complied with EMC’s representations and warranties. Ambac requested loan files for 695 defaulted loans and hired an independent consultant to review the loans files. After receiving Ambac’s requests, on or about October 2007 Bear Stearns hired Clayton as a third party consultant to perform a due diligence review of the loan files that Ambac requested. Unbeknownst to Ambac and under Silverstein’s direction, the vice president in charge of Bear Stearns’ due diligence led an effort to collect the loan files so that they could be sent to Clayton for this due diligence review.²⁸⁹ The

²⁸⁶ See 9/25/10 Lu Deposition Tr. at 205-13, questioning regarding email from Alan Lu (J.P. Morgan Securities Inc. Claims Analyst) to Tamara Jewell (J.P. Morgan Securities Inc. Project Manager), dated April 7, 2008, and attached “Securitization Breach Review Defective Rate Detail” report, EMC-AMB 009089704-705 (confirming that loans with “canceled/cured repurchase claims” against sellers “in distress” were “subtracted from the securitization breach review pipeline”).

²⁸⁷ “Bear Stearns Internal Audit Report – EMC Mortgage Corporation (‘EMC’) Limited Review of Representations and Warrants Department,” EMC-AMB 010858511-515.

²⁸⁸ See, e.g., Email from Whitney Long (EMC Residential Mortgage, Vice President of Risk Management and Claims) to Alison Malkin (J.P. Morgan Securities Inc. Executive Director, Securitized Products), dated April 22, 2008, EMC-AMB 007169162-163 (“Attached is the pipeline of loans pending security buyout.”).

²⁸⁹ Email from John Mongelluzzo (Bear Stearns & Co. Vice President, Due Diligence) to Baron Silverstein (Bear, Stearns & Co. Senior Managing Directors, Co-Head Mortgage Finance), dated

same vice president and a due diligence manager then coordinated and directed Clayton's review of the loan files.²⁹⁰ During the time of the review, Silverstein reported to Nierenberg and Verschleiser that the review was taking place along with other due diligence audits.²⁹¹

192. Clayton's review found that the sample of loans contained pervasive material breaches. Clayton performed a due diligence review of the loans and sent EMC daily reports showing Clayton's breach findings.²⁹² The final report produced for this review identified material breaches for **56%** of the loans.²⁹³ Bear Stearns never told Ambac that it hired Clayton to review these loans and did not inform Ambac of Clayton's findings. Nor did Bear Stearns provide Ambac or any other participant with "prompt notice" of the breaches Clayton identified in 2007.

193. Making matters even worse, after deliberately concealing the defects identified by Clayton at the end of 2007, in mid-2008 Bear Stearns also ignored its commitments to repurchase or cure these non-compliant loans. Specifically, Ambac's analysis, like Clayton's, also revealed breaches of representations and warranties in almost 80% of the loans examined, with an aggregate principal balance of approximately \$40.8 million. Upon completing its analysis, by letters dated April 25 and May 23, 2008, Ambac asked EMC, in compliance with its

October 31, 2007, EMC-AMB 001424875-878 ("We have investors who are asking for files to review that are at the servicer. I'm going to need to arrange diligence.").

²⁹⁰ Email from John Mongelluzzo (Bear Stearns & Co. Vice President, Due Diligence) to Pattie Sears (EMC Mortgage Corporation, Due Diligence Manager) and Adam Peat (Clayton Client Service Manager), dated October 31, 2007, EMC-AMB 001728476-483.

²⁹¹ E-mail from Baron Silverstein to, among others, Jeffrey Verschleiser and Michael Nierenberg, dated November 12, 2007, EMC-AMB 001422820-821.

²⁹² E-mail from Pattie Sears (EMC Mortgage Corporation, Due Diligence Manager) to, among others, John Mongelluzzo (Bear Stearns & Co. Vice President, Due Diligence), dated November 5, 2007, EMC-AMB 011012036-037.

²⁹³ CLAY-AMBAC 019669, November 16, 2007 Loan Disposition Summary (AMB0710) prepared by Clayton Services, Inc. for Bear Stearns. Clayton reviewed 596 Ambac loans and found "material" issues with 337.

contractual obligations, to cure, repurchase, or provide substitutes for approximately 526 breaching loans, but EMC refused to do this for all but a few. As discussed further in Section III.F below, as of May 2008, JP Morgan had assumed control of EMC and immediately instituted a policy barring EMC from honoring legitimate repurchase requests from Ambac as well as other insurers and investors. Thereafter, by letters dated July 21 and August 20, 2008, the executive director of JP Morgan's Securitized Products division (Alison Malkin) with no prior knowledge of the Transactions rejected Ambac's breach notices regarding these non-compliant loans, even though Bear Stearns itself hired a third party consultant to conduct a review of the loans and identified material breaches throughout the very same sample of loans.

194. Bear Stearns also did not disclose that, in the same time frame, it implemented a trading strategy to capitalize on the harm resulting from its fraudulent and breaching conduct. That is, Bear Stearns implemented a trading strategy to "short" banks with large exposure to Ambac-insured securities. In his November 2007 self-evaluation, Verschleiser bragged that at "the end of October, while presenting to the risk committee on our business I told them that a *few financial guarantors were vulnerable* to potential write downs in the CDO and MBS market and *we should be short* a multiple of 10 of the shorts I had put on . . . In less than three weeks we made approximately \$55 million on just these two trades."²⁹⁴

195. Bolstered by this success, Bear Stearns carried this trading strategy into 2008. On February 17, 2008, a Bear Stearns trader told colleagues and Verschleiser, "*I am positive fgic is done and ambac is not far behind.*"²⁹⁵ The next day, in the same email chain, the trader again wrote to Verschleiser and others to clarify which banks had large exposures to Ambac, asking

²⁹⁴ Email from Jeffrey Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk), dated November 20, 2007, EMC-AMB 009600760-763.

²⁹⁵ Email from Adam Siegel (Bear Stearns & Co. Senior Managing Director, ABS/MBS Credit Trading), dated February 17, 2008, EMC-AMB 012117052-063.

“*who else has big fgiic or abk [Ambac] exposures besides soc gen?*”²⁹⁶ A colleague replied: “I believe the five with the biggest exposures are Barclays, CIBC, Merrill, Soc Gen and UBS. I think ABN, BNP, DB, HSBC and RBS have less.”²⁹⁷ Bear Stearns in fact entered into short positions with respect to those banks.²⁹⁸

196. As it was “shorting” the banks holding Ambac-insured securities, Bear Stearns continued to conceal the defects it discovered relating to collateral that back the securities issued in the Transactions.

E. BEAR STEARNS THREATENED THE RATING AGENCIES TO AVOID DOWNGRADES THAT REFLECTED THE TRUE VALUE OF ITS SECURITIES

197. The Offering Documents used to market the securities issued in each of the Transactions affirmatively state that the rating agencies “will monitor the ratings it issues on an ongoing basis and may update the rating after conducting its regular review”²⁹⁹

198. By mid-October 2007, the rating agencies had become increasingly concerned with the accuracy of the disclosures made by Bear Stearns regarding its mortgage-backed securities. As a consequence, S&P and Moody’s downgraded the ratings on Bear Stearns’ mortgaged-backed securities. Tom Marano was indignant at the gall of the rating agencies to contravene the will of Bear Stearns. In no uncertain terms, he directed his staff to cut-off all fees due to the rating agencies:

²⁹⁶ Email from Adam Siegel (Bear Stearns & Co. Senior Managing Director, ABS/MBS Credit Trading) to Jeffrey Verschleiser, among others, dated February 18, 2008, EMC-AMB 012117048-051.

²⁹⁷ Email from Warren Saft (Bear Stearns & Co. trader), to Verschleiser, among others, dated February 18, 2008, EMC-AMB 012117048-051.

²⁹⁸ Email from Beau Paulk (Bear Stearns & Co. employee) to Marano, Nierenberg, and Verschleiser, among others, dated March 17, 2008, EMC 011189682-83 (attaching “Department Hedge Summary” as of March 14, 2008). Bear Stearns also entered into credit default swaps wherein it stood to profit on Ambac’s demise. *Id.*

²⁹⁹ SACO 2006-8 ProSupp at S-89; BSSLT 2007-1 (Group I) ProSupp at S-109.

“My intention is to contact my peer at each firm as well as the investors who bought the deals. From there, we are going to demand a waiver of fees. In the interim, *do not pay a single fee to either rating agency. Hold every fee up.*”³⁰⁰

199. Even the Bear Stearns Managing Director hired from a rating agency to liaise with the agencies conceded that Bear Stearns’ attempt to browbeat the rating agencies was improper.³⁰¹ But Bear Stearns’ attempt to coerce the rating agencies to manipulate their ratings was just one of the many improper measures it took to avoid recognition of its liability arising from its securitizations.

F. AFTER THE MERGER WITH JP MORGAN, BEAR STEARNS IMPLEMENTED POLICIES TO REJECT WHOLESALING ITS REPURCHASE OBLIGATIONS TO MANIPULATE ITS ACCOUNTING RESERVES

200. After JPMorgan Chase & Co. acquired Bear Stearns for nominal consideration following its remarkable collapse in the spring of 2008, JP Morgan deliberately frustrated investors’ and insurers’ rights in the Bear Stearns securitizations in order to avoid bringing Bear Stearns’ massive exposure related to its securitizations into its consolidated financial statements. Most significantly, JP Morgan implemented a bad-faith strategy to reject without justification insurers’ and investors’ demands for the repurchase of breaching loans from the Bear Stearns securitizations.

201. Shortly after taking control of Bear Stearns’ operations in March 2008, JP Morgan implemented a moratorium on the repurchase of breaching loans from securities. On May 16, 2008, the Executive Director of JP Morgan’s Securitized Products division (Alison Malkin) issued an email alerting Bear Stearns employees “**IMPORTANT: Please do not**

³⁰⁰ Email from Marano to Silverstein, Cheryl Glory (Bear, Stearns & Co. Managing Director, Mortgage Finance), et al., dated October 17, 2007, EMC-AMB 001424910-912 (emphasis added)

³⁰¹ 4/19/2006 Glory Deposition Tr. at 73. See also *id.* at 82-83 (After being confronted with Marano’s email, Ms. Glory conceded that it is “not normal course of business.”).

repurchase any loans” because “JPM is evaluating processes and has put a temporary hold until they have finished.”³⁰² On July 14, 2008, Malkin reinforced the absolute nature of JP Morgan’s directive, stating that “[t]he only way a loan can be repurchased from a deal is if I send an email.”³⁰³ With the moratorium in place, JP Morgan immediately began (i) cancelling the repurchase of large volumes of loans that Bear Stearns previously determined had to be repurchased, and (ii) arbitrarily denying subsequent demands by investors and insurers to repurchase breaching loans from Bear Stearns’ securitizations.

202. In May 2008, with “less than a month on the job,” Malkin told the Bear Stearns executives previously responsible for the breach review that their “own breach determinations with respect to its own loans in its own securitizations are incorrect,” and “reversed EMC/Bear’s findings of breaches with respect to the very loans that are at issue in this transaction.”³⁰⁴ In her initial review alone, conducted on or about May 5, Malkin “disagreed with 56% of EMC/Bear Stearns findings.”³⁰⁵ The rationale and motivation of Malkin’s reversals was not lost on the former Bear Stearns executives, who observed that “[f]rom *a reserves standpoint* . . . the number has dropped from \$31M/- \$13.9M to \$17M/- \$7.6M.”³⁰⁶ Thus, within days of assuming control of

³⁰² Email from Alison Malkin (J.P. Morgan Securities Inc. Executive Director, Securitized Products) to Ashley Poole (EMC Mortgage Corp. Analyst, Representations and Warranties Department) and Whitney Long (EMC Residential Mortgage Vice President, Risk Management and Claims), dated May 16, 2008, EMC-AMB 007165488-490 at 489 (emphasis added).

³⁰³ Email from Alison Malkin (J.P. Morgan Securities Inc. Executive Director, Securitized Products) to Gary Lyles (Bear Stearns & Co., Internal Audit Department), dated July 14, 2008, EMC-AMB 010858522-524.

³⁰⁴ 1/22/2010 Megha Rule 30(b)(6) Deposition Tr. at 190-92.

³⁰⁵ Email from Whitney Long (EMC Residential Mortgage, Vice President of Risk Management and Claims) to Alison Malkin (J.P. Morgan Securities Inc. Executive Director, Securitized Products), dated May 5, 2008, EMC-AMB 007173918-919.

³⁰⁶ *Id.* (emphasis added).

the repurchase process, JP Morgan cut by over half the breach findings made in order to reduce by a corresponding amount JPMorgan Chase & Co.'s accounting liability.

203. In an effort to justify its reversal of the repurchase determinations, JP Morgan caused EMC to take newfound positions as to circumstances in which loans must be repurchased from a securitization that were inconsistent with, and contravened, EMC's own interpretation of its obligations prior to May 2008.

204. Bear Stearns' securitization breach team knew full well that JP Morgan's newly imposed bases for rejecting repurchase demands were contrived. For instance, Malkin took the position that the following were not breaches warranting the repurchase of loans from the securitization: (i) the absence of key documentation from the loan file (without which the loan could be rescinded) and (ii) a finding that the borrowers' stated income was unreasonable for the loan given. The head of Bear Stearns' securitization breach team was properly baffled by those positions: "The idea that missing certain significant docs is not a security breach issue is a fairly foreign concept that I have just not gotten my mind around yet. The stated income issue is very similar, in that the reasonableness test was a requirement in virtually all the guidelines from the various lenders that we obtained loans from."³⁰⁷ Nonetheless, there was nothing the former Bear Stearns executive could do, as post-merger "ultimately the authority to resolve any debate sat with JPMorgan."³⁰⁸ Thus, at JP Morgan's directive, on May 14, 2008, the executive canceled the repurchase of loans that "we have previously added to the Repurchase Log, but we need to re-address using our *updated* standards."³⁰⁹

³⁰⁷ Email from Michael Peacock (EMC Mortgage Corporation Securitization Breach Team) to Tamara Jewell (EMC Residential Mortgage, Project Manager), dated May 8, 2008, EMC-AMB 007173931-932.

³⁰⁸ 6/10/2010 Peacock Deposition Tr. at 254-56.

³⁰⁹ Email from Michael Peacock (EMC Mortgage Corporation Securitization Breach Team), dated May 14, 2008, EMC-AMB 009119930-931 at 931 (emphasis added).

205. Once the pending repurchase determinations had been “adjusted,” JP Morgan implemented an across-the-board policy of rejecting Ambac’s and other insurers’ and investors’ repurchase demands to manipulate its accounting reserves and conceal from JPMorgan Chase & Co.’s consolidated financials the massive liability owed for Bear Stearns’ fraudulent securitization practices. Reflecting this bad-faith initiative, as it was confronted with an escalating volume of repurchase demands, JP Morgan steadily increased its overall denial rate: JP Morgan denied 83% of all claims reviewed between May and June 2008,³¹⁰ and thereafter denied claims on virtually all the breaching loans identified in Ambac’s subsequent repurchase demands.

206. During this same time period, Ambac began making increasing numbers of repurchase demands arising from EMC’s breaches of its representations and warranties pertaining to the loans in the Transactions. Among the loans initially submitted for repurchase were the 526 loans that Bear Stearns had re-underwritten with Clayton in the late 2007. Although Ambac provided detailed substantiation for the breaches identified, in July and August 2008, Malkin responded on EMC’s behalf under the contractual agreements with Ambac and rejected Ambac’s repurchase requests for virtually all of the breaching loans. The duplicity and improper basis for JP Morgan’s contrived rejections is evident when compared to the 56% breach rate Bear Stearns and Clayton found before the JP Morgan merger for the 526 loans that comprised the majority of loans EMC refused to repurchase in Malkin’s July and August 2008 responses.

