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

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

Present: HON. ALAN D. SCHEINKMAN,
Justice.

----------X

MBIA INSURANCE CORPORATION,

Plaintiff,

-against-

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

Defendant.

----------X

Index No. 64676/2012
Motion Date: 7/24/14
Seq. # 5

DECISION & ORDER

Scheinkman, J:

This is an action to recover damages for fraud brought by an MBIA Insurance Corporation ("MBIA" or "Plaintiff"), the insurer of a mortgage securitization transaction against J.P.Morgan Securities LLC (f/ka Bear, Stearns & Co., Inc.) ("Defendant" or "Bear Stearns"), the underwriter of the transaction.

By Decision and Order dated and entered May 6, 2014 (the "May 2014 Decision"), this Court granted summary judgment to Bear Stearns on the sole cause of action asserted in Complaint – actual fraud – on the ground that there was no evidence to support the claim that MBIA relied upon the intentional misrepresentations made by Bear Stearns. However, in doing so, the Court acknowledged that unpleaded causes of action may be given consideration in opposition to summary judgment. This Court specifically determined that: (a) there was "at least some evidence in this record that would support a claim based on [Insurance Law] Section 3105" (May 2014 Decision at 34); and (b) "there is evidence that would suggest considerable merit to Plaintiff's unpleaded claim that Bear Stearns had a duty to disclose which it breached, giving rise to a claim for fraudulent concealment" (*id.* at 37 [footnote omitted]).

Because of the existence of potentially viable, though unpleaded, claims, the Court dismissed the extant Complaint with an explicit proviso – "provided, however, that said Plaintiff is granted leave to move, if it be so advised, within 20 days of the date hereof, to interpose an amended complaint asserting claims based upon Insurance Law Section 3105 and upon fraudulent concealment" (*id.* at 40).

Plaintiff has timely moved for leave to amend. Defendant has opposed the amendment. In resolving the motion, the Court assumes familiarity with the May 2014 Decision and incorporates that Decision by reference.

THE STANDARD ON A MOTION TO AMEND

Leave to amend or supplement pleadings should be freely granted unless the amendment sought is palpably improper or insufficient as a matter of law, or unless prejudice and surprise directly result from the delay in seeking the amendment (*McCaskey, Davies & Assocs., Inc. v New York City Health & Hosps. Corp.*, 59 NY2d 755, 757 [1983], *citing* CPLR 3025, subd [b]; *Fahey v County of Ontario*, 44 NY2d 934, 935 [1978]; *see Maloney Carpentry, Inc. v Budnik*, 37 AD3d 558 [2d Dept 2007]; *Emilio v Robison Oil Corp.*, 28 AD3d 417 [2d Dept 2006]; *Bolanowski v Trustees of Columbia Univ. in City of N.Y.*, 21 AD3d 340 [2d Dept 2005]; *Luberda v Spameni,* 303 AD2d 384 [2d Dept 2003]; *Adams v Jamaica Hosp.*, 258 AD2d 604 [2d Dept 1999]; *Nissenbaum v Ferazzoli*, 171 AD2d 654 [2d Dept 1991]; *Haven Assoc. v Donro Realty Corp.*, 96 AD2d 526 [2d Dept 1983]; *Mosely v Baker*, 59 AD2d 936 [2d Dept 1977]). The court has discretion in connection with such applications and the presumption is that leave should be granted "unless the proposed amendment would cause prejudice or surprise to the opposing party" (*39 College Point Corp. v Transpac Capital Corp.*, 27 AD3d 454, 454 [2d Dept 2006]; *see also Fahey, supra*]).

The standard is more restrained where the motion for leave to amend is made long after the case has been certified for trial. In such event, judicial discretion in allowing amendments should be "'discrete, circumspect, prudent and cautious'" and exercised sparingly (*see, e.g., Alrose Oceanside, LLC v Mueller*, 81 AD3d 574, 575 [2d Dept 2011], *quoting Morris v Queens Long Island Med. Group, P.C.*, 49 AD3d 827, 828 [2d Dept 2008]).