207. The fraud and improper conduct reflected in JP Morgan’s duplicitous conduct also is patent from the repurchase demands JP Morgan made on behalf of EMC against the

³¹⁰ See Claims Against EMC Exposure Rollforward as of June 18, 2008, EMC-AMB 008922742.

suppliers of the loans in the Bear Stearns securitizations pertaining to the very same loans that were submitted for repurchase from EMC. That is, while simultaneously rejecting Ambac's and other insurers' positions and refusing to repurchase breaching loans, JP Morgan advanced those very same breach positions in an attempt to recover funds for itself from originators that supplied the loans to EMC. The following examples for loans in the SACO 2005-10 Transaction gleaned from Bear Stearns' own files obtained in discovery illustrate this abhorrent conduct:

- **EMC Loan Number [REDACTED]**: After Bear Stearns securitized the loan, Ambac discovered material breaches in the loan and issued a repurchase request to EMC on October 20, 2008 because *inter alia* the loan was missing verification that the borrower had two years employment as required by the guidelines. By letter dated January 5, 2009, JP Morgan then demanded that the loan originator repurchase the same loan asserting the position that it is “believed by the Purchaser [EMC] to be breach [sic] Mortgage Loan” because “[t]he file does not contain documentation to support the borrower has been self employed for two years as required by guidelines,” and thus adopting verbatim the exact same breach described in Ambac's repurchase request. Yet just days later, on January 16, 2009, EMC rejected Ambac's repurchase claim claiming that “the subject borrower, loan and/or property satisfied applicable guidelines or reasonable exceptions thereto at the time that the loan was made.”
- **EMC Loan Number [REDACTED]**: After Bear Stearns securitized the loan, Ambac discovered material breaches in the loan and issued a repurchase request to EMC on October 20, 2008 because “the underwriter has shown negligence in qualifying the borrower for a loan she could not reasonably afford. . . The borrower would need to state \$6050/month to meet the 45% maximum DTI.” By letter dated January 5, 2009, JP Morgan then demanded that the loan originator repurchase the same loan asserting the position that it is “believed by the Purchaser [EMC] to be breach [sic] Mortgage Loan” and copied nearly verbatim the exact same underwriting failures and defects described in Ambac's repurchase request. Yet just days later, on January 16, 2009, EMC rejected Ambac's repurchase claim.
- **EMC Loan Number [REDACTED]**: After Bear Stearns securitized the loan, Ambac discovered material breaches in the loan and issued a repurchase request to EMC on October 20, 2008 because *inter alia* the underwriter was negligent in qualifying the borrower for a loan she could not reasonably afford, the loan was missing verification of employment, and the credit report was not in the file. By letter dated January 5, 2009, JP Morgan then demanded that the loan originator repurchase the same loan asserting the position that it is “believed by the Purchaser [EMC] to be breach [sic] Mortgage Loan” because the borrower's income did not pass a “reasonability test” and the file was missing a verification

of employment and original credit report. Once again, despite acknowledging the breaches identified by Ambac, just days later, on January 16, 2009, EMC rejected Ambac's repurchase demand, claiming that "[t]he subject borrower, loan and/or property satisfied applicable guidelines or reasonable exceptions thereto at the time that the loan was made."

- **EMC Loan Number [REDACTED]**: After Bear Stearns securitized the loan, Ambac discovered material breaches in the loan and issued a repurchase request to EMC on April 25, 2008 because *inter alia* the borrower's stated income of \$12,500 was overstated and the employment was misrepresented. EMC rejected Ambac's repurchase claim on July 21, 2008 claiming that "EMC is not in receipt of documentation to dispute borrower's income as represented." In direct contravention of EMC's response to Ambac, by letter dated September 19, 2008, JP Morgan demanded that the loan originator repurchase the same loan asserting the position that it is "believed by the Purchaser [EMC] to be breach [sic] Mortgage Loan" because the "borrower's employment as stated on the application was misrepresented" and "the income of \$12,500 provided in the application is unreasonable."

208. In addition to the foregoing examples, documents and databases uncovered from JP Morgan's internal files show that at the same time that JP Morgan "disagreed" with approximately 6,000 breaching loans identified in Ambac's repurchase requests, JP Morgan was issuing repurchase requests to originators for at least 736 of those loans between June and August 2009 reciting the same or similar breaches in those loans that JP Morgan rejected in its responses to Ambac.

209. JP Morgan also rebuffed Ambac's breach claims and barred repurchase of loans even where Bear Stearns had previously demanded that the originator repurchase the exact same loan. Bear Stearns' formal claims notices and supporting quality control documentation issued to loan originators reveal loans suffering from borrower misrepresentations, fraud, underwriting failures, missing documentation and other defects that by Bear Stearns' own admission, "were not eligible for delivery," and thus should never have been securitized.³¹¹ JP Morgan

³¹¹ Consistent with the representations and warranties and remedies that EMC extended to Ambac in the MLPAs, Bear Stearns purchased loans pursuant to a mortgage loan purchase agreements that require the seller to repurchase or cure any loan defects that "materially and adversely" affect the value of a loan, or

intentionally and knowingly concealed these repurchase claims and asserted factual positions that were directly contrary to Bear Stearns' own affirmative investigations confirming the very same defects that Ambac subsequently identified in the same loans, which include by way of example the following:

- **EMC Loan Numbers** [REDACTED], [REDACTED], [REDACTED], [REDACTED], [REDACTED], and [REDACTED]: After Bear Stearns securitized the loans in one of the Transactions, it submitted a repurchase claim against the entities from which it purchased the loans on the grounds that the borrower failed to disclose existing liabilities at time of origination. Bear Stearns asserted that the loans violated underwriting guidelines and/or were originated through fraud, error, negligence, misrepresentation or material omission. In response to Ambac's subsequent repurchase demands based on the same defect, EMC refused to repurchase the loans stating: "There is no documentation in the file reflecting debts existed at the time of origination but were not considered by the lender. The loan file contains a credit report conforming to the applicable guidelines and all reported obligations were used in the underwriting process."
- **EMC Loan Number** [REDACTED]: After Bear Stearns securitized the loan in the SACO 2005-10 Transaction, it submitted a repurchase claim against the entity from which it purchased the loan on the grounds that the verification of rent in the credit file was misrepresented because its quality control review confirmed that "the borrower *never paid \$1,275 in monthly rent*," rather "the monthly rent was \$750." Accounting for actual rental payment, Bear Stearns asserted that the loan violated underwriting guidelines. In response to Ambac's subsequent repurchase demand based on the same defect, EMC refused to repurchase the loan stating the loan complied with underwriting guidelines and asserting the position that "the *[verification of rent] in file that shows the borrower has been paying rent of \$1275 for 58 months.*"
- **EMC Loan Number** [REDACTED]: After Bear Stearns securitized the loan in the SACO 2006-2 Transaction, it submitted a repurchase claim against the entity from which it purchased the loans on the grounds that misrepresentation of income violated underwriting guidelines requiring that "income be reasonable for the position." Bear Stearns supported its claim with the borrower's bankruptcy petition filed after the origination date of the loan. In response to Ambac's subsequent repurchase demand based on the same defect and which also referenced the borrowers' bankruptcy petition, EMC refused to repurchase the

EMC's interests therein. *See* EMC Seller Guide (effective Oct. 3, 2005) § 11.03, EMC-AMB 003378797-883 at p. 66; *see also* Mortgage Loan Purchase and Interim Service Agreement between EMC and SunTrust Mortgage (dated May 1, 2002) § 7.03, STM-00007246-7250. *See also* Section III.C.3, above.

loan stating that the loan complied with underwriting guidelines and asserting the position that “Borrower misrepresentation (if any) discovered subsequent to closing is not a breach of the representations and warranties stated.”

210. Moreover, as discussed above, to quietly resolve its repurchase claims, Bear Stearns also entered into confidential settlement agreements providing it with a monetary payment, that it pocketed in lieu of repurchasing the toxic loans from the securitizations. To date, EMC has produced over 100 of these confidential settlement agreements, many of which show that EMC recovered significant funds concerning the very same loans Bear Stearns securitized in one of the Transactions. These settlement agreements not only confirm the validity of Ambac’s repurchase demands, but demonstrate JP Morgan’s duplicity in causing EMC to reject those demands for illegitimate ends and keep those recoveries for itself. The following settlements are illustrative:

- EMC’s Settlement Agreement with SouthStar Funding LLC, dated January 30, 2007, EMC-AMB 008911066-82: In this agreement, SouthStar “agree[d] to pay \$2,604,515.26 *in lieu of repurchasing* the Defective Loans” The settlement resolved EMC’s claim as to at least 12 of the loans in the Transactions, including EMC Loan Number [REDACTED]. For this loan, EMC identified a “Problem Request Type” for “OCCU REP.” Bear Stearns’ internal databases further states that for this loan: “THE BORROWER DID NOT OCCUPY THE SUBJECT PROPERTY AS SOLD TO EMC.” Even though Bear Stearns securitized this loan on the basis that it was owner occupied, after this settlement agreement was finalized, EMC continued to conceal the defect and rejected Ambac’s put-back request – ***also based on an occupancy misrepresentation*** – claiming that “[t]here is no documentation in the loan file negating the borrower’s intent at the time of funding to occupy the subject property.”
- EMC’s Settlement Agreement with Plaza Home Mortgage, dated October 1, 2007, EMC-AMB 004729716-33: In this agreement, Plaza Home Mortgage “agree[d] to pay \$1,000,000.00 to EMC . . . *in lieu of repurchasing* the Defective Loans” At least 20 of the 33 loans included in the settlement are loans in one of the four Transactions at issue.
- EMC’s Settlement Agreement with SunTrust Mortgage, dated December 18, 2007, EMC-AMB 008911045-65: In this agreement, “[w]ith regard to the Defective Loans . . . the Company and EMC agree as follows . . . the Company shall pay to EMC an amount equal to \$11,874,031.09 . . . for full payment and satisfaction of the Monetary Claims, and the balance of the Settlement Amount (if

any) for settlement of the Defective Loans.” Of the 67 loans included for non-EPD reasons, at least 7 loans are Transaction loans.

211. JP Morgan’s scam was not limited to Ambac, but was part and parcel of a bad-faith corporate policy. Indeed, JP Morgan has engaged in identical fraudulent conduct involving other financial guaranty insurers including Syncora Guarantee Inc. (“Syncora”), a monoline similarly situated to Ambac, in a deal involving mortgage loans of similar type and vintage as the Transactions. For example, on March 4, 2008, Syncora, which also insured Bear Stearns securitizations, gave formal notice to EMC of 380 securitized loans that breach one or more of EMC’s representations and warranties, and described the breaches affecting each loan with specificity.³¹² Within days after receiving Syncora’s notice, on March 11, Bear, Stearns & Co.’s Managing Director of claims issued a repurchase demand on EMC’s behalf to GreenPoint, the entity that sold those loans to EMC prior to securitization, asserting that the *same exact breaches* identified by Syncora constitute breaches of GreenPoint’s representations and warranties under its agreement with EMC.³¹³ (In its notice, EMC even attached Syncora’s detailed description of such breaches.) GreenPoint refused to repurchase the loans because, among other things, EMC had not repurchased any of those loans from the securitization and, thus, suffered no loss.³¹⁴ Thereafter, on June 26, 2008, JP Morgan’s Executive Director Alison Malkin continued to pursue EMC’s claims against GreenPoint, adamantly asserting “*that it is EMC’s position that*

³¹² Letter from XL Capital Assurance, Inc. to EMC Mortgage Corp., dated March 4, 2008, EMC-SYN 000002855-58

³¹³ Letter from Stephen Golden (Bear, Stearns & Co. Managing Director, Warehouse and EMC Residential Mortgage President) to GreenPoint Mortgage Funding, Inc., dated March 11, 2008, EMC-SYN 00283796 - 99

³¹⁴ Letter from Rose Medina (GreenPoint Vice President, Rep & Warranty) to Stephen Golden (Bear, Stearns & Co. Managing Director, Warehouse and EMC Residential Mortgage President), undated, EMC-SYN 00283794-95 (responding to Stephen Golden’s March 11, 2008 letter)

*these breaches materially and adversely affect the value of the [loans].*³¹⁵ Remarkably, at the same time as JP Morgan was attempting to recover from GreenPoint by adopting Syncora's breach positions as its own, Malkin took diametrically opposing positions in repeatedly refusing to comply with all but 4% of Syncora's repurchase demands.³¹⁶ In the end, Syncora was left with no alternative but to file suit against EMC to recover for its breaches.³¹⁷

212. Yet another form of JP Morgan's interference with EMC's repurchase obligations was preventing EMC from repurchasing breaching loans put back by investors and insurers where JP Morgan could not recoup its losses from the sellers of those breaching loans. A witness who performed claims analysis for EMC until the JP Morgan takeover and maintained the same role for JP Morgan under the direction of Alison Malkin³¹⁸ confirmed that JP Morgan

³¹⁵ Letter from Alison Malkin (J.P. Morgan Securities Inc. Executive Director, Securitized Products) to Rose Medina (GreenPoint Vice President, Rep & Warranty), dated June 26, 2008, EMC-SYN 000003048; 1/22/2010 Megha 30(b)(6) Deposition Tr. 257-58 (Q: So there's no ambiguity whatsoever that as of June 26, 2008, EMC was taking the position that the breaches that Syncora identified materially and adversely affected the value of the revolving credit lines, correct? . . . A. (Perusing) This letter reads that, yes. Q. Thank you. And you see no ambiguity whatsoever in that statement, do you? A. No, I don't.").

³¹⁶ Letter from Jackie Oliver (EMC Mortgage Corporation Senior Vice President, Chief Servicing Counsel) to XL Capital Assurance, Inc., dated June 4, 2008, EMC-SYN 000002859-2914; Letter from Alison Malkin (J.P. Morgan Securities Inc. Executive Director, Securitized Products) to XL Capital Assurance, Inc., dated August 4, 2008, EMC-SYN 00620317-343.

³¹⁷ See *Syncora Guarantee, Inc. v. EMC Mortg. Corp.*, No. 09-CV-3106 (PAC) (S.D.N.Y.). Two other monoline insurers have filed suit against EMC for substantially similar grounds. See *CIFG Assurance North America, Inc. v. EMC Mortg. Corp.*, No. 2009-30395-211 (Tex. Dist. Denton County); *Assured Guaranty Corp. v. EMC Mortg. Corp.*, No. 10-CV-5367 (S.D.N.Y.). In addition, the Federal Home Loan Bank of Seattle and the Federal Home Loan Bank of San Francisco recently brought actions against Bear, Stearns & Co., among others, alleging that it made numerous untrue statements or omissions of material facts in relation to securitization of loans. See *Federal Home Loan Bank of Seattle v. Bear, Stearns & Co., Inc.*, No. 10-CV-151 (RSM) (W.D. Wa. June 10, 2010); *Federal Home Loan Bank of San Francisco v. Credit Suisse Securities (USA) LLC, et. al.*, No. CGC 10-497839 (Cal. Super. Ct. June 10, 2010); *Federal Home Loan Bank of San Francisco v. Credit Suisse Securities (USA) LLC, et. al.*, No. CGC 10-497840 (Cal. Super. Ct. June 10, 2010).

³¹⁸ 9/25/2010 Lu Deposition Tr. at 10-11, 63-65, 131-38.

implemented a policy of conditioning repurchase determinations on whether JP Morgan had recourse to the loan seller.³¹⁹

213. The conflicting and incompatible positions that JP Morgan asserted on EMC's behalf exemplifies JP Morgan's bad-faith strategy to reject legitimate repurchase demands by financial guarantors in order to mask any exposure to those claims on its financial statements – while at the same time keeping for itself any recoveries from the entities that originated and sold EMC the defective loans. JP Morgan employed these fraudulent and deceptive practices in order to tortiously interfere with and frustrate Ambac's contractual rights and remedies. JP Morgan did so without any regard for EMC's financial interest (which was severely compromised by the blatant contractual breaches).