RES JUDICATA DOES NOT BAR THE AMENDMENTS

Much of Defendant's opposition rests on the argument that amendment is precluded by *res judicata.*

Plaintiff contends that *res judicata* does not apply as no final judgment has yet been entered, the only judicial decree being the order granting Defendant summary judgment, subject to leave to Plaintiff to seek to replead. The Court adopts the view that an order entered resolving a contested summary judgment motion is entitled to *res judicata* effect, even if a formal judgment has not been entered on that order, as long as the other elements of *res judicata* are present (*Vavolizza v Krieger*, 33 NY2d 351, 356 [1974]; Siegel, New York Practice § 445 [5th ed 2011]).

The Court also assumes that the time to appeal the May 2014 Decision has expired without an appeal having been taken. Accordingly, *res judicata* attaches

without regard to whether a judgment has been entered as yet.

There is no dispute that the grant of summary judgment, which is the procedural equivalent of a trial, results in a final judgment on the merits and bars another action between the same parties based upon the same cause of action (*see, e.g., Collins v Bertram Yacht Corp.*, 42 NY2d 1033, 1034 [1977]). It is also axiomatic that, once a claim is brought to a final conclusion, all other claims arising out of the same transaction or series of transactions are barred, even if based on different theories (*see, e.g., O'Brien v City of Syracuse*, 54 NY2d 353, 357 [1981]; *Keselman v City of New York*, 95 AD3d 1278, 1279 [2d Dept 2012], *lv denied* 20 NY3d 856 [2013]).

Thus, it cannot be doubted that MBIA is precluded from suing Bear Stearns again – outside of this action – on claims arising from the 2006-HE4 Securitization, no matter what theory is asserted.

It also seems obvious that Bear Stearns could not detour around *res judicata* by moving to amend its pleading *after* summary judgment was granted dismissing that pleading and without the court having granted it leave to replead or leave to seek to replead as a part of the summary judgment determination (*see Hanover Ins. Co. v Carley*, 234 AD2d 268 [2d Dept 1996]; *Keller v Kruger*, 2013 NY Slip Op 51572[U], 41 Misc 3d 1204[A] [Sup Ct, Kings County 2013 [Battaglia, J.]). Bear Stearns' position is, however, broader. It contends that the grant of summary judgment on the pleaded cause of action precludes the assertion now of the unpleaded claims, even though the Court recognized the viability of the unpleaded claims in its review of the parties' summary judgment submissions. The Court does not agree.

As noted in the May 2014 Decision, unpleaded causes of action may be considered on summary judgment, "'so long as plaintiff may in a proper case be permitted to amend its complaint to allege the cause of action proved in its submissions ....'" (*id* at 32, *quoting Alvord and Swift v Stewart M. Muller Constr. Co.,* 46 NY2d 276, 281 [1978] [Breitel, Ch. J.]).

Had, at the time of Bear Stearns' summary judgment motion, MBIA actually moved, or cross-moved, for leave to amend its complaint so as to interpose the two unpleaded claims now at issue, the Court, if it granted the amendment, could have denied the motion for summary judgment as premature, given that Defendant would not have as yet joined issue with the service of a pleading responding to the amended complaint (*see Organek v Harris*, 90 AD3d 1512 [4th Dept 2011]). In the absence of such a motion, however, the Court perceived then, and still perceives, that it had two viable options.

There are cases in which courts, including the Appellate Divisions, have granted summary judgment to defendant while simultaneously and *sua sponte* granting plaintiff leave to serve an amended complaint asserting the viable, but hitherto unpleaded, claim presented in opposition to summary judgment *(see, e.g., J.R. Adirondack Enter., Inc. v Hartford Cas. Ins. Co.,* 292 AD2d 771 [4th Dept 2002];

Wolfson v Mandell, 13 AD2d 760 [1st Dept 1961], *affd* 11 NY2d 704 [1962]; *Bright v O'Neill*, 3 AD2d 729 [2d Dept 1957]; *see also Pomeranz v Dineen*, 114 AD2d 944 [2d Dept 1985]). This approach has disadvantages: (a) it involves the granting of a motion to serve an amended pleading without first requiring the plaintiff to provide a proposed amendment (*see* CPLR 3025[b]); *Branch v Abraham and Strauss Dept. Store,* 220 AD2d 474 [2d Dept 1995]); and (b) it deprives the defendant of an opportunity to be heard on the issue as to whether to allow the amendment. As to the latter point, and apart from the merit of the proposed amendment, the defendant is entitled to an opportunity to present relevant facts and circumstances on the issue of whether allowing the amendment would cause cognizable prejudice.

There are numerous cases, including many from the Appellate Divisions, in which the courts have done what this Court did, *i.e.*, grant summary judgment to the defendant on the pleaded cause of action but grant leave to the plaintiff to apply for leave to serve an amended complaint (*see, e.g., Bennardi & Assoc., Inc. v Ramsons One, Inc.*, 8 AD3d 948 [3d Dept 2004]; *Harrington v City of Plattsburgh,* 216 AD2d 724 [3d Dept 1995]; *Raymond Babtkis Assoc., Inc. v Tarazi Realty Corp.*, 34 AD2d 754 [1st Dept 1970]*; Irving Finance Corp. v Wegener*, 30 AD2d 958 [1st Dept 1968]). By pursing this course of action, whether to allow an amendment can be decided in light of the proposed pleading with both parties having a full and fair opportunity to address all relevant issues, including the issue of prejudice. In this regard, this Court was sensitive to the fact that Bear Stearns' only opportunity to address the unpleaded claims in this case was in its reply papers and, therefore, may not have had a full opportunity to address the viability of the unpleaded claims and to address whether there would be cognizable prejudice to an amendment (that Plaintiff had not specifically requested).

To accept Defendant's *res judicata* contention, it would have to be concluded that the cited appellate authorities invited an idle, precluded application, particularly since in each of them, as in this case, the courts, in granting summary judgment, recognized potentially viable claims and reserved them as fit subjects of continued litigation. Moreover, it would effectively penalize Plaintiff for the Court's decision to give Defendant the opportunity to be heard on the issue of the amendment, instead of the Court just having granted leave to amend *sua sponte*. Defendant's position would also render entirely superfluous the Court of Appeals' ruling in *Alvord and Swift v Stewart M. Muller Constr. Co., supra*, which specifically endorsed the process of allowing an unpleaded claim, found meritorious on summary judgment, to be asserted via an amendment. This Court cannot conclude that these authorities contemplated a doomed and idle exercise or that the distinguished judges who participated in the cited decisions, including the then Chief Judge who authorized the *Alvord and Swift* decision, were unmindful of *res judicata* principles.

In that regard, it is a recognized *res judicata* principle that it is inequitable to preclude a party from asserting a claim based *res judicata* where the court, in the first proceeding, expressly reserved the plaintiff's right to pursue a later or continued litigation (*see Landau v LaRossa, Mitchell & Ross*, 11 NY3d 8, 14 [2008]; *1626 Second Ave. LLC v Salsberg*, 105 AD3d 432 [1st Dept 2013]; *see also Breslin Realty Dev.*

Corp. v Shaw, 72 AD3d 258 [2d Dept 2010]). Here, the May 2014 Decision expressly reserved two unpleaded claims for future litigation and, as result, *res judicata* does not bar the Court from entertaining them. Stated another way, while the Court must give *res judicata* effect to its grant of summary judgment, it may not give it broader effect than its determination reflects (*see* Siegel, New York Practice §287 [5th ed 2011]). While the Court granted summary judgment to Defendant on the pleaded claim, and that claim is now precluded, the Court simultaneously reserved for future litigation the two unpleaded claims, which are, therefore, not precluded.

The Court further notes that the May 2014 Decision explained that the granting of summary judgment to Defendant was "without prejudice" to a motion by Plaintiff to interpose an Amended Complaint (May 2014 Decision at 3). Thus, the May 2014 Decision left alive, and viable for later litigation, the two unpleaded causes of action (*see Maurischat v County of Nassau,* 81 AD3d 793 [2d Dept 2011]; *Holley by Holley v Mandate Realty Corp.*, 121 AD2d 202 [1st Dept 1986], *affd* 69 NY2d 721 [1987]].

This discussion would be sufficient but for two appellate decisions cited by Defendant which appear, on the surface, to support Defendant's position.