214. JP Morgan's wholesale denial of the claims made by Ambac and other financial guarantors or private investors also is in stark contrast to the significantly higher approval rates for breaching loans identified by government-sponsored entities such as Fannie Mae and Freddie Mac. To avoid disqualification of the right to continue to do business with the government-sponsored entities, and with the weight of the federal government behind their demands, JP Morgan took markedly divergent positions with respect to the government-sponsored entities' loans than it did with respect to similar defects identified by Ambac.

215. As the extreme positions JP Morgan is taking to avoid EMC's repurchase obligations was being discovered, its reserving practices for repurchase obligations likewise have

³¹⁹ 9/25/2010 Lu Deposition Tr. at 131-38 (“Q. So to sum it up a little more clearly, Alison Malkin instructed Ashley Poole to add analysis of recourse to seller to the claims against analysis? (over objection) A. Based on this e-mail, yes. Q. Okay. And in turn Ms. Poole instructed you to fulfill that request, correct? A. Yes.”).

also attracted the scrutiny of financial regulators.³²⁰ In January 2010, the SEC issued a comment letter following an 8-K filing by JPMorgan Chase & Co. seeking substantial additional disclosures concerning its repurchase reserves. The SEC requested a detailed explanation as to how JP Morgan “establish[es] repurchase reserves for various representations and warranties . . . made to . . . GSE’s, monoline insurers and any private loan purchasers,” including “the specific methodology employed to estimate the allowance related to various representations and warranties, *including any differences that may result depending on the type of counterparty to the contract.*”³²¹ A full inquiry of JP Morgan’s repurchase practices and policies necessarily will demonstrate its improper rejection of its repurchase obligations to manipulate its accounting reserves.

IV. BEAR STEARNS FRAUDULENTLY INDUCED AMBAC AND INVESTORS TO PARTICIPATE IN THE TRANSACTIONS

216. Bear Stearns knowingly and with the intent to induce reliance thereon made material misrepresentations to Ambac and investors and actively concealed material information pertaining to the specific Transactions at issue in this litigation.

217. These misrepresentations and omissions fraudulently induced Ambac to insure and investors to purchase the securities issued in the Transactions.

218. Ambac and the investors reasonably relied to their detriment on Bear Stearns’ false and misleading representations and omissions made in the investor presentations and the Offering Documents. Ambac also reasonably relied to its detriment on Bear Stearns’ false and

³²⁰ Menal Mehta, *The SEC Just Demanded More Information on JPMorgan Repurchase Liabilities*, Bus. Insider, June 24, 2010, available at <http://www.businessinsider.com/sec-jpmorgan-reserves-liabilities-2010-6>.

³²¹ Letter from Amit Pande (SEC Accounting Branch Chief) to Michael J. Cavanaugh (JPMorgan Chase & Co. Chief Financial Officer) dated January 29, 2010 at pp. 1-2 (emphasis added), available at <http://www.scribd.com/doc/33507476/SEC-Letter-to-JPM-Re-More-Disclosure-on-Buybacks-Jun-17-2010>.

misleading representations and omissions in its other oral and written communications made *in advance of* each of the Transactions. Further, Bear Stearns' false and misleading representations and omissions pertaining to each Transaction fraudulently induced Ambac to enter into each successive Transaction.

219. As particularized in the preceding sections, Bear Stearns made false and misleading representations and omitted material information concerning, among other things, (i) its internal operations, including its seller approval, due diligence, quality control, and loan repurchase protocols, (ii) the actual due diligence purportedly conducted on the loans in the Transactions, (iii) the mortgage loan data Bear Stearns disseminated for each Transaction, (iv) the rating agencies' shadow ratings Bear Stearns secured for each Transaction, (v) the historical performance of Bear Stearns' securitizations and mortgage loans, and (vi) Bear Stearns' wherewithal and intent to stand behind the representations and warranties EMC made in the Transaction Documents.

220. Ambac's reasonable reliance on Bear Stearns' representations and omissions was contemporaneously documented in the memoranda Ambac prepared to obtain internal approval from its Credit Committee for each of the Transactions, each referred to as a "Credit Memorandum," and collectively, the "Credit Memoranda."³²² To start, the Credit Memorandum for each Transaction underscored the perceived significance of Bear Stearns as a counterparty, noting that "Bear, Stearns & Co. Inc. ('Bear Stearns' or 'Bear') has requested that Ambac

³²² Email from Patrick McCormick (Ambac First Vice President, MBS Department of Structured Finance) to Darryl Smith (Bear, Stearns & Co., Fixed Income Structured Credit Sales, Securitization Side), dated March 16, 2007, ABK-EMC01536345-346 ("Even though we BID on these deals, they have not been underwritten nor approved by our Credit Committee. As always, we are not committed on a deal, until it is approved by our Credit Committee . . ."); Email from Darryl Smith (Bear, Stearns & Co., Fixed Income Structured Credit Sales, Securitization Side) to Patrick McCormick (Ambac First Vice President, MBS Department of Structured Finance), dated March 16, 2007, ABK-EMC02414491 (recommending that Ambac send an email to Bear traders reminding them that Ambac's "committee is more than just formality . . . that committee is still an important hurdle.").

insure” the Transactions.³²³ The Credit Memoranda emphasized Ambac’s reliance on Bear Stearns’ reputation as an “[e]xperienced and established issuer with proven track record,” and a “well established investment bank and issuer.”³²⁴ As the Credit Memoranda demonstrate, Bear Stearns leveraged its reputation to instill in Ambac false assurances regarding the historical performance of the SACO shelf,³²⁵ and Bear Stearns’ purported intent to stand behind the representations and warranties it gave through EMC regarding the veracity of the mortgage loan data and the underwriting practices used in making the loans.

221. Ambac specifically noted in its Credit Memoranda the significance of the fact that “EMC Mortgage Corporation as the sponsor of the transaction will provide Reps and Warranties on the loans, specifically they will guarantee that ‘the information set forth in the Mortgage Loan Schedule hereto is true and correct in all material respects.’”³²⁶ This commitment to attest to the *truth* of the mortgage loan data Bear Stearns provided was reproduced verbatim from the email sent by the Bear, Stearns & Co. Managing Director for United States Residential Mortgage Backed Securities Investor Relations to Ambac the day before the Credit Memorandum was submitted for the Transaction approval, showing the import of the representation.³²⁷ Bear Stearns made the same representation to the rating agencies to secure the shadow (and final)

³²³ See SACO 2005-10 Credit Memorandum, dated December 16, 2005, § 2.1; SACO 2006-02 Credit Memorandum, dated January 13, 2006, § 2.1; SACO 2006-08 Credit Memorandum, dated August 10, 2006, § A.6; BSSLT 2007-1 Credit Memorandum, dated March 27, 2007, § A.6.

³²⁴ See, e.g., SACO 2005-10 Credit Memorandum, dated December 16, 2005, § 1; SACO 2006-02 Credit Memorandum, dated January 13, 2006, § 1.

³²⁵ See, e.g., SACO 2005-10 Credit Memorandum, dated December 16, 2005, § 2.22; SACO 2006-02 Credit Memorandum, dated January 13, 2006, § 2.22; BSSLT 2007-1 Credit Memorandum, dated March 27, 2007, § A.6.

³²⁶ BSSLT 2007-1 Credit Memorandum, dated March 27, 2007, § E.

³²⁷ See Email from Cheryl Glory (Bear, Stearns & Co. Managing Director, Mortgage Finance) to Ambac, dated March 26, 2007, EMC-AMB 001431663-664 (“we do provide a rep and warranty that ‘the information set forth in the Mortgage Loan Schedule hereto is true and correct in a material respects.’”).

ratings, without which Ambac would not have agreed to issue its policies (as evidenced by the reference to the ratings throughout the Credit Memoranda).

222. The Credit Memoranda could not be clearer, moreover, that Ambac relied on Bear Stearns' representations concerning the due diligence it purportedly conducted on the securitized loan pools: "There is no additional diligence done at the time of securitization as *we rely on the EMC bulk and flow diligence process.*"³²⁸ And the Credit Memoranda explicitly reiterate Bear Stearns' representations that it conducted 100% due diligence on the loans in the Transactions: "The HELOCs have been sourced through Bears' bulk acquisition channel and are *100% re-underwritten in terms of credit and legal compliance.*"³²⁹ What Ambac did not know was that Bear Stearns' representations were false and misleading, and in this regard, that Bear Stearns viewed its due diligence to be useless and a "waste of money."

223. The Credit Memorandum pertaining to the BSSLT Transaction also recites Bear Stearns' disclosures about the so-called benefits of improvements to its underwriting criteria and efforts to limit securitization from "terminated" or "suspended" loan originators and sellers.³³⁰ Bear Stearns did not disclose that it was clearing out its inventory of loans that it had previously purchased from these entities while simultaneously discontinuing quality control over these very loans that it knew represented markedly greater risks, in what its own traders described as a "going out of business sale."³³¹

³²⁸ See, e.g., 2005-10 Credit Memorandum, dated December 16, 2005, § 10.14; 2006-02 Credit Memorandum, dated January 13, 2006, § 9.3.

³²⁹ See 2006-08 Credit Memorandum, dated August 10, 2006, § A.6; BSSLT Credit Memorandum, dated March 27, 2007, § E.

³³⁰ BSSLT 2007-1 (Group II and III) Credit Memorandum, dated April 13, 2007.

³³¹ See Section III.C.7, above.

224. Lacking the accurate depiction of Bear Stearns' practices and perspective, Ambac's reliance on Bear Stearns' representations and warranties was reasonable and consistent with the industry practice and the parties' bargain. As was the general practice and the parties' agreement, Bear Stearns and Ambac assumed risk and undertook due diligence consistent with their respective roles in the Transactions.

225. Bear Stearns as the sponsor and seller (through EMC), and as underwriter and deal manager (through Bear, Stearns & Co.), assumed the *risk* and the burden of assessing the validity of the attributes of the mortgage loans that it conveyed to the trusts, including that the loans were originated pursuant to the appropriate underwriting guidelines and were not fraudulently procured. Ambac as the insurer bore the *market risk* and the burden of evaluating whether loans *bearing the attributes represented by Bear, Stearns & Co. Inc. and warranted by EMC* would perform after the closing of the Transactions.

226. That was a reasoned risk allocation. Bear Stearns was in privity with – and often financed – the originators that sold to Bear Stearns the loans that it conveyed to the securitization trusts. Bear Stearns dictated the underwriting guidelines, owned the loans and held the loan files, which afforded it access and control over information required to evaluate the loans. To the extent Bear Stearns identified any defect in the loans, it had the right to exclude the loan from any transaction with the entity selling Bear Stearns the loans or demand that they repurchase the loans if the defects were discovered after purchase. Bear Stearns thus had the means before the closing of the Transaction to assess the quality of the loans and recourse in the event a defect was discovered. In contrast, Ambac was not in privity with the originators, never owned the loans or the loan files, and lacked recourse against the originators. It therefore made sense for the

sophisticated parties to agree that Bear Stearns would bear the loan origination risk, and Ambac would bear the market risk, assuming accurate disclosures by Bear Stearns.

227. This risk allocation arrangement enabled each party to conduct the appropriate due diligence *consistent and commensurate with* the risk each bore. Bear Stearns purported to carefully vet the originators from which it bought the loans, re-underwrite the loans before it purchased the loans, and conduct further review of the loans after acquisition.

228. Ambac, in turn, (i) conducted on-site reviews of Bear Stearns' operations, (ii) secured and evaluated Bear Stearns' representations concerning the seller approval, due diligence, quality control, and repurchase protocols Bear Stearns purportedly performed, (iii) conducted extensive modeling of its exposure to interest rate and other market variables using the mortgage loan data represented as true by Bear Stearns, (iv) assessed the adequacy of Bear Stearns' wherewithal to stand behind its representations and warranties, and (v) analyzed the represented performance of Bear Stearns' prior securitizations, and (vi) secured from Bear Stearns its commitment to provide, through EMC, representations and warranties concerning, among other things, the veracity of the mortgage loan data Bear Stearns provided and underwriting practices followed.

229. The representations and warranties that Bear Stearns provided through EMC, and on which Ambac relied, were the means by which the parties memorialized and effectuated the reasoned risk allocation, and therefore, were the essential inducement for Ambac to participate in the Transactions.³³²

³³² Consistently, when asked whether "EMC deemed it important to make representations and warranties in order to persuade the RMBS investors to purchase from Bear Stearns," Haggerty testified that "Bear Stearns was marketing the certificates. It was viewed as a positive that EMC was making the reps and warranties." 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 131.

V. BEAR STEARNS' EXPRESS REPRESENTATIONS, WARRANTIES, AND CONTRACTUAL COVENANTS WERE A MATERIAL INDUCEMENT TO AMBAC TO PARTICIPATE IN THE TRANSACTIONS AND ISSUE ITS INSURANCE POLICIES

A. THE TRANSACTION DOCUMENTS

1. The SACO 2005-10 Transaction

230. As the Sponsor/Seller in the SACO 2005-10 Transaction, EMC, acting at all times at the direction and under the control of Bear, Stearns & Co. pooled and securitized approximately 13,172 residential mortgage loans, which EMC had previously purchased from numerous mortgage-loan originators, with an aggregate principal balance of approximately \$626,731,100. These loans served as collateral for the issuance of more than \$574 million in publicly offered mortgage-backed securities.³³³

231. The SACO 2005-10 Transaction closed on December 30, 2005 and was effectuated through the following series of agreements executed by EMC and its affiliates that governed, among other things, the rights and obligations of the various parties with respect to the mortgage loans and the securities that resulted from their securitization.

232. EMC, acting as Seller, sold and assigned its entire interest in the mortgage loans to its affiliate Bear Stearns Asset Backed Securities I LLC ("BSABS I") pursuant to a MLPA dated as of December 30, 2005 (the "SACO 2005-10 MLPA"). Under the SACO 2005-10 MLPA, EMC made numerous detailed representations and warranties concerning the mortgage loans.

233. BSABS I, in turn, sold its interest in the mortgage loans to the SACO I Trust 2005-10 (the "SACO 2005-10 Trust") pursuant to a Pooling and Servicing Agreement ("PSA") dated as of December 1, 2005 (the "SACO 2005-10 PSA"). The SACO 2005-10 Trust then

³³³ Additional mortgage-backed securities issued in the SACO 2005-10 Transaction were not offered to the public.

issued various classes of mortgage-backed securities, the most senior of which were registered with the SEC and underwritten and marketed to investors by Bear, Stearns & Co. by means of the related Prospectus and ProSupp. In order to enhance the marketability of the securities and its return on the Transaction, EMC sought to obtain a financial-guaranty insurance policy from Ambac.

234. As an inducement to issue the policy, EMC entered into an I&I Agreement with Ambac, dated as of December 30, 2005 (the “SACO 2005-10 I&I Agreement”), whereby, among other things, EMC made numerous representations and warranties to Ambac with respect to the SACO 2005-10 Transaction, including that the representations and warranties that it had made in the SACO 2005-10 MLPA were true and correct in all material respects, and agreed to indemnify Ambac in the event that EMC’s representations and warranties proved to be untrue. The other parties to the SACO 2005-10 I&I Agreement are BSABS I, the SACO 2005-10 Trust, LaSalle Bank National Association (“LaSalle”), as Master Servicer and Securities Administrator, and Citibank N.A. (“Citibank”), as Trustee.

235. Relying on Bear Stearns’ pre-contractual representations detailed above and EMC’s representations and warranties, covenants and indemnities contained in and encompassed by the SACO 2005-10 I&I Agreement, SACO 2005-10 MLPA, and SACO 2006-2 PSA, Ambac issued Certificate Guaranty Insurance Policy No. AB0961BE (the “SACO 2005-10 Policy”). Under the SACO 2005-10 Policy, Ambac agreed to insure certain payments of interest and principal with respect to the most senior, or investment-grade, classes of the securities issued in the SACO 2005-10 Transaction (the “SACO 2005-10 Insured Certificates”). The SACO 2005-10 Insured Certificates were underwritten and marketed, and sold to note purchasers (“SACO 2005-10 Note Purchasers”), by Bear, Stearns & Co.

2. The SACO 2006-2 Transaction

236. Shortly after securing the insurance policy for the SACO 2005-10 Transaction, EMC sought to have Ambac insure the SACO 2006-2 Transaction, which closed on January 30, 2006.

237. EMC, acting at all times at the direction and under the control of Bear, Stearns & Co., pooled approximately 13,261 mortgage loans, with an aggregate principal balance of approximately \$704,481,804, that were secured by junior liens on one- to four-family residential properties. These loans in turn served as collateral for the issuance of more than \$645 million in publicly offered mortgage-backed securities.³³⁴ EMC had previously acquired these loans from numerous originators. The SACO 2006-2 Transaction was effectuated through the following series of agreements.

238. EMC, acting as Seller, sold and assigned its entire interest in the mortgage loans to BSABS I pursuant to a MLPA dated as of January 30, 2006 (“SACO 2006-2 MLPA”). BSABS I, in turn, sold its interest in the mortgage loans to the SACO I Trust 2006-2 (the “SACO 2006-2 Trust”) pursuant to a PSA dated as of January 1, 2006 (the “SACO 2006-2 PSA”).³³⁵ The SACO 2006-2 Trust then issued various classes of mortgage-backed securities, the most senior of which were registered with the SEC and underwritten and marketed to investors by Bear, Stearns & Co. by means of the related Prospectus and ProSupp.

239. As in the case of the SACO 2005-10 Transaction, EMC, to induce Ambac to issue a financial-guaranty insurance policy, entered into an I&I Agreement with Ambac, dated as of January 30, 2006 (the “SACO 2006-2 I&I Agreement”), to which BSABS I, the SACO 2006-2

³³⁴ Additional mortgage-backed securities issued in the SACO 2006-2 Transaction were not offered to the public.

³³⁵ For convenience of reference, the SACO 2005-10 PSA and SACO 2006-2 PSA are hereinafter referred to collectively as the PSAs, and each individually as a PSA.

Trust, LaSalle, and Citibank are also parties, and the terms of which are virtually identical to those of the SACO 2005-10 I&I Agreement.

240. Relying on Bear Stearns' pre-contractual representations detailed above, EMC's representations and warranties, covenants and indemnities contained in and encompassed by the SACO 2006-2 I&I Agreement, SACO 2006-2 MLPA, and SACO 2006-2 PSA, and having recently received assurances from EMC regarding its due-diligence practices, Ambac issued Certificate Guaranty Insurance Policy No. AB0971BE and Certificate Guaranty Insurance Policy No. AB0972BE (collectively, the "SACO 2006-2 Policy"). Under the SACO 2006-2 Policy, Ambac agreed to insure certain payments of interest and principal with respect to the most senior, or investment-grade, classes of the securities issued in the SACO 2006-2 Transaction for the benefit of the holders of those securities (the "SACO 2006-2 Insured Certificates"). The SACO 2006-2 Insured Certificates were underwritten and marketed, and sold to note purchasers ("SACO 2006-2 Note Purchasers"), by Bear, Stearns & Co.

3. The SACO 2006-8 Transaction

241. A few months after securing the insurance policies for the SACO 2006-2 Transaction, Bear Stearns again marketed another of EMC's deals to investors and Ambac in connection with the SACO 2006-8 Transaction, which closed on September 15, 2006.

242. On September 15, 2006, in consummating the SACO 2006-8 Transaction, EMC pooled 5,282 HELOCs, with an aggregate principal balance of approximately \$361,200,413, that were secured primarily by second-lien positions on one- to four-family residential properties. These loans in turn served as collateral for the issuance of approximately \$356 million in publicly offered mortgage-backed securities.³³⁶ In completing the SACO 2006-8 Transaction,

³³⁶ Additional mortgage-backed securities issued in the SACO 2006-8 Transaction were not offered to the public.

EMC, acting at all times at the direction and under the control of Bear, Stearns & Co., securitized these HELOCs in much the same manner as it securitized the mortgage loans involved in the two previous deals.

243. EMC, acting as Seller, sold and assigned its entire interest in the Mortgage Loans to BSABS I pursuant to a MLPA dated as of September 15, 2006 (the “SACO 2006-8 MLPA”). BSABS I, in turn, sold its interest in the HELOCs to the SACO I Trust 2006-8 (the “SACO 2006-8 Trust”) pursuant to a Sale and Servicing Agreement (“SSA”) dated as of September 15, 2006 (the “SACO 2006-8 SSA”).

244. As part of the 2006-8 Transaction, an Indenture dated as of September 15, 2006, was entered into by and among the SACO 2006-8 Trust, LaSalle, and Citibank, as Indenture Trustee, and provided for, among other things, the issuance of SACO I Trust 2006-8 Mortgage-Backed Notes, Series 2006-8 representing the indebtedness of the SACO 2006-8 Trust, the most senior of which were registered with the SEC and underwritten and marketed to investors by Bear, Stearns & Co. by means of the related Prospectus and ProSupp.

245. As an inducement to Ambac to issue its insurance policy, EMC, BSABS I, the SACO 2006-8 Trust, LaSalle, and Citibank entered into an I&I Agreement with Ambac, dated as of September 15, 2006 (the “SACO 2006-8 I&I Agreement”), whereby EMC made numerous representations and warranties and undertook certain obligations in consideration for Ambac’s issuance of its insurance policy.³³⁷ The SACO 2006-8 I&I Agreement contains substantially the same terms and conditions as the I&I Agreements in the two previous Transactions.

246. Relying on Bear Stearns’ pre-contractual representations detailed above and EMC’s representations and warranties, covenants, and indemnities contained in and

³³⁷ See 2006-8 I&I Agreement at 2, fourth full recital.

encompassed by the SACO 2006-8 I&I Agreement, SACO 2006-8 MLPA, and SACO 2006-8 SSA, Ambac issued Certificate Guaranty Insurance Policy No. AB1020BE (the “SACO 2006-8 Policy”). Under the SACO 2006-8 Policy, Ambac agreed to insure certain interest and principal payments with respect to, and for the benefit of the holders of, the most senior, or investment-grade, class of securities issued in the SACO 2006-8 Transaction (the “SACO 2006-8 Insured Notes”). The SACO 2006-8 Insured Notes were underwritten and marketed, and sold to note purchasers (“SACO 2006-8 Note Purchasers”), by Bear, Stearns & Co.

4. *The BSSLT 2007-1 Transaction*

247. Finally, not long after securing an insurance policy for the SACO 2006-8 Transaction, Bear Stearns sought to obtain an insurance policy from Ambac for the BSSLT 2007-1 Transaction, which closed on April 30, 2007.

248. In effectuating the BSSLT 2007-1 Transaction, EMC, acting at all times at the direction and under the control of Bear, Stearns & Co., pooled approximately 5,173 HELOCs, with an aggregate principal balance of approximately \$351,881,948, that were secured primarily by second-lien positions on residential properties. These loans in turn served as collateral for the issuance of more than \$348 million in publicly offered mortgage-backed securities (“Group I Notes”).³³⁸ In addition, EMC, acting at all times at the direction and under the control of Bear, Stearns & Co., pooled approximately 12,621 conventional mortgage loans, with an aggregate principal balance of approximately \$838,903,950, that were secured by second-lien mortgages on single-family homes. These loans in turn served as collateral for the issuance of \$776,623,000 in publicly offered mortgage-backed securities (“Group II and III Notes”). The BSSLT 2007-1 Transaction was effectuated through the following series of agreements.

³³⁸ Additional mortgage-backed securities issued in the BSSLT 2007-1 Transaction were not offered to the public.

249. EMC, acting as Seller, sold and assigned its entire interest in the Group I HELOCs, Group II Mortgage Loans, and Group III Mortgage Loans to its affiliate BSABS I pursuant to a MLPA dated as of April 30, 2007 (the “BSSLT 2007-1 MLPA”).³³⁹ BSABS I, in turn, sold its interest in the Group I HELOCs, Group II Mortgage Loans, and Group III Mortgage Loans to the BSSLT 2007-1 Trust (the “BSSLT 2007-1 Trust”)³⁴⁰ pursuant to a SSA dated as of April 30, 2007 (the “BSSLT 2007-1 SSA”).³⁴¹

250. As part of the BSSLT 2007-1 Transaction, an Indenture dated as of April 30, 2007 was entered into by and among the BSSLT 2007-1 Trust, LaSalle, and Citibank, as Indenture Trustee, and provided for, among other things, the issuance of BSSLT Trust 2007-1 Mortgage-Backed Notes, Series 2007-1 representing the indebtedness of the BSSLT 2007-1 Trust, the most senior of which were registered with the SEC and underwritten and marketed to investors by Bear, Stearns & Co. by means of the related Prospectus and ProSupp.

251. As in the case of each of the three prior Transactions, as an inducement to Ambac to issue its insurance policy, EMC, BSABS I, the BSSLT 2007-1 Trust, LaSalle, and Citibank entered into an I&I Agreement with Ambac, dated as of April 30, 2007 (the “BSSLT 2007-1 I&I Agreement”),³⁴² the terms of which are substantially the same as the I&I Agreements in the prior three Transactions.

³³⁹ For convenience of reference, the SACO 2005-10 MLPA, SACO 2006-2 MLPA, SACO 2006-8 MLPA, and BSSLT 2007-1 MLPA are hereinafter referred to collectively as the MLPAs, and each individually as an MLPA.

³⁴⁰ For convenience of reference, the SACO 2005-10 Trust, SACO 2006-2 Trust, SACO 2006-8 Trust, and BSSLT 2007-1 Trust are hereinafter referred to collectively as the Trusts, and each individually as a Trust.

³⁴¹ For convenience of reference, the SACO 2006-8 SSA and BSSLT 2007-1 SSA are hereinafter referred to collectively as the SSAs, and each individually as an SSA.

³⁴² For convenience of reference, the SACO 2005-10 I&I Agreement, SACO 2006-2 I&I Agreement, SACO 2006-8 I&I Agreement, and BSSLT 2007-1 I&I Agreement are hereinafter referred to collectively as the I&I Agreements, and each individually as an I&I Agreement.

252. Relying on Bear Stearns' pre-contractual representations detailed above and EMC's representations and warranties, covenants and indemnities contained in and encompassed by the BSSLT 2007-1 I&I Agreement, Ambac issued the Certificate Guaranty Insurance Policy No. AB1075BE (the "BSSLT 2007-1 Policy").³⁴³ Under the BSSLT 2007-1 Policy, Ambac agreed to insure certain payments of interest and principal with respect to, and for the benefit of, the holders of the most senior classes of Notes issued in the BSSLT 2007-1 Transaction (the "BSSLT 2007-1 Insured Notes").³⁴⁴ The BSSLT 2007-1 Insured Notes were underwritten and marketed, and sold to note purchasers ("BSSLT 2007-1 Note Purchasers"), by Bear, Stearns & Co.³⁴⁵

B. EMC'S EXPRESS REPRESENTATIONS AND WARRANTIES THAT EFFECTUATED THE PARTIES' BARGAINED-FOR RISK ALLOCATION

253. Under the Transaction Documents, the principal and interest payments from the loans³⁴⁶ were to provide the cash flow necessary to make the monthly principal and interest payments due on the Notes. Ambac's insurance policies required it to make payments to insured Note Purchasers to the extent there was a shortfall of cash flow available from the loans, once the protection provided by subordinated classes of securities and other credit enhancement was eroded. Ambac agreed to assume this risk of payment default, which depended upon the truth of the information Bear Stearns provided to Ambac regarding the pedigree of the securitized loans

³⁴³ For convenience of reference, the SACO 2005-10 Policy, SACO 2006-2 Policy, SACO 2006-8 Policy, and BSSLT 2007-1 Policy are hereinafter referred to collectively as the Policies, and each individually as a Policy.

³⁴⁴ For convenience of reference, the SACO 2005-10 Insured Certificates, SACO 2006-2 Insured Certificates, SACO 2006-8 Insured Notes, and BSSLT 2007-1 Insured Notes are hereinafter referred to collectively as the Notes.

³⁴⁵ For convenience of reference, the SACO 2005-10 Note Purchasers, SACO 2006-2 Note Purchasers, SACO 2006-8 Note Purchasers, and BSSLT 2007-1 Note Purchasers are hereinafter referred to collectively as the Note Purchasers.

³⁴⁶ For convenience of reference, the HELOCs and conventional mortgage loans, as the case may be, involved in these four Transactions are hereinafter referred to simply as the "loans."

and Bear Stearns' purportedly thorough due diligence practices. Consequently, from the perspective of the Note Purchasers (or the Insurer standing in their shoes), the key provisions of the deal documents were those that allocated to EMC the risk of loss due to misrepresentations, fraud or other failures that EMC was in the position to control.

1. *Loan-Level Representations and Warranties*

254. The provisions of the principal Transaction Documents that allocated to EMC such risk of loss are EMC's representations and warranties regarding, among other things, the origination (including underwriting) and other key attributes of the loans, and are found in Section 7 of the respective MLPAs.

255. Among its extensive representations and warranties in the SACO 2005-10 and SACO 2006-2 Transactions, EMC represented and warranted as to each mortgage loan that:

MLPA § 7(a): "The information set forth in the Mortgage Loan Schedule on the Closing Date is complete, true and correct."

MLPA § 7(h): "Each loan at the time it was made complied in all material respects with applicable local, state and federal laws, including but not limited to, all applicable anti-predatory lending laws."

MLPA § 7(q): ". . . [I]mmediately prior to the Cut-off Date, there was no default, breach, violation or event of acceleration existing under the Mortgage or the Mortgage Note and there was no event which, with the passage of time or with notice and the expiration of any grace or cure period, would constitute a default, breach, violation or event of acceleration, and the related Mortgage Loan Seller has not waived any default, breach, violation or event of acceleration."

MLPA § 7(s): "At the time of origination, each Mortgaged Property was the subject of an appraisal which conformed to the underwriting requirements of the originator of the Mortgage Loan, and the appraisal is in a form acceptable to Fannie Mae or Freddie Mac."

MLPA § 7(t): "The origination, servicing and collection practices with respect to each Mortgage Note and Mortgage including, the

establishment, maintenance and servicing of the escrow accounts and escrow payments, if any, since origination, have been conducted in all respects in accordance with the terms of Mortgage Note and in compliance with all applicable laws and regulations and, unless otherwise required by law or Fannie Mae/Freddie Mac standards, in accordance with proper, prudent and customary practices in the mortgage origination and servicing business”

MLPA § 7(dd): “Each Mortgage Loan at the time of origination was underwritten in general in accordance with guidelines not inconsistent with the guidelines set forth in the Prospectus Supplement and generally accepted credit underwriting guidelines.”

MLPA § 7(ee): “No error, omission, misrepresentation, fraud or similar occurrence with respect to a Mortgage Loan has taken place on the part of either Mortgage Loan Seller or the related Originator.”

256. In addition to representations and warranties that are virtually identical to those referenced above, EMC also made the following additional representations and warranties with respect to the loans contained in the SACO 2006-8 Transaction:

MLPA § 7(d): “No HELOC had a Combined Loan to Value Ratio at the time of origination of more than 100%.”

MLPA § 7(j): “. . . No fraud, error, omission, misrepresentation, gross negligence or similar occurrence with respect to a HELOC has taken place on the part of any Person, including without limitation, the Mortgagor, any appraiser, any builder or developer, or any other party involved in the origination or servicing of the HELOC.”

257. Finally, in the BSSLT 2007-1 Transaction, EMC represented and warranted as to each loan that:

MLPA § 7(a): “[T]he information set forth in the Mortgage Loan Schedule hereto is true and correct in all material respects.”