The first case to be considered is *Buckley & Co. v City of New York* (121 AD2d 933 [1st Dept 1986], *lv dismissed* 69 NY2d 742 [1987]). There, the Supreme Court entered an order granting summary judgment as to the third and fourth causes of action and dismissing those causes of action, while, in the same breath, granting "leave to plaintiff, upon a factual showing of merit, to replead" (Order entered December 4, 1984 at 2, annexed as Exhibit 1 to Affirmation of Marc L. Greenwald, Esq. dated July 21, 2014 ["Reply Aff."]). On appeal, the Appellate Division held that it was proper to grant summary judgment to defendant on the two causes of action but error to *sua sponte* allow plaintiff to replead the same two causes of action that had just been dismissed. The First Department's rationale is instructive:

> A motion for summary judgment does not direct the court's attention to the sufficiency of the pleading, but rather to the factual basis for the action or defense .... Once a court has granted or denied a summary judgment motion based on the facts adduced before it, the matter is res judicata ....; new life may not be breathed into it through permissive repleading, even upon a showing of merit. The time to demonstrate the merit of an action or defense challenged on a motion for summary judgment is before the motion is decided .... The conclusive effect of a judgment on the merits may not be fatally undermined, as it was here, by allowing the party whose cause is dismissed a second chance to litigate the matter (*Buckley & Co., supra* 121 AD2d at 934-935).

It is evident that the Supreme Court in *Buckley* made two related errors. It granted summary judgment on two claims but allowed the *very same* claims to be repleaded. And it posited repleading upon a "factual showing of merit", though the factual showing of merit was the entire point of opposing summary judgment, *i.e.*, if there was a time to show that there was factual merit to the claims, it was in opposition to summary judgment. It is obvious that a party cannot avoid having to lay bare its proof in its opposition to summary judgment by awaiting a later opportunity to seek to replead. Moreover, the test on summary judgment is not whether the plaintiff has pleaded a claim but whether there is evidence sufficient to warrant a trial on the pleaded claim. As the First Department put it, the time to demonstrate the merit of a claim challenged on a motion for summary judgment is before the motion is decided. While the unpleaded claims were not directly challenged on the motion, Plaintiff presented evidence as to their viability in opposition to the motion and the Court's decision on the motion included its determination that the unpleaded claims had sufficient viability to warrant allowing Plaintiff to seek to formally plead them.

The present circumstance is entirely different from *Buckley*. This Court did not, and will not, permit Plaintiff to again present the very cause of action previously dismissed. Moreover, the factual basis for the two unpleaded causes of action were presented in the opposition to the motion for summary judgment and found to be sufficiently meritorious to warrant granting Plaintiff the opportunity to seek to present them. This is not a case of breathing new life into a case that died; rather, the Court terminated only the pleaded cause of action while preserving the life of the two unpleaded claims.

The other case to be considered in *Reznick v Tanen* (162 AD2d 594 [2d Dept 1990]). There, the Supreme Court granted summary judgment dismissing all four causes of action but granted the plaintiff leave to replead. The Second Department reversed the order, stating:

> On appeal, the plaintiff does not dispute that summary judgment dismissing the complaint was appropriate. However, the defendants correctly contend that it was error for the Supreme Court to grant the plaintiff leave to replead. The plaintiff's argument that the court could properly infer from the record that the plaintiff possessed an unpleaded cause of action for breach of the parties' stipulation of settlement of a prior action, and therefore, grant leave to replead, is without merit. Having granted summary judgment based on the facts before it, the Supreme Court was without authority to grant the plaintiff leave to replead (*Reznick, supra* 162 AD2d at 594, *citing Buckley & Co., supra).*

It is apparent that the *Reznick* decision rests upon the Appellate Division's

determination that there was no proper basis in the record on the motion for summary judgment upon which to infer that there was a potentially meritorious but unpleaded cause of action for breach of a prior settlement stipulation. Here, the record on the motion for summary judgment showed the existence of potentially meritorious but unpleaded causes of action.

For these reasons, the Court concludes that *res judicata* does not preclude granting the amendment.

THE PROPOSED AMENDMENTS

The Proposed Amended Complaint would present two new causes of action: (1) a proposed Cause of Action No. 2 which is styled as Fraudulent Concealment; and (2) a proposed Cause of Action No. 3, which is headed "Material Misrepresentation in the Procurement of an Insurance Contract."

In addition, the Proposed Amended Complaint would retain as Cause of Action No. 1 the "Fraud" Cause of Action previously dismissed by this Court. MBIA explains in a footnote to its heading on this cause of action that it has reasserted this cause of action in order to "preserve its right to appeal the granting of summary judgment on this cause of action upon final judgment" and to "clarify" that this fraud claim is "informed" by Section 3105 of the New York Insurance Law (Proposed Amended Complaint at 26 n2).