MLPA § 7(c): “[E]ach Mortgage Loan at the time it was made complied in all material respects with all applicable local, state and federal laws and regulations, including, without limitation, usury, equal credit opportunity, disclosure and recording laws and all applicable predatory, abusive and fair lending laws; and each

Mortgage Loan has been serviced in all material respects in accordance with all applicable local, state and federal laws and regulations, including, without limitation, usury, equal credit opportunity, disclosure and recording laws and all applicable anti-predatory lending laws and the terms of the related Mortgage Note, the Mortgage and other loan documents.”

MLPA § 7(d): “[T]here is no monetary default existing under any Mortgage or the related Mortgage Note and there is no material event which, with the passage of time or with notice and the expiration of any grace or cure period, would constitute a default, breach or event of acceleration; and neither the Seller, any of its affiliates nor any servicer of any related Mortgage Loan has taken any action to waive any default, breach or event of acceleration”

MLPA § 7(n): “[A]t the time of origination, each Mortgaged Property was the subject of an appraisal which conformed to the underwriting requirements of the originator of the Mortgage Loan and, the appraisal is in a form acceptable to Fannie Mae or FHLMC.”

MLPA § 7(r): “[T]he information set forth in Schedule A of the Prospectus Supplement with respect to the Mortgage Loans is true and correct in all material respects.”

MLPA § 7(t): “[E]ach Mortgage Loan was originated in accordance with the underwriting guidelines of the related originator.”

258. As demonstrated by their number, scope, and particularity, the foregoing representations and warranties were designed to convey absolute confidence that EMC was standing behind the quality of the loans and, specifically, accepting the risk of loss should any of the loans be found to have been included in the Transactions in violation of any representation or warranty.

2. Transactional-Level Representations and Warranties

259. EMC induced Ambac to issue the Policies by, among other things, extending to Ambac the representations and warranties that EMC had made in the MLPAs, PSAs, and SSAs, providing even broader representations and warranties in the I&I Agreements, and affording

Ambac even greater remedies for breaches of EMC's representations and warranties than those that EMC had extended to the Trusts and Note Purchasers in the Transaction Documents. These additional representations and remedies were consistent with Ambac's central role in the Transactions as the ultimate backstop for payments due to the Note Purchasers. EMC's numerous representations and warranties to Ambac, and the broad remedies afforded for their breach, conveyed EMC's blanket commitment that the loans that EMC had sold to the Trusts conformed to EMC's representations and warranties and were not tainted by fraud, error, omission, misrepresentation, negligence, or similar occurrence in their origination or underwriting. In providing this commitment, Bear Stearns assured Ambac that EMC would bear the risk of loss in the event that any of its representations and warranties proved inaccurate.

260. EMC's broad representations and warranties, and its commitment to bear the risk of their inaccuracy, are clearly and unambiguously stated in the I&I Agreements. First, the I&I Agreements explicitly extend to Ambac the numerous representations and warranties that EMC made in the MLPAs:

I&I Agreement § 2.04(1): *Company Documents*. The representations and warranties of the Seller [EMC] contained in the Company Documents³⁴⁷ to which it is a party are true and correct in all material respects and the Seller [EMC] hereby makes each such representation and warranty to, and for the benefit of, the Insurer [Ambac] as if the same were set forth in full herein.³⁴⁸

261. Second, the I&I Agreements provide that Ambac is a third-party beneficiary of the other principal Transaction Documents, with all rights afforded thereunder, including the representations, warranties, and covenants that EMC made in the key Transaction Documents:

³⁴⁷ The I&I Agreements for all of the Transactions define "Company Documents" to include, among other things, the I&I, the MLPA, and the SSA or PSA, as applicable.

³⁴⁸ The language in Section 2.04(1) is identical in each of the I&I Agreements.

I&I Agreement § 2.05(j): *Third-Party Beneficiary*. The Seller [EMC] agrees that the Insurer [Ambac] shall have all rights of a third-party beneficiary in respect of the Company Documents and hereby incorporates and restates its representations, warranties and covenants as set forth therein for the benefit of the Insurer.³⁴⁹

262. Third, the I&I Agreement for each Transaction adds for Ambac’s benefit new representations and warranties not found in the underlying Transaction Documents, including EMC’s promise as to the truthfulness of the information it provided to Ambac about each of the Transactions:

I&I Agreement § 2.04(j): *Accuracy of Information*. No information supplied by the Seller [EMC] contained in the Company Documents to which it is a party nor other material information relating to the operations of the Seller or the financial condition of the Seller, as amended, supplemented or superseded, furnished to the Insurer in writing or in electronic format by the Seller contains any statement of material fact which was untrue or misleading in any material respect when made. The Seller does not have any knowledge of any circumstances that could reasonably be expected to cause a Material Adverse Change with respect to the Seller. Since the furnishing of the Company Documents, there has been no change nor any development or event involving a prospective change known to the Seller that would render any of the Company Documents untrue or misleading in any material respect.³⁵⁰

I&I Agreement § 2.04 (k): *Compliance with Securities Laws*. . . . The Company Information³⁵¹ in the Offering Documents³⁵² do not contain any untrue statement of a material fact and do not omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which they were made, not misleading³⁵³

³⁴⁹ SACO 2006-8 I&I Agreement § 2.05(j). Section 2.05(j) of the I&I Agreements for the other Transactions includes virtually identical language.

³⁵⁰ The language in Section 2.04(j) is identical in each of the I&I Agreements for all the Transactions.

³⁵¹ The I&I Agreements for all of the Transactions define “Company Information” as “all information with respect to the Offering Documents other than the Insurer Information and the Underwriter Information.”

³⁵² The I&I Agreements in all of the Transactions define “Offering Documents” to include the Free Writing Prospectus, the Prospectus Supplement, the Base Prospectus, and any document with respect to

263. EMC's warranty to Ambac in Section 2.04(k) of the I&I Agreements are significant. As discussed in detail above, the Offering Documents contained disclosures pertaining to the loan characteristics, the underwriting and due diligence conducted, and the risks associated with an investment in the Notes. In making this representation about the Offering Documents, which was material and incremental to the representations and warranties made in the MLPAs, EMC sought to provide further comfort to Ambac about the accuracy and completeness of the total mix of information about the Transactions made available by EMC. In so doing, EMC again assumed the risk that the disclosures misstated or omitted material facts. In fact, as previously discussed, this representation and warranty was breached because the Offering Documents contained false and misleading information about key loan metrics on a pool-wide basis, and the underwriting and due diligence performed on the loans, and contained material omissions because they failed to disclose the abysmal origination, underwriting and due-diligence practices and procedures that account for the incredible incidence of fraud and gross underwriting failings plaguing these loans.

C. EMC'S CONTRACTUAL COVENANTS REINFORCING THE PARTIES' BARGAINED-FOR RISK ALLOCATION

1. EMC's Promise to Give Prompt Notice of Breaches

264. To reinforce the parties' bargained-for risk allocation and further assure the deal participants that the loans complied with its representations and warranties, the MLPAs provide ongoing obligations on all securitization participants to promptly disclose any loan found to have been included in the Transactions in violation of any of EMC's myriad loan-level representations and warranties.

the insured notes or certificates (as the case may be) that makes reference to the policies approved by Ambac.

³⁵³ The language in Section 2.04(k) is identical in each of the I&I Agreements.

265. Specifically, Section 7 of the MLPA for the SACO 2006-8 Transaction³⁵⁴

provides, in pertinent part, as follows:

Upon discovery or receipt of notice by the HELOC Seller [EMC], the Purchaser [a Bear Stearns affiliate], the Issuer, the Note Insurer [Ambac] or the Indenture Trustee of a breach of any representation or warranty of the HELOC Seller set forth in this Section 7 which materially and adversely affects the value of the interests of the Purchaser, the Issuer, the Note Insurer, the Noteholders or the Indenture Trustee in any of the HELOCs . . . or which adversely affects the interests of the Note Insurer, the party discovering or receiving notice of such breach shall give prompt written notice to the others.

266. Section 7 of the MLPAs for the SACO 2005-10 and SACO 2006-2 Transactions similarly provides, in pertinent part, as follows:

Upon discovery or receipt of notice by the Sponsor [EMC], the Certificate Insurer [Ambac], the Purchaser [a Bear Stearns affiliate] or the Trustee of a breach of any representation or warranty of the Sponsor set forth in this Section 7 which materially and adversely affects the value of the interests of the Purchaser, the Certificateholders, the Certificate Insurer or the Trustee in any of the Mortgage Loans . . . the party discovering or receiving notice of such breach shall give prompt written notice to the others.

267. The PSAs and SSAs relating to the Transactions, as applicable, contain corresponding and virtually identical notification provisions.³⁵⁵

268. The notification provisions are absolute; they are in no way conditioned on EMC's ability to pursue claims against the originators of those loans or ultimately cure the defects affecting the breaching loans. Instead, they are designed to give prompt notice to the Transactions' participants of any breaching loan to ensure that EMC – and not Ambac, the Transactions, or its investors – bear the risk of loss associated with defective loans that EMC should not have securitized.

³⁵⁴ Section 7 of the BSSLT 2007-1 MLPA includes a substantially identical provision.

³⁵⁵ *See, e.g.*, PSA § 2.03 for the SACO 2005-10 and SACO 2006-2 Transactions.

269. EMC's promise to promptly notify other Transaction participants of breaching loans subsequently found to have been included in the Transactions was also a material inducement of Ambac's and investors' participation in the Transactions.

2. *EMC's Promise to Repurchase or Cure Breaching Loans Within 90 Days*

270. Disclosing the existence of breaching loans identified in the Transactions was necessary and essential to enforcing EMC's express contractual obligation to repurchase those loans or cure the breach in a timely manner (*i.e.*, 90 days) – and, thus, minimize the risk of loss to the Transactions' investors and insurer in the event Bear Stearns securitized defective loans by allocating those risks squarely to EMC.

271. To carry out this bargained-for risk allocation, and to convey absolute confidence that EMC was standing behind the quality of the securitized loans, EMC agreed in the MLPAs that, should any of its loan-level representations and warranties prove untrue, it would cure the breach(es) or remove the breaching loan(s) from the pool. To this end, immediately following the notification obligations described above, Section 7 of the MLPA for the SACO 2006-8 Transaction³⁵⁶ provides, in pertinent part, as follows:

In the case of any such breach of a representation or warranty set forth in this Section 7, within 90 days from the date of discovery by [EMC], or the date [EMC] is notified by the party discovering or receiving notice of such breach (whichever occurs earlier), [EMC] will (i) cure such breach in all material respects, (ii) purchase the affected HELOC at the applicable Purchase Price, or (iii) if within two years of the Closing Date, substitute a qualifying Substitute HELOC in exchange for such HELOC.

³⁵⁶ Section 7 of the MLPAs entered into in the three other Transactions include substantially identical provisions.

272. The PSAs and SSAs relating to the Transactions, as applicable, contain corresponding and virtually identical remedial provisions.³⁵⁷

273. While EMC's cure, repurchase, or substitution obligation (the "Repurchase Protocol") was a critical Transaction feature and a material inducement for Ambac to insure the Transactions, the parties intended this remedy to address the inadvertent inclusion in the Transactions by EMC of the aberrant non-complying loan. Because these provisions do not adequately address or compensate Ambac for the enormous harm inflicted by Bear Stearns' fraud or the wholesale failures to comply with the express representations and warranties that EMC made in the Transaction Documents, the Repurchase Protocol is inadequate and was not intended in such circumstances. EMC thwarted the intent of the parties embodied in their contractual agreements by selling to the Trusts predominantly non-compliant loans and pervasively breaching its representations and warranties by misrepresenting material facts and omitting material information. Further compounding the harm, EMC, under the direction of Bear, Stearns & Co. and subsequently JP Morgan executives, has essentially made a mockery of the Repurchase Protocol by refusing to repurchase all but a negligible number of defective loans submitted to it by Ambac.

**D. THE BROAD LEGAL AND EQUITABLE REMEDIES RESERVED
AND AFFORDED TO AMBAC UNDER THE TRANSACTION DOCUMENTS**

***1. Ambac's Express Right to Pursue Any
and All Remedies at "Law or Equity"***

274. The parties understood that the Repurchase Protocol would not fully address the quantum of risk and harm borne by Ambac in the event of wholesale misrepresentation of facts material to its risk assessment. Accordingly, while other parties to the Transactions may be

³⁵⁷ See PSAs § 2.03.

limited to the remedies set forth in the MLPA and SSA or PSA, as applicable, Ambac is not. Section 5.02 of the I&I Agreements provides that any and all remedies at law and in equity – including those available in the Company Documents – are available to Ambac on a non-exclusive and cumulative basis.

275. Pursuant to Section 5.02(a) of the I&I Agreements, EMC agreed that upon the occurrence of an “Event of Default,”³⁵⁸ which event includes EMC’s breaches of the loan-level representations and warranties in the MLPA, Ambac may

take whatever action at law or in equity as may appear necessary or desirable in its judgment to collect the amounts, if any, then due under this Insurance Agreement . . . or to enforce performance and observance of any obligation, agreement or covenant of . . . [EMC] under Company Documents.

Section 5.02(b) of the I&I Agreements further provides that any and all remedies at law and in equity – including those available in the Company Documents – are available to Ambac on a non-exclusive and cumulative basis.³⁵⁹

276. Pursuant to Section 5.03(a) of the I&I Agreements, EMC expressly agreed that “[t]he exercise by [Ambac] of any right hereunder shall not preclude the exercise of any other right, and the remedies provided herein to [Ambac] are declared in every case to be cumulative and not exclusive of any remedies provided by law or equity.”³⁶⁰

³⁵⁸ An “Event of Default” is defined under Section 5.01(a) of the I&I Agreements as occurring when, among other things, “[a]ny representation or warranty made by the Depositor, the Issuing Entity, the Master Servicer or the Seller hereunder or under the Company Documents, or in any certificate furnished hereunder or under the Company Documents, shall prove to be untrue or incomplete in any material respect.”

³⁵⁹ The language in Section 5.02 is identical in each of the I&I Agreements.

³⁶⁰ The language in Section 5.03 is identical in each of the I&I Agreements.

2. *Ambac’s Contractual Rights to Indemnification and Reimbursement*

277. Pursuant to Section 3.04 of the I&I Agreements, EMC also agreed to pay and indemnify Ambac for any and all losses, claims, demands, damages, costs, or expenses by reason of, among other things,

the negligence, bad faith, willful misconduct, misfeasance, malfeasance or theft committed by any director, officer, employee or agent of the . . . Seller [EMC] in connection with any Transaction arising from or relating to the Company Documents;

the breach by the . . . Seller [EMC] of any representation, warranty or covenant under any of the Company Documents . . . ; or

any untrue statement or alleged untrue statement of a material fact contained in any Offering Document or any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading . . .

„³⁶¹

278. In Section 3.03(b) of the I&I Agreements, EMC further agreed to reimburse Ambac for “any and all charges, fees, costs and expenses that the Insurer may reasonably pay or incur, including reasonable attorneys’ and accountants’ fees and expenses (“Reimbursable Expenses”) in connection with . . . the enforcement, defense or preservation of any rights in respect of any of the Company Documents”³⁶²

VI. EMC’S PERVASIVE BREACHES OF ITS REPRESENTATIONS AND WARRANTIES

A. AMBAC’S LOAN-LEVEL REVIEW UNCOVERED PERVASIVE BREACHES

279. A loan-level review and analysis undertaken by Ambac’s independent consultants (at enormous effort and expense) has revealed that a significant number loans in the Transactions

³⁶¹ The language in Section 3.04(a) is identical in each of the I&I Agreements.

³⁶² The language in Section 3.03(b) is identical in each of the I&I Agreements.

breach one or more of EMC's extensive loan-level representations and warranties pertaining to the underwriting of the loans and the key loan metrics for each Transaction.