THE PROPOSED "FRAUD" CLAIM

The Court declines to permit Plaintiff to restate a claim as to which summary judgment of dismissal was granted. To allow Plaintiff to do so would run afoul of *Buckley & Co.,* discussed previously. To the extent Plaintiff seeks appellate review, it had its opportunity to appeal the May 2014 Decision (and perhaps may have the right to appeal a final judgment). Plaintiff does not have the right to replead a cause of action previously dismissed on summary judgment.

Accordingly, Plaintiff may not include Cause of Action No. 1 (¶¶66-77) in an amended pleading.

THE PROPOSED FRAUDULENT CONCEALMENT CLAIM

The proposed fraudulent concealment claim alleges that Bear Stearns fraudulently concealed material facts by, in particular, not sharing MDMC's "reports" of September 18, 19, 20, or 25, 2006 though the MDMC reports would have been material

to MBIA's decision to offer insurance on the transaction (Proposed Amended Complaint, ¶¶79-80). MBIA alleges that Bear Stearns withheld the information with the intent to defraud MBIA and, further that Bear Stearns' fraudulent intent is evidenced by its sending of an altered and "seemingly innocuous" due diligence report on September 27, 2006 (*id.*, ¶¶81-82). Plaintiff asserts that Bear Stearns had a duty to disclose the true results of the due diligence due to the contractual relationship between Bear Stearns and MBIA and, in particular, Bear Stearns' agreement to share MDMC's due diligence results with MBIA (*id.*, ¶83). MBIA also maintains that Bear Stearns owed a duty to disclose the due diligence results because of Bear Stearns' superior knowledge that was not known to MBIA (*id.*, ¶84), because of Bear Stearns' misleading, partial disclosures (*id.*, ¶85) and because Bear Stearns engaged in active concealment (*id.*, ¶86). MBIA alleges that it relied to its detriment on Bear Stearns' alleged omissions of material facts and, so relying, issued the insurance policy (*id.*, ¶¶87-88).

Notwithstanding this Court's recognition in the May 2014 Decision that a fraudulent concealment claim had potential merit, Bear Stearns now argues that there is no merit to the claim because MBIA cannot show that it actually relied on Bear Stearns' misrepresentations or omissions (Def. Opp. Mem. at 15). The Court does not agree.

In the May 2014 Decision, this Court concluded that MBIA's actual fraud claim failed because there was no evidence that MBIA ever looked at the September 27, 2006 email and its attachment, the purported due diligence report. That determination is binding and entitled to preclusive effect. However, that effect does not preclude the prospect that MBIA justifiably relied on Bear Stearns' failure, during the period *prior* to the September 27, 2006 email, to disclose the problems known to Bear Stearns as well as its failure to disclose that the delivery of the due diligence reports was being delayed because Bear Stearns was engaging in efforts to alter them prior to delivery.

The gist of this fraudulent concealment claim is entirely different from whether Bear Stearns sent an email and attachments on September 27, 2006 which contained false information. Rather, the gist of the fraudulent concealment claim is, as the Court put it in the May 2014 Decision, predicated

> on Bear Stearns' failure to disclose what it knew to MBIA, *i.e.*, that the initial due diligence results showed that there were significant problems with the collateral pool, that GMACM was insisting on including all of the pool in the deal, and that both MDMC and Bear Stearns had been engaging in a process of attempting to sanitize the due diligence results, with the consequence that the due diligence results

> were delivered at the last minute to MBIA, who was unaware of the problems and the efforts to sanitize them (May 2014 Decision at 35).

Bear Stearns also claims that MBIA's fraudulent concealment claim fails because it cannot allege the requisite duty to disclose (Def. Opp. Mem. at 16). The Court disagrees. While it may ultimately be that MBIA cannot establish its case, the Court adheres to the views expressed in the May 2014 Decision that a duty to disclose may properly be found to exist in the context of this case.

In particular, the Court repeats the following statements from the May 2014 Decision:

> There is evidence that shows that the underwriter realized that the due diligence results showed the loan pool was problematic. There is evidence from which it may be inferred that the underwriter perceived that, if the insurer was given the unaltered information (to which it was entitled), the insurer might balk at insuring the deal. There is evidence that the underwriter, in order to mask the problems with the collateral pool from the insurer, undertook to deliver the due diligence results to the insurer itself (rather than having them transmitted by the third party who performed the due diligence), delayed for nine days in providing the insurer with any information, used that time to massage the results, and then gave the altered results to the insurer at the last hours before the closing.
>
> If this evidence is credited by the trier of facts, the underwriter may have breached a duty to disclose the true facts and, if the underwriter engaged in the active concealment of the truth, it may be held liable for its actions. Intentionally altering the due diligence results so as to disguise their true import and delivering them only at the last-minute and without disclosure of the underlying problems known to the underwriter and of the alterations made to the results by the underwriter may be found to have thwarted the insurer's ability to protect itself. The insurer had a contractually-based entitlement to access to a third-party due diligence report. The underwriter could not withhold the report for days, alter it, and then tender an altered report at the last minute, without at least disclosing to the insurer that the report had been altered or that there were problems with the collateral pool (May 2014 Decision

at 2-3).

* * *

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

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

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

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

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

Here, there is evidence that would suggest considerable merit to Plaintiff's unpleaded claim that Bear Stearns had a duty to disclose which it breached, giving rise to a claim for fraudulent concealment.[1]

Bear Stearns agreed to provide the due diligence results to Plaintiff and it may be inferred that it was obligated to do so within a reasonable time of receipt of the results from the third party due diligence firm. However, instead of forwarding those results when they first came in from MDMC some 9 days before the closing, Bear Stearns withheld them from MBIA, delayed providing them despite requests for them from MBIA, used the time to make alterations to the results, and then sent the altered results to MBIA at the last

---

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

> minute. While Bear Stearns may not have known that Desharnais was traveling, it may be that the last minute nature of the transmission was intended to prevent MBIA from having a meaningful opportunity to review the results (May 2014 Decision at 36-38).

In addition to these observations, the Court also notes that the concepts embodied in Insurance Law Section 3105 may be relevant to whether Bear Stearns had a duty to speak. This issue is discussed further *infra*.

The Court is satisfied that the Proposed Cause of Action No. 2 adequately pleads a claim of fraudulent concealment.

THE PROPOSED INSURANCE LAW CLAIM

Proposed Cause of Action No. 3 is described as follows in the Proposed Amended Complaint:

> This is a claim for material misrepresentation in the procurement of an insurance contract, brought under common law as informed by New York Insurance law Section 3105, which entitles an insurer to rescind an insurance policy or obtain non-rescissory damages, including the right to recover any claims paid under the policy, when the applicant withholds material information from the insurer (Proposed Amended Complaint, ¶91).

Bear Stearns argues that Section 3105 does not create an independent claim for compensatory damages and that it only gives an insurer the "'hatchet of rescission'" (Def. Opp. Mem. at 20, *quoting GuideOne Special Mut. Ins. Co. v Congregation Adas Yereim*, 593 F Supp 2d 471, 486 [ED NY 2009]). In responding to Bear Stearns' statute of limitations' argument, MBIA concedes that its proposed "third cause of action was not created by Section 3105; rather, Section 3105 informs the common law cause of action" (Plf. Reply Mem. at 12).

The leading New York state case authority on the application of Insurance Law Section 3105 is *MBIA Ins. Corp. v Countrywide Home Loans, Inc.* (34 Misc 3d 895 [Sup Ct, NY County 2012]), notwithstanding that the decision was modified somewhat on appeal (105 AD3d 412 [1st Dept 2013]). In the Supreme Court decision, Justice Bransten stated that fraud claims by an insurer against an applicant for insurance are "informed" by the common law and by Insurance Law Sections 3105 and 3106 (*MBIA Ins. Corp., supra* 34 Misc 3d at 905). On appeal, the Appellate Division stated: "the motion court was not required to ignore the insurer/insured nature of the relationship

between the parties to the contract in favor of an across the board application of common law" (*MBIA Ins. Corp., supra* 105 AD3d at 412). Thus, it appears that, in approaching the application of common law principles in fraud claims between insurers and their insureds, the courts are required to factor in the nature of the relationship between the parties, including the impact of the Insurance Law sections. However, the decision does not support the idea that there is an independent cause of action under the Insurance Law.