280. To date, Ambac, through its independent consultant, has reviewed a total of 6,309 loans across the Transactions. The results of Ambac's loan-level analyses revealed that at least 5,724 loans breached one or more of EMC's representations and warranties, evidencing a staggering 90% breach rate. These loans contain one or, in most cases, more than one defect that constitute a breach of one or more of the numerous representations and warranties made by EMC in the applicable MLPA and materially altered the loans' risk profile. These defects include:

- rampant fraud, primarily involving misrepresentation of the borrower's income, assets, employment, or intent to occupy the property as the borrower's residence (rather than as an investment), and subsequent failure to so occupy the property;
- failure by the borrower to accurately disclose his or her liabilities, including multiple other mortgage loans taken out to purchase additional investment property;
- inflated and fraudulent appraisals; and,
- pervasive violations of the loan originators' own underwriting guidelines and prudent mortgage-lending practices, including loans made to borrowers (i) who made unreasonable claims as to their income, (ii) with multiple, unverified social-security numbers, (iii) with debt-to-income and loan-to-value ratios above the allowed maximums, or (v) with relationships to the applicable originator or other non-arm's-length relationships.

281. Each of these breaches adversely affected Ambac's interests, or materially and adversely affected the value of Ambac's interests in the identified loan. Loans subject to fraud, that were not originated and underwritten pursuant to prudent and proper practices, or the key attributes of which are otherwise misrepresented are markedly more risky and therefore less valuable than loans not suffering from such shortcomings.

282. In addition to the non-performing loans, Ambac randomly selected 1,562 loans from the Transactions, of which 1,492 loans were available to review, thereby constituting a

statistically sound representative sample of the loans in the Transaction. The randomly selected loans from each Transaction included both defaulted loans and loans still current in payments (as well as loans that had already paid in full at the time of Ambac's review). The results of this randomly-generated sample were shocking, and demonstrate with a high degree of certainty that breaches of representations and warranties exist in a comparable percentage of loans *in the total loan pool* in each Transaction.

- Of the sample of 377 randomly selected loans in the SACO 2005-10 Transaction, Ambac identified breaches of representations and warranties in 340 loans, or 90%.
- Of the sample of 378 randomly selected loans in the SACO 2006-2 Transaction, Ambac identified breaches of representations and warranties in 347 loans, or 92%.
- Of the sample of 366 randomly selected loans in the SACO 2006-8 Transaction, Ambac identified breaches of representations and warranties in 338 loans, or 92%.
- Of the sample of 361 randomly selected loans in the BSSLT 2007-1 Transaction, Ambac identified breaches of representations and warranties in 325 loans, or 90%.

283. Pursuant to Section 7 of the MLPAs, through a series several letters between on April 25, 2008 and June 17, 2010, Ambac promptly gave formal notice to EMC and the other deal participants identifying the breaching loans found to have been included in the Transactions, and describing such breach, or breaches, affecting those loans with specificity. Upon receipt of such notices, EMC became obligated under the applicable MLPAs and PSAs/SSAs to repurchase or cure the affected loans within 90 days. Ambac's notices further reserved any and all rights to assert additional claims or demands including with respect to indemnification, reimbursement, breaches, or other claims.

284. JP Morgan – acting with authority to perform EMC's obligations under the Transaction Documents – responded to Ambac's breach notices between July 2008 and

November 2010 agreeing to repurchase *only 52 loans, or less than 1%, of the 5,724 of breaching loans* that Ambac identified. EMC, at the behest of its new management under JP Morgan, refused to repurchase any of the remaining loans or acknowledge the breaches in what amounts to a deliberate and bad faith frustration of the repurchase protocol further compounding the massive harm inflicted by Bear Stearns on Ambac and the Transactions' investors. And, despite EMC's assurances and follow-up requests by Ambac, EMC has failed even to repurchase those loans that it committed to repurchase, demonstrating its blatant and bad-faith disregard of its contractual obligations and representations.³⁶³

285. By its wholesale rejection of Ambac's repurchase demands, JP Morgan has thus made clear that it has no intention of allowing EMC to honor its contractual obligations. In its detailed responses to Ambac's breach notices, JP Morgan has taken positions in order to fraudulently reduce reserves that are wholly contrary to the express and unambiguous requirements of the applicable underwriting guidelines that EMC represented were adhered to, EMC's other representations and warranties, its contractual covenants contained in the Transaction Documents and, perhaps most shockingly, *the findings made and conclusions reached by Bear Stearns' own post-acquisition quality control department – findings that are memorialized in repurchase demands made by EMC and JP Morgan to the sellers of these same loans.*

³⁶³ Bear Stearns did not respond to Ambac's letters requesting prompt repurchase of the loans that Bear Stearns agreed were in breach and represented would be repurchased. See Letter from Ambac to EMC, dated September 16, 2009, ABK-EMC02664451-454 (SACO 2005-10), ABK-EMC02664443-446 (SACO 2006-2), ABK-EMC02664439-442 (SACO 2006-8), and ABK-EMC02664447-450 (BSSLT 2007-1).

B. BEAR STEARNS' INTERNAL DOCUMENTS AND ADMISSIONS CONTRADICT ITS REJECTION NOTICES TO AMBAC AND REVEAL BEAR STEARNS' BAD FAITH

286. Consistent with Bear Stearns' operational abuses discussed above, EMC and JP Morgan regularly asserted and resolved repurchase claims against the entities from which it acquired securitized loans based on material and adverse defects affecting the loans at issue in the Transactions.³⁶⁴

287. Internal databases and documentation reflecting these claims activities and the quality control findings made on the mortgage loans constitute significant admissions as to pervasive defects in securitized loan pools due to, among other things, rampant misrepresentations or fraud concerning borrowers' ability to repay their debts, and abject underwriting failures that violate proper and prudent mortgage-lending practices, including the actual underwriting guidelines that were supposed to be used to originate the loans.

288. The internal databases available to and used by Bear Stearns (and then JP Morgan) irrefutably show the defects observed in a large number of the loans at issue in the Transactions and establish Bear Stearns' deliberate misrepresentation of its due diligence and quality control operations while marketing the Transactions and selling the Notes at issue in this case. In spite of, or potentially because of, the pertinent information contained in such databases, EMC initially refused to disclose them. For example, Bear Stearns' internal databases show, among other things, the status of securitized loans subject to claims activity and reveal that Bear Stearns (i) filed a "Problem Loan Worksheet" – which its internal policy documents require to be "created by the QC auditors as loans are reviewed, for those loans with breaches of reps and

³⁶⁴ See Section III.F, above.

warrants, fraud, compliance issues, or misrepresentation”³⁶⁵ – with respect to at least 2,900 loans, and (ii) filed formal claims against sellers due to EPD violations or other substantive defects on almost 4,000 loans. Similarly, Bear Stearns has made partial disclosures of its internal quality control data, including “Quality Control Management Summaries” and “Loan Review Detail Reports,” indicating several hundred loans EMC deemed to be “Defective” and the reasons supporting that determination.

289. Although the defects conclusively establish breaches of EMC’s representations and warranties given to Ambac and other securitization participants, in its deliberate bid to conceal the quality of the loans, Bear Stearns did not disclose these breaches upon discovery, which constitutes a separate breach of EMC’s express obligation to provide “prompt” notice of its discovery of breaching loans.

290. Moreover, when Ambac uncovered the same defects that Bear Stearns’ quality control and claims departments had previously and independently identified, JP Morgan deliberately and in bad faith directed EMC to reject Ambac’s claims for its own illegitimate purposes, including JP Morgan’s attempts to obtain recoveries from EMC’s suppliers based on the same breaches raised by Ambac for those loans.

C. AMBAC’S DISCOVERY OF BORROWERS AND OTHER THIRD PARTIES VALIDATES THE BREACHES IDENTIFIED IN ITS REPURCHASE NOTICES

291. Documents subpoenaed by Ambac and its deposition examinations of many of the borrowers confirm Ambac’s initial findings that the mortgage loan pools securitized by Bear Stearns in the Transactions are replete with fraud, misrepresentations, and violations of underwriting guidelines. Following are just some of the examples pertaining to loans that (i)

³⁶⁵ EMC Conduit Manual, Chapter 10 Quality Control Process, dated October 1, 2004, EMC-AMB 004413698-735 at 700.

Bear Stearns securitized in the SACO 2006-8 Transaction, (ii) Ambac reviewed as part of its random sample, and (ii) JP Morgan continues to bar EMC from repurchasing despite Ambac's breach notices:

- **EMC Loan Number [REDACTED]**: This second-lien loan, with a principal balance of \$52,000, was made to a borrower in Palm Coast, Florida for the purchase of a property valued at \$260,000. The borrower also obtained a first-lien loan in the amount of \$208,000. The borrower's loan application stated that he lived in Monterrey, California, earned \$11,500 per month as a manager for the Sherwin Williams Company, had over \$7,200 in his bank account, and was purchasing the house in Florida as a second home. Ambac found, among other things, that the loan application misrepresented the borrower's income because an affidavit the borrower filed with his bankruptcy petition in 2007 indicates his average monthly income in 2005 to be approximately \$4,300 per month and in 2006 to be \$5,715 per month. Ambac also found that the loan application misrepresented the borrower's employment, and its breach notice advised Bear Stearns of these findings and the representations and warranties breached as a result thereof. At a deposition on March 27, 2010, the borrower confirmed these findings and also testified that at the time of closing he had approximately \$3,100 in his bank account, and not \$7,200 as listed on the loan application. The borrower also testified that he was told at the closing that he had only fifteen minutes to sign all the paperwork, which had already been prepared and dated. The borrower complained, stating that he wanted to review the paperwork overnight, but was told by the mortgage broker that if he did not sign everything in fifteen minutes, "the loan was gone and the house was gone." Further, prior to the closing, the borrower had told the mortgage broker via telephone that he wanted a single, adjustable rate mortgage. The borrower discovered for the first time on his own at the closing that he was taking out two loans instead of one. He was still unaware that the second loan was an "interest only" HELOC which had an initial annual percentage rate of 6.50%. This rate was only applicable for the first three months, at which time it would reset to an adjustable rate mortgage with an annual percentage rate of prime plus 5%. The borrower discovered for the first time that the HELOC was an "interest only" loan when the three month teaser rate expired and his payments on the HELOC almost doubled.
- **EMC Loan Number [REDACTED]**: This second-lien loan with a principal balance of \$67,000 was made to two ministers (borrower and co-borrower) for the purchase of a property valued at \$337,000 in Henderson, Nevada. The couple's loan application indicated the borrower's income to be \$11,850 per month as an ad developer for Heath and Associates advertising, Inc. in San Luis Obispo, California and the co-borrower's income as \$5,950 per month as a teacher in San Luis Obispo for the State of California. The loan closed as a "primary residence" – *i.e.*, the borrowers were required to occupy the property as their primary residence. Ambac found, among other things, that the couple's stated income was

not reasonable, that the couple never occupied the property after closing, and that the loan application did not disclose that the couple had purchased another house in Nevada and had also refinanced their home in Arroyo Grande, California. Ambac advised Bear Stearns of these findings and the representations and warranties breached as result thereof. Deposition examinations of the couple not only corroborated these findings, but also revealed that the borrower was *unemployed* at the time of closing and *never worked for Heath and Associates Advertising*. The deposition also revealed that EMC had notice that the borrowers never occupied the property in Henderson because, immediately upon closing, it began sending the monthly mortgage statement to the borrowers' primary residence in California. In fact, when the borrowers could no longer pay their monthly mortgage payments, they contacted EMC and stated that they needed a deferment because the house in Henderson was a rental which had been vacant for a number of month. In contravention of the parties' agreement, EMC failed to notify Ambac of this breach, and then when notified by Ambac of this and other misrepresentations, refused to repurchase the loan.

- **EMC Loan Number [REDACTED]**: This loan, with a principal balance of \$57,000, was made to a borrower in East Bethel, Minnesota for the purchase of a property valued at \$385,000. The borrower also obtained a first-lien loan with a balance of \$304,000. The borrower's loan application indicated her income to be \$10,500 per month and identified her employment as a national visual merchandise coordinator for Kohl's Department Stores. Ambac found that the borrower was employed in a local capacity, which would make her stated income of \$10,500 not reasonable. Ambac advised Bear Stearns of these findings and the representations and warranties breached as result thereof. During the March 21, 2010 deposition, the borrower corroborated these findings. She testified that she has never held a national position at Kohl's and at the time of closing earned approximately \$2,700 per month.
- **EMC Loan Number [REDACTED]**: This second-lien HELOC in the amount of \$104,000 was made to a borrower for the purchase of a property with the purchase price of \$520,000. The loan application stated that borrower was employed as a general manager at Foto Mart, paid \$2,500 per month in rent, and had almost \$13,000 in her bank account – factors which suggest that the borrower had the ability to pay approximately \$4,400 per month in housing expenses for the new property. Ambac found that the underwriter demonstrated negligence or misconduct in not verifying the large increase in the borrower's bank balance immediately prior to closing in light of the fact that her average account balance over the past three months was \$518. Further, the borrower's credit report did not support her employment as a manager and her average bank balance of \$518 did not support an earning potential from a management position. Ambac advised Bear Stearns of these findings and the representations and warranties breached as result thereof. The borrower testified at a deposition on November 19, 2009 that she earned approximately \$2,270 per month as a babysitter and has never worked at Foto Mart. The borrower's loan file contained a verification of employment indicating that a loan underwriter called "Jorge," a manager at Foto Mart, and

confirmed that the borrower was employed there as a general manager. The borrower testified that Jorge was actually her mortgage broker. The deposition also revealed that the borrower paid approximately \$600 per month in rent prior to purchasing the property, and not \$2,500 as indicated on the loan application. The borrower testified that twelve cancelled checks which purport to verify that she paid \$2,500 per month in rent were forged: She did not sign these checks and the handwriting is someone else's.

292. For all of these loans, EMC represented and warranted, among other things, that (i) they complied in all material respects with applicable local, state and federal laws, including but not limited to, all applicable anti-predatory lending laws; (ii) at the time of closing, there was no default, breach, violation or event of acceleration existing under the Mortgages or Mortgage Notes (which the underlying loan documentation specifically states that a material misrepresentation in connection with obtaining the loan constitutes in a default); (iii) that the origination and servicing practices with respect to these loans have been conducted in all respects in accordance with the terms of the Mortgage Note and in compliance with all applicable laws and regulations and, unless otherwise required by law or Fannie Mae/Freddie Mac standards, in accordance with proper, prudent and customary practices in the mortgage origination and servicing business; and (iv) no fraud, error, omission, misrepresentation, gross negligence or similar occurrence with respect to these loans has taken place on the part of any Person, including without limitation, the Mortgagors, or any other party involved in the origination or servicing of these loans.

VII. HARM SUFFERED BY AMBAC AND NOTE PURCHASERS

293. The Transactions that Bear Stearns marketed and effectuated based on its materially false and misleading representations and disclosures have failed miserably. An overwhelming percentage of the loans that Bear Stearns securitized in each of the Transactions either have been written off as total losses or are severely delinquent causing massive shortfalls in the cash-flows of principal and interest needed to pay down the securities. As a result, the

Note Purchasers have incurred severe losses that have been passed on to Ambac as the financial guarantor.

294. The Transactions have experienced cumulative losses of more than \$1.3 billion in the aggregate as of December 31, 2010. A significant portion of the loans in each Transaction are severely delinquent or charged-off, measured either by number or by loan balance (as reflected in the following table):

<u>Transaction</u>	<u>Cumulative Losses</u>	<u>% of Loans Severely Delinquent or Charged-Off (by Loan Balance)</u>
SACO 2005-10	\$123.6 million	39.32%
SACO 2006-2	\$279.5 million	42.43%
SACO 2006-8	\$140.8 million	41.35%
BSSLT 2007-1	\$800.8 million	67.67%

295. The severe losses realized by the Transactions have resulted in Ambac having to make claim payments to insured Note Purchasers. As reflected in the following table, as of December 31, 2010, Ambac has paid, or is obligated to pay, claims of more than \$768.2 million in the aggregate.