This Court views the Proposed Cause of Action No. 3 as duplicative of either: (a) the express misrepresentation claim, which is barred by *res judicata*; or (b) the common law fraudulent concealment claim which, to the extent already indicated, the Court will allow to be pleaded.

The Proposed Cause of Action No. 3 is partially based on "concealment" of material information, *i.e.*, the results of the due diligence review. The Proposed Cause of Action No. 3 also complains of Bear Stearns' "misrepresentation of that material information through the transmission of an altered due diligence report on September 27, 2006." Likewise, in Paragraph 93 of the Proposed Amended Complaint, it is alleged that Bear Stearns "misrepresented the results of MDMC's due diligence review by sending MBIA an altered due diligence report on September 27, 2006, while telling MBIA that it was the MDMC report and without disclosing that Bear Stearns had altered the report."

This Court has already held that MBIA cannot prove reliance upon the September 27, 2006 email and attachments because it never so much as glanced at them. Hence, a common law claim of fraud predicated upon an express affirmative misrepresentation fails. There is nothing in Insurance Law Section 3015 that dispenses with, or alters, the common law requirement that an insurer must show reliance upon the claimed misrepresentation in a fraud action.

While MBIA argues that under Section 3105 the only question is whether "knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such a contract" (Plf. Reply Mem. at 13, *quoting* Ins. Law § 3105[b][1]), the argument is based on a quotation from the statute which is plainly taken out of context. The quoted language is from the statutory definition of materiality of the misrepresentation:

> No misrepresentation shall be deemed material unless knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such contract.

While it may be that this language alters or varies the common law definition of materiality, materiality of the misrepresentation being an element of the common law cause of action, there is nothing in this language that alters the common

law rule that a misrepresentation must be relied upon in order to be actionable.

Indeed, while the parties debate whether compensatory damages are available, they do not disagree that one available remedy is rescission. Indeed, Section 3105 speaks to whether the insurer can "avoid any contract of insurance." And it is well settled that rescission cannot be obtained without the insurer establishing that it relied upon the claimed misrepresentation (*see, e.g., Edwards v U.S. Liab. Ins. Co.*, 14 AD3d 649 [2d Dept 2005]). Having already had a full and fair opportunity to show that it relied on the claimed misrepresentation contained in the September 26, 2006 email and its attachments, the law of the case precludes allowing MBIA to have a second bite at the reliance apple (*see, e.g., Engel v Eichler*, 300 AD2d 622 [2d Dept 2002]; *see also Clark v Clark*, 117 AD3d 668 [2d Dept 2014]; *see generally Martin v City of Cohoes*, 37 NY2d 162 [1975]).

As to the portion of the Proposed Cause of Action No. 3 that relates to fraudulent concealment, it does appear that, while Section 3105 of the Insurance Law speaks of representations as "statement[s] as to past or present fact", case law recognizes the applicability of the statute to rescission claims based on concealment of facts, as distinguished from assertion of facts (*see James v Town Ins. Co.,* 112 AD3d 786 [2d Dept 2013], *lv denied* 23 NY3d 901 [2014]; *Dwyer v First Unum Life Ins. Co.*, 41 AD3d 115 [1st Dept 2007]; *Gentile v Continental American Life Ins. Co.*, 215 AD2d 626 [2d Dept 1995]).

Consequently, the Court must revisit an issue that it discussed, but did not rule upon, in the May 2014 Decision – whether the Insurance Law provisions apply to these facts. As discussed in that Decision (at 33), Section 3105 applies to statements made to the insurer "by, or under the authority of, the applicant for insurance or the prospective insured." After a review of relevant case law, this Court stated as follows:

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

> with MBIA, *i.e.*, accepted the offer of MBIA to provide insurance on condition that Bear Stearns (along with GMACM) provide access to due diligence information.
>
> If MBIA had moved to amend its complaint to include a cause of action under Section 3105, the Court's examination of the merits of such a claim would be confined to determining whether the proposed claim is palpably insufficient or patently devoid of merit on its face (*see, e.g., Rosicki, Rosicki and Assocs., P.C. v Cochems*, 59 AD3d 512 [2d Dept 2009]).