<u>Transaction</u>	<u>Claims</u>	<u>Date of Ambac's First Claim Payment</u>
SACO 2005-10	\$37.9 million	October 2008
SACO 2006-2	\$109.7 million	April 2008
SACO 2006-8	\$115.0 million	September 2007
BSSLT 2007-1	\$505.6 million	July 2008

296. But for Ambac's coverage obligations to fund the shortfalls under the Policies, the Note Purchasers would have been deprived of the principal and interest payments. Subject to the

terms of the Policies, Ambac guaranteed to make payments for the benefit of the Note Purchasers in the event that cash flows received by the trusts became insufficient to pay down the Notes.³⁶⁶

297. Due to the high rate of expected defaults, future claims payments by Ambac are inevitable. Therefore, in addition to the substantial claims payments already made by Ambac under the Policies, Ambac has been forced to set aside hundreds of millions of dollars in reserves based on the expectation of future shortfalls affecting the Transactions.

298. As discussed above, the pervasive breaches of EMC's representations and warranties, revealed by the loan-file reviews and Bear Stearns' internal documents, and supported by the dismal loan performance in all four of the Transactions, pierce the very heart of the bargain struck by the parties. As has only recently become clear, EMC did not sell to the Trusts the contemplated portfolio of loans with the represented attributes. Rather, Bear Stearns transferred pools where the overwhelming majority of loans did not bear any resemblance to the loans EMC represented and warranted would comprise the pools. In doing so, Bear Stearns induced Ambac into insuring each successive Transaction based upon materially false and misleading information about that Transaction *and* the ones preceding it.

299. Contrary to EMC's representations and warranties in Section 2.04(k) of the I&I Agreements, the Offering Documents that Bear Stearns prepared to market the Notes that Ambac

³⁶⁶ In contrast with other types of insurer-insured relationships, in a securitization transaction a monoline insurer such as Ambac generally does not have access to information relating to the identity of the insureds, *i.e.*, the Note Purchasers. Instead, Ambac makes payments to the trusts set up for each Securitization, which, in turn, makes the payment to the Note Purchasers. Further, because Bear Stearns – not Ambac – marketed and sold the Notes to the Note Purchasers upon closing of each Transaction, Bear Stearns and EMC know the identity of the Note Purchasers, which they have withheld from Ambac. By document requests dated March 3, 2010, Ambac demanded that EMC provide Ambac with “Documents sufficient to identify the name, address, phone number and email address as to any investor or purchaser of the securities issued in connection with any of the Transactions.” Ambac made clear that this information was needed for it to prosecute this action, conduct discovery, and exercise its rights under the Transaction Documents. EMC refused to comply, and after a motion to compel by Ambac, has recently been ordered to produce communications with those investors.

insured (and the same documents that it filed with the SEC) contained material misrepresentations and omissions because they did not adequately or accurately disclose the true attributes of the loans (*e.g.*, the weighted average combined loan-to-value ratio, occupancy status, or debt-to-income ratio), the level of fraud and underwriting failings permeating the EMC loan pools, the grossly deficient origination practices of the originators of these loans, EMC's dismal due-diligence practices, the duplicitous role of its quality control department, or its scheme to recover from originators and pocket substantial sums of money that rightfully belonged to the securitization Trusts (*i.e.*, Ambac and the investors). Ambac would never have issued its Policies or agreed to participate in the Transactions had it known the true facts

300. Having pervasively and systematically breached its representations and warranties and wholly eviscerated the Repurchase Protocol, EMC has materially breached each of the I&I Agreements as a whole, which breaches entitle Ambac to be (i) returned to the position it would have been in had it not entered into the I&I Agreements and issued its Policies and (ii) compensated for the incremental harm incurred as a result of its participation in each of the Transactions.

301. At the very least, this relief requires the payment to Plaintiff by Bear Stearns of all claim payments made to date and all future claim payments required to be made under the respective Policies.

VIII. JPMORGAN CHASE & CO. HAS STRIPPED EMC OF ITS ASSETS, SEEKING TO RENDER EMC A JUDGMENT-PROOF SHELL, BUT SUBJECTING JPMC BANK TO SUCCESSOR LIABILITY

302. Subsequent to the filing of the original Complaint in this action detailing EMC's liability for the extensive losses suffered by Ambac, JP Morgan Chase & Co. has taken steps to strip EMC of its assets and render it unable to satisfy any judgment against it. In violation of EMC's numerous contractual obligations to Ambac, on or about April 1, 2011, JPMorgan Chase

& Co. effectuated an intercompany asset sale whereby EMC transferred to its affiliate, JPMC Bank, all of EMC's servicing-related assets (the "Asset Transfer"). (The mortgage servicing business entails processing payments from borrowers for securitized mortgages, such as those included in the Transactions, and distributing the proceeds to the Trusts, as well as pursuing delinquent borrowers and bringing foreclosure actions.) The transferred servicing assets include servicing rights on the four Transactions at issue in this litigation, several other Ambac-insured securitizations, as well as dozens of other securitizations. The servicing operations EMC sold to JPMC Bank constituted substantially all of EMC's assets and its last remaining operating assets. EMC has been shorn of its assets and has become, in essence, a shell. By taking these improper actions, JPMorgan Chase & Co. has subjected its subsidiary, JPMC Bank, to liability as EMC's successor.

A. EMC'S PAST SERVICING OPERATIONS

303. EMC acted as a servicer in connection with all four Transactions at issue in this litigation. At the time of the Transactions, servicing was one of EMC's several business operations, and one that Bear Stearns featured prominently in its discussions with Ambac. As explained above, EMC also specialized in the acquisition, securitization and disposition of mortgage loans. But by the time of the Asset Transfer in early 2011, JPMorgan Chase & Co. had shut down EMC's mortgage loan acquisition and securitization operations. Servicing was EMC's last remaining business operation, and its servicing business constituted EMC's last remaining substantial asset.

B. EMC'S COVENANTS NOT TO TRANSFER ITS ASSETS OR ITS SERVICING RIGHTS WITHOUT AMBAC'S CONSENT

304. Pursuant to the terms of express negative covenants in the I&I Agreements governing the Transactions, EMC agreed, among other things, not to merge with any person,

transfer substantially all of its assets, or interfere with the enforcement of any rights of Ambac. Specifically, pursuant to Section 2.06 of the I&I Agreements, EMC gave express covenants not to take certain actions “unless [Ambac] shall otherwise expressly consent in writing.”³⁶⁷ Among other things, EMC covenanted:

Limitation on Mergers, Etc. *[EMC] shall not consolidate with or merge with or into any Person or transfer all or substantially all of its assets* to any Person or liquidate or dissolve except as provided in the Company Documents to which it is a party or as permitted hereby. *[EMC] shall furnish to [Ambac] all information* relating to it *requested* by [Ambac] that is reasonably necessary to determine compliance with this paragraph.³⁶⁸

Impairment of Rights. *[EMC] shall not take any action*, or fail to take any action, *if such action or failure to take action may result in a Material Adverse Change* specified in clause (ii) of the definition of Material Adverse Change with respect to [EMC], *or may interfere with the enforcement of any rights of [Ambac]* under or with respect to any of the Company Documents. [EMC] shall give [Ambac] written notice of any such action or failure to act by it on the earlier of: (i) the date upon which any publicly available filing or release is made with respect to such action or failure to act or (ii) promptly prior to the date of consummation of such action or failure to act. *[EMC] shall furnish to [Ambac] all information requested* by it that is reasonably necessary to determine compliance with this paragraph.³⁶⁹

305. “Material Adverse Change,” for purposes of Section 2.06(a) of the I&I Agreements, is defined as “a material adverse change in . . . the ability of [EMC] to perform its obligations, if any, under any of the Company Documents.”³⁷⁰

³⁶⁷ The language in Section 2.06 is identical in each of the I&I Agreements.

³⁶⁸ SACO 2006-8 I&I Agreement § 2.06(c) (emphasis added). The language in Section 2.06(c) is identical in each of the I&I Agreements.

³⁶⁹ SACO 2006-8 I&I Agreement § 2.06(a) (emphasis added). The language in Section 2.06(a) is identical in each of the I&I Agreements.

³⁷⁰ SACO 2006-8 I&I Agreement § 1.01. The language in Section 1.01 is identical in each of the I&I Agreements.

306. EMC similarly committed not to transfer its servicing rights in the Transactions without Ambac’s consent. Under the PSAs or SSAs governing the Transactions, a “Company Default” is caused when, among other things, “[EMC] attempts to assign its right to servicing compensation hereunder or *[EMC] attempts to sell or otherwise dispose of all or substantially all of its property or assets or to assign this Agreement or the servicing responsibilities hereunder*”³⁷¹ A Company Default by EMC can be waived only “*with the consent of [Ambac]*”³⁷²

307. These restrictions on EMC’s ability to merge, liquidate, or transfer all or substantially all of its assets generally, as well as on its ability to transfer the servicing rights in the Transactions, were critical contractual protections for Ambac. Ambac required assurances that its counterparty in the Transactions had the continuing financial wherewithal to stand behind the critical obligation, explained above, to cure or repurchase defective loans in the Transactions, reimburse Ambac and provide the indemnities required by its agreements with Ambac. In addition, given the important role of the mortgage servicer in ensuring that borrowers adhered to their payment obligations and recovering against those that did not – so that the loans contributed the expected revenues to the Trusts – Ambac also insisted upon a level of control over which party filled that role.

³⁷¹ SACO 2006-8 SSA § 7.05(vi). *See also* SACO 2005-10 PSA § 9.05(vi); SACO 2006-2 PSA § 9.05(vi); BSSLT 2007-1 SSA § 7.05(vi).

³⁷² SACO 2006-8 SSA § 7.06. *See also* SACO 2005-10 PSA § 9.06; SACO 2006-2 PSA § 9.06; BSSLT 2007-1 SSA § 7.06.

C. EMC BREACHED ITS COVENANTS NOT TO MERGE OR TRANSFER SUBSTANTIALLY ALL OF ITS ASSETS

308. JPMorgan Chase & Co., however, ignored these contractual obligations, and completed the Asset Transfer that stripped EMC of its sole remaining operating asset despite Ambac's express and repeated objections to the transfer.

309. On April 30, 2009, EMC first requested Ambac's consent for a planned transfer of servicing assets to JPMC Bank. In requesting Ambac's consent, EMC acknowledged that Ambac's consent to a transfer of EMC's servicing assets was required by contracts governing the Transactions.

310. Following EMC's request for Ambac's consent to the proposed transfer of servicing assets to JPMC Bank, Ambac made various informational requests to EMC in order to ascertain the fairness of consideration, and otherwise fully evaluate the proposed transaction and EMC's compliance with its contractual obligations. EMC did not comply with Ambac's requests. EMC refused to provide basic information to Ambac, such as (i) the agreement or agreements setting forth the complete terms of the transfer, and (ii) financial information reflecting the expected assets and liabilities of EMC immediately following the asset transfer. Ambac sought this information because, as the recipient of EMC's representations and warranties relating to billions of dollars of mortgage loans deposited into numerous securitization trusts insured by Ambac and repurchase obligations relating thereto, Ambac was entitled to assure itself that the valuable, income-producing assets were not being transferred for inadequate consideration. In view of EMC's continued refusal to provide basic information to Ambac regarding the consideration to be received by EMC and the financial condition of EMC post-transfer, Ambac refused to grant its consent for the proposed transfer of servicing assets by letter dated May 28, 2009.

311. In October 2010, nearly a year and a half after first raising the issue, counsel for EMC informed Ambac of its renewed intention to transfer EMC's servicing assets to JPMC Bank.

312. Ambac received a written request for consent dated November 12, 2010. Ambac once again requested information necessary to evaluate the proposed transaction and whether to provide the requested consent, such as information reflecting: whether EMC would receive fair consideration in exchange for the servicing assets; whether EMC was insolvent or would be rendered insolvent by the transfer; and whether the Asset Transfer would "interfere with the enforcement of any rights of [Ambac] under or with respect to any of the Company Documents."³⁷³ For example, Ambac again requested the agreement or agreements setting forth the complete terms of the transfer. In addition, Ambac requested any third-party valuations to assess whether EMC was receiving fair value for the servicing assets.

313. During discussions from December 2010 through March 2011 with counsel for JPMorgan Chase & Co., Ambac repeatedly reiterated its need for such information in order to evaluate the request. Ambac also repeatedly reiterated that it could not, and would not, consent to the request without this critical information.

314. Once again, and in violation of the I&I Agreements, EMC and JP Morgan Chase & Co. withheld information necessary for Ambac to evaluate the proposed asset transfer and EMC's compliance with its obligations. Specifically, JPMorgan Chase & Co. refused to provide on EMC's behalf the agreement or agreements setting forth the complete terms of the transfer and any third-party valuations being relied upon to determine the purchase price. Accordingly, Ambac refused to grant its consent to the proposed Asset Transfer.

³⁷³ SACO 2006-8 I&I Agreement 2.06(a). The language in Section 2.06(a) is identical in each of the I&I Agreements.

315. On April 4, 2011, counsel for JPMorgan Chase & Co. advised Ambac that the Asset Transfer had been completed on April 1, 2011, despite Ambac's refusal to provide its consent. As a result, EMC is in breach of the I&I Agreements, PSAs and SSAs governing the Transactions.

316. On June 3, 2011, counsel for Ambac notified EMC, *inter alia*, that EMC breached each of the I&I Agreements and the PSA/SSAs governing the Transactions by completing the Asset Transfer without the required consent of Ambac, and demanded that EMC remedy the breaches within 30 days. EMC refused to remedy its breaches.

317. Ambac has been greatly harmed by EMC's breaches of contract in effectuating the Asset Transfer without Ambac's required consent. Among other harms, as a consequence of the Asset Transfer, EMC has been stripped of its business operations and left as a shell without the wherewithal to satisfy its ongoing contractual obligations to Ambac in the Transactions.

D. AMBAC'S CONTRACTUAL RIGHTS TO SUE ANY SUCCESSOR OF EMC

318. In addition to breaching EMC's contractual obligations, the Asset Transfer has resulted in JPMC Bank becoming liable to Ambac for all obligations of EMC, including the repurchase of all breaching loans, as EMC's successor under the Successor and Assigns provisions of each of the MLPAs governing the Transactions:

Any person into which [EMC] may be merged or consolidated (or any person resulting from any merger or consolidation involving [EMC]), any person resulting from a change in form of [EMC] or any person succeeding to the business of [EMC], shall be considered the "successor" of [EMC] hereunder and shall be considered a party hereto without the execution or filing of any paper or any further act or consent on the part of any party hereto. .

³⁷⁴
..

³⁷⁴ SACO 2006-8 MLPA § 23 (emphasis added). *See also* SACO 2005-10 MLPA § 24; SACO 2006-2 MLPA § 24; BSSLT 2007-1 MLPA § 23.

319. The Pooling and Servicing Agreements governing the SACO 2005-10 and SACO 2006-2 Transactions similarly provide:

*Any Person into which . . . [EMC] . . . may be merged or consolidated, or any corporation resulting from any merger or consolidation to which . . . [EMC] . . . shall be a party, or any Person succeeding to the business of . . . [EMC] . . . , shall be the successor of . . . [EMC] . . . hereunder, without the execution or filing of any paper or further act on the part of any of the parties hereto, anything herein to the contrary notwithstanding.*³⁷⁵

320. Section 4.04 of the I&I Agreements provides that the I&I Agreements “shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns.”³⁷⁶

321. Because the servicing business was EMC’s sole remaining ongoing operating business, when JPMC Bank succeeded to that business through the Asset Transfer, it succeeded to EMC’s obligations in the Transactions pursuant to the plain terms of the Transaction Documents.

E. JPMORGAN CHASE & CO. EFFECTUATED A DE FACTO MERGER OF EMC AND JPMC BANK

322. In addition to becoming EMC’s successor by operation of these contractual provisions, the Asset Transfer orchestrated by the two entities’ mutual parent company, JPMorgan Chase & Co, resulted in JPMC Bank becoming liable for all of the obligations and liabilities of EMC by operation of law. Ultimate ownership of the servicing operations that EMC transferred remain unchanged: both before and after the Asset Transfer, EMC and JPMC Bank

³⁷⁵ SACO 2005-10 PSA § 8.02(b) (emphasis added). *See also* SACO 2006-2 PSA § 8.02(b). The SSAs governing the SACO 2006-8 and BSSLT 2007-1 deals do not contain equivalent provisions.

³⁷⁶ SACO 2006-8 I&I Agreement § 4.04(a). The language in Section 4.04(a) is identical in each of the I&I Agreements.

were affiliates of the same banking family and ultimately owned by the same parent holding company, JPMorgan Chase & Co.

323. In addition, EMC has ceased independent business operations. EMC's website now describes EMC as "a brand of JPMorgan Chase Bank, N.A.,"³⁷⁷ and states that "JPMorgan Chase Bank, N.A. services loans under the EMC Mortgage name."³⁷⁸ EMC no longer services mortgages, and no longer engages in any other business operations.

324. JPMC Bank has assumed the obligations necessary for the uninterrupted continuation of the operations performed by EMC prior to the Asset Transfer. Specifically, JPMC Bank has assumed EMC's obligations to service mortgage loans under the contracts governing various RMBS deals, including the four Transactions at issue in this litigation.

325. JPMC Bank has retained EMC's management and personnel, as well as EMC's physical locations and, as noted, EMC's assets and general business operations. After the Asset Transfer, EMC's former management and personnel continue to handle the transferred servicing operations from the same business locations. EMC's former servicing operations located in Dallas, Texas – now belonging to JPMC Bank – are continuing to handle payment processing, borrower inquires and related functions.³⁷⁹

³⁷⁷ EMC Mortgage® A Brand of JPMorgan Chase Bank, N.A., <https://www.emcmortgagecorp.com/EMCMORTGAGE/> (last visited July 18, 2011).

³⁷⁸ EMC Mortgage® A Brand of JPMorgan Chase Bank, N.A., About Us, https://www.emcmortgagecorp.com/EMCMORTGAGE/MainContent/about_us.jsp (last visited July 18, 2011).

³⁷⁹ EMC Mortgage® A Brand of JPMorgan Chase Bank, N.A., Contact Us, https://www.emcmortgagecorp.com/EMCMORTGAGE/MainContent/contact_us.jsp (last visited July 18, 2011).

FIRST CAUSE OF ACTION

(Against Defendants JP Morgan and EMC for Fraudulent Inducement)

326. Plaintiff realleges and incorporates by reference paragraphs 1 through 325 of this Complaint.

327. As set forth above, Defendants JP Morgan (formerly Bear, Stearns & Co.) and EMC made materially false public statements, and omitted material facts, with the intent to defraud the public and Ambac.

328. Defendants made materially false statements and omitted material facts with the intent to defraud Ambac in pre-contractual communications between Ambac and Defendants' officers.

329. Defendants, knowingly and with the intent to defraud, delivered to Ambac materially false and misleading documentation, including investor presentations, loan tapes, and Offering Documents, and fraudulently-induced ratings by the rating agencies.

330. Ambac reasonably relied on Defendants' statements and omissions when it entered into the I&I Agreements and issued its Policies.

331. As a result of Defendants' statements and omissions, Ambac insured pools of loans that had a risk profile far higher than Defendants led Ambac to understand.

332. As a result of Defendants' false and misleading statements and omissions, Plaintiff has suffered, and will continue to suffer, damages.

333. Because Defendants committed these acts and omissions maliciously, wantonly, oppressively, and with knowledge that they would affect the general public – which they have – Plaintiff is entitled to punitive damages.

SECOND CAUSE OF ACTION

(Against Defendant EMC for Breaches of Representations and Warranties)

334. Plaintiff realleges and incorporates by reference paragraphs 1 through 333 of this Complaint.

335. The I&I Agreement in each Transaction is a valid and binding agreement between Ambac and EMC. In the I&I Agreements, EMC explicitly agreed to extend to Ambac the numerous representations and warranties that EMC made in the MLPAs.

336. Ambac has performed its obligations under the I&I Agreements.

337. EMC has materially breached its representations and warranties under Section 7 of the MLPAs and Section 2.04 of the I&I Agreements.

338. Plaintiff has been damaged and will continue to be damaged in an amount to be determined at trial.

THIRD CAUSE OF ACTION

(Against Defendant EMC for Breaches of Repurchase Obligation)

339. Plaintiff realleges and incorporates by reference paragraphs 1 through 338 of this Complaint.

340. EMC has materially breached its obligations under Section 7 of the MLPAs and Section 2.03 of the PSAs or SSAs, as applicable, by refusing to cure, repurchase, or provide substitutes for the loans that breached EMC's representations and warranties and with respect to which (i) EMC had discovered the breach or (ii) notice of breach has been provided by Ambac to EMC.

341. Plaintiff has been damaged and will continue to be damaged in an amount to be determined at trial.

FOURTH CAUSE OF ACTION

(Against Defendant JP Morgan for Tortious Interference with Contractual Relationship)

342. Plaintiff realleges and incorporates by reference paragraphs 1 through 341 of this Complaint.

343. Under Section 7 of the MLPAs and Section 2.03 of the PSAs or SSAs, as applicable, EMC is required to cure, repurchase, or provide substitutes for loans that breached EMC's representations and warranties.

344. Bear, Stearns & Co. at all relevant times had notice and knowledge of this contractual relationship between Ambac and EMC and of the contractual obligations referred to in Paragraph 316 above. After EMC and Bear, Stearns & Co. were acquired by JPMorgan Chase & Co., JP Morgan also had notice and knowledge of such contractual obligations.

345. As a direct and proximate result of JP Morgan's tortious interference, which is continuing, EMC breached such contractual obligations, and is continuing to do so.

346. JP Morgan's tortious interference was, and is, improper and without justification or privilege. JP Morgan's interference was not intended to, and did not, further the economic interest of EMC; and, as a mere affiliate of EMC, JP Morgan did not have its own economic interest in EMC which would be protected by EMC's breach of its contractual obligations to Ambac. Moreover, JP Morgan's interference was not intended to protect any purported economic interest it had in EMC; rather, it did so in order to assist its parent corporation, JP Morgan Chase, in effectuating a massive accounting fraud based on an unjustified and material understatement of reserves on its financial statements relating to the liability inherited from EMC for repurchase obligations associated with defective loans.

347. Moreover, JP Morgan effectuated its interference with EMC's contractual obligations to Ambac by fraudulently and deceptively representing to Ambac that the rejections of Ambac's repurchase demands were based on the reasons set forth in the written responses to those demands.

348. JP Morgan engaged in these actions through improper, fraudulent and deceptive means and with the conscious, willful, wrongful, tortious, illegal, and wanton intent to manipulate JPMorgan Chase & Co.'s required accounting disclosures and injure Ambac in its trade or business.

349. As a direct and proximate result of the conduct described herein, Plaintiff has been damaged, and continues to be damaged, in its trade or business. Plaintiff has suffered, and will continue to suffer, monetary loss that it would not have suffered but for JP Morgan's tortious conduct, and are threatened with continuous and irreparable damage and/or loss.

FIFTH CAUSE OF ACTION

(Against Defendant EMC for Material Breaches of Each of the I&I Agreements)

350. Plaintiff realleges and incorporates by reference paragraphs 1 through 349 of this Complaint.

351. EMC induced Ambac to enter into the I&I Agreements and to issue the Policies by making extensive representations and warranties concerning the loans that EMC caused to be sold to the Trusts, and by agreeing to broad remedies for breaches of those representations and warranties.

352. EMC's representations and warranties were material to Ambac's decision to insure each of the Transactions, and Ambac was induced thereby to enter into each I&I Agreement and perform its obligations thereunder.

353. EMC has materially breached the I&I Agreements, and the loan-by-loan cure-repurchase-or-substitution remedy is both inadequate to address the magnitude and pervasiveness of the breaches identified and is being frustrated by EMC's wholesale failure to comply with it.

354. Plaintiff has been damaged and will continue to be damaged in an amount to be determined at trial.

SIXTH CAUSE OF ACTION

(Against Defendant EMC for Indemnification)

355. Plaintiff realleges and incorporates by reference paragraphs 1 through 354 of this Complaint.

356. Pursuant to Section 3.04(a) of the I&I Agreements, Ambac is entitled to be indemnified for any and all claims, losses, liabilities, demands, damages, costs, or expenses of any nature arising out of or relating to the transactions contemplated by the Company Documents by reason of, among other things, (i) the negligence, bad faith, willful misconduct, misfeasance, malfeasance or theft committed by any director, officer, employee or agent of EMC, (ii) the breach by EMC of any of the representations, warranties, or covenants contained in the Company Documents, and (iii) any untrue statement or alleged untrue statement of material fact contained in any Offering Document or any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.

357. By reason of the foregoing, EMC has caused Plaintiff to pay claims and incur losses, costs, and expenses, and will continue to cause Plaintiff to pay claims and incur losses, costs, and expenses.

SEVENTH CAUSE OF ACTION

(Against Defendant EMC for Breach of Contract – the Asset Transfer)

358. Plaintiff re-alleges and incorporates by reference paragraphs 1 through 357 of this Complaint.

359. EMC has consolidated with, merged into, or transferred all or substantially all of its assets to JPMC Bank without Ambac's express written consent, in violation of Section 2.06 of the I&I Agreements, and in violation of Section 9.05 of the SACO 2005-10 PSA, Section 9.05 of the SACO 2006-2 PSA, Section 7.05 of the SACO 2006-8 SSA, and Section 7.05 of the BSSLT 2007-1 SSA.

360. EMC failed to furnish to Ambac all information relating to the Asset Transfer requested by Ambac that was reasonably necessary for Ambac to determine EMC's compliance with Sections 2.06(a) and 2.06(c) of the I&I Agreements.

361. Before EMC and JPMC Bank consummated the Asset Transfer on or about April 1, 2011, Ambac made repeated requests to EMC for certain information that would allow Ambac to determine, among other things, whether the transfer would "interfere with the enforcement of any rights of [Ambac] under or with respect to any of the Company Documents."

362. EMC failed to provide Ambac with the requested information and consummated the Asset Transfer in breach of Section 2.06 of the I&I Agreements and without obtaining Ambac's consent. EMC's failure was without justification and was a breach of the I&I Agreements.

363. The Asset Transfer constitutes a Company Default by EMC under Section 7.05 of the SSAs or Section 9.05 of the PSAs governing the Transactions. Ambac's consent is required for there to be a waiver of EMC's default. Ambac has not provided the requisite consent. As a result, the Company Default is continuing.

364. As a result of EMC's breaches, Ambac has been and will continue to be damaged in an amount to be determined at trial.

365. In addition, by virtue of EMC's breach of the I&I Agreements, Ambac is entitled to specific performance of EMC's obligation to provide information relating to the Asset Transfer requested by Ambac.

EIGHTH CAUSE OF ACTION

(Against Defendant EMC for Attorneys' fees and costs)

366. Plaintiff realleges and incorporates by reference paragraphs 1 through 365 of this Complaint.

367. Pursuant to Section 3.03(b) of the I&I Agreements, EMC agreed to reimburse Ambac for any and all charges, fees, costs, and expenses paid or incurred in connection with, among other things, enforcing, defending, or preserving Ambac's rights under the Company Documents.

368. Plaintiff has incurred numerous expenses, including attorneys' fees and expert fees, in order to enforce, defend, and preserve its rights under the relevant agreements.

NINTH CAUSE OF ACTION

(Against Defendant JPMC Bank for Successor Liability)

369. Plaintiff re-alleges and incorporates by reference paragraphs 1 through 368 of this Complaint.

370. JPMC Bank is liable for any and all damages, reimbursement and indemnification amounts resulting from the wrongful actions of EMC, as alleged herein, because both contractually under the Transaction Documents and as a matter of law JPMC Bank is the

successor to EMC as a result of EMC's Asset Transfer to JPMC Bank on or about April 1, 2011, wherein JPMC Bank acquired all or substantially all of EMC's assets.

371. JPMC Bank is a person that has succeeded to the business of EMC. As a result, JPMC Bank is the successor to EMC under the MLPAs governing the Transactions and automatically became a party to the MLPAs in accordance with their terms. In addition, because JPMC Bank is a person that succeeded to the business of EMC, JPMC Bank is the successor to EMC under the PSAs governing the SACO 2005-10 Transaction and the SACO 2006-2 Transaction and automatically became a party thereto in accordance with their terms. Also because JPMC Bank is the successor to EMC, the I&I Agreements governing the Transactions are binding on JPMC Bank.

372. Additionally, JPMC Bank is the successor to all of the obligations and liabilities of EMC by operation of law as a consequence of the de facto merger of JPMC Bank and EMC resulting from the Asset Transfer.

373. After the Asset Transfer, there remains continuity of ownership of EMC and JPMC Bank. Both before and after the Asset Transfer, EMC and JPMC Bank were ultimately owned and controlled by the same parent holding company, JPMorgan Chase & Co.

374. EMC has ceased its ordinary business operations. After the Asset Transfer, JPMC Bank services loans under the EMC Mortgage Name.

375. JPMC Bank has assumed the liabilities necessary for the uninterrupted continuation of the operations performed by EMC prior to the Asset Transfer. Specifically, JPMC Bank has assumed EMC's obligations to service mortgage loans under the contracts governing various RMBS deals, including the four Transactions at issue in this litigation.

376. JPMC Bank has retained EMC's management and personnel, as well as EMC's physical locations, assets, and general business operations. After the Asset Transfer JPMC Bank has continued the servicing operations once belonging to EMC using EMC's employees, management and facilities.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff respectfully prays for the following relief:

- For an award of all legal, equitable, and punitive damages, to be proven at trial, against Defendants for their fraudulent inducement of Ambac's participation in the Transactions and issuance of its Policies;
- For an award of compensatory, consequential, and/or rescissory damages, including all of Plaintiff's claims payments made and to be made in the future, and any other present and future damages to be proven at trial, for Defendants' willful, wanton, and malicious material breaches of its contracts with Ambac;
- For an order compelling EMC to comply with its obligations under MLPA § 7, SSA § 2.03, and PSA § 2.03, as applicable, in each Transaction to cure, repurchase, or substitute the loans that breach its representations and warranties;
- For an award of compensatory damages for EMC's material breach of its representations and warranties under MLPA § 7 and I&I Agreement § 2.04 in each Transaction and its obligation to cure, repurchase, or substitute the loans that breach its representations and warranties pursuant to the remedial provisions of MLPA § 7, SSA § 2.03, and PSA § 2.03, as applicable in each Transaction, in an amount to be proven at trial;
- For an order of indemnification for the claim payments and other losses and expenses Plaintiff has paid or will pay in the future pursuant to I&I Agreement § 3.04(a) in each Transaction;
- For an order awarding reimbursement of Plaintiff's attorneys' fees, and other costs and expenses incurred in enforcing, defending, or preserving their rights under the Transaction Documents pursuant to I&I Agreement § 3.03(b) in each Transaction;
- For an order of prejudgment interest;
- For an order requiring EMC to provide to Ambac all information requested regarding the Asset Transfer, which EMC is required by Section 2.06 of the I&I Agreements to provide;

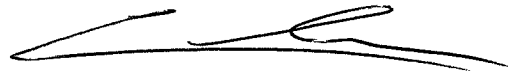
- For an order holding JPMC Bank liable as EMC's successor to pay in full any award of damages in this case and any reimbursement or indemnification amounts for which EMC may be liable to Ambac; and
- For an Order awarding Plaintiff such other and further relief as the Court deems just and proper.

JURY DEMAND

Plaintiff demands a trial by jury for all issues so triable as a matter of right.

Dated: New York, New York
July 18, 2011

Respectfully Submitted,



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