In the Proposed Cause of Action No. 3, MBIA would allege that Bear Stearns was an applicant for insurance because: (a) it initiated contact with MBIA; (b) was responsible for soliciting a bid from MBIA; (c) provided information about the securitization MBIA; (d) MBIA submitted its bids to Bear Stearns; (e) Bear Stearns, along with GMACM, selected MBIA as the insurer; (f) Bear Stearns told MBIA it was the selected insurer; and (g) Bear Stearns continued to serve as an intermediary between MBIA and the other parties, including GMACM (Proposed Amended Complaint, ¶95; *see also id.* at ¶20).

While these allegations are sufficient to show that Bear Stearns was involved in the insurance application, they fall short, in this Court's view, of being sufficient to support a claim that Bear Stearns was either the applicant or that the claimed acts of fraudulent concealment were committed by Bear Stearns "under the authority" of the applicant.

MBIA has not, in support of its motion, submitted anything that could be fairly described as an application for insurance. Hence, despite the Court providing MBIA with the opportunity to submit what it would contend is the insurance application, MBIA has not provided it. On the other hand, Bear Stearns has submitted underwriting documents showing that Bear Stearns was acting as an underwriter and as agent for other underwriters (*see* Affirmation of Richard A. Edlin, Esq., dated June 30, 2014, ["Edlin Aff."] Ex. C at JPMS_GM06HE4_00114076-01114098).[2]

Hence, the Court must conclude that MBIA has not offered any evidence that Bear Stearns was an applicant for insurance. The Court cannot agree that

---

[2]While Bear Stearns argues that the Underwriting Agreement (§5.12) provides that "the Company" acknowledges that Bear Stearns was not acting as its fiduciary or agent (Def. Opp. Mem. at 22-23), the "Company" is defined therein as Residential Asset Mortgage Products, Inc. (*see* Edlin Aff., Ex. C at JPMS_GM06HE4_00114076). There is nothing that indicates that MBIA was a party to the Underwriting Agreement or should otherwise be held bound thereby.

assisting in seeking insurance, such as by soliciting and evaluating bids and serving as an intermediary, is sufficient to turn the assistor into the functional equivalent of the applicant. However, it remains to consider whether Section 3105 can apply because of conduct of Bear Stearns undertaken "by the authority" of the applicant or insured. The Court concludes that it cannot apply here for the simple reason that nowhere in the Proposed Amended Complaint does MBIA allege that the alleged conduct was undertaken "by the authority of," with the approval of, or even with the knowledge of GMACM.

The allegations in the Proposed Amended Complaint fall far short of alleging that Bear Stearns' conduct was requested by GMACM, was authorized by GMACM, or was even known to GMACM. As noted in the Proposed (and in the Original) Complaint, Bear Stearns stood to earn millions through securitization deals such as this one (Proposed Amended Complaint, ¶17). Thus, Bear Stearns had its own economic reasons to see to it that the deal closed. MBIA, despite the opportunity afforded to it by this Court, has failed to allege facts, or show the existence of any facts, that would support an inference that Bear Stearns was acting "by the authority" of GMACM when it engaged in the alleged fraudulent concealment (*see Financial Guar. Ins. Co. v Putnam Advisory Co.,* 2014 WL 1678912 [SD NY 2014] at *9)

For these reasons, the Court will not permit the assertion of the Proposed Cause of Action No. 3.

THE ISSUE OF PREJUDICE

Defendant argues that allowing an amended complaint by Plaintiff would cause it prejudice, *i.e.,* "'significant trouble [and] expense that could have been avoided had the original pleading contained what the amended one seeks to add'" (Def. Opp. Mem. at 23, *quoting Jacobson v Croman*, 107 AD3d 644, 645 [1st Dept 2013]).

Defendant asserts that the amendments must necessarily involve new elements and new facts which would require extensive additional discovery (Def. Opp. Mem. at 23). Somewhat inconsistently, Defendant points out that discovery is closed and it would have gone about conducting depositions and discovery differently had it been informed of the amendment earlier (*id.* at 24).

However, the only amendment that will be considered by the Court is an amendment so as to interpose a cause of action for fraudulent concealment.

Simply because allowing an amendment would require a defendant to pursue additional discovery does not by itself constitute prejudice sufficient to warrant the denial of the opportunity to amend (*Jacobson v Croman*, *supra)*. Here, Defendant has not offered any affidavit or affirmation which identifies any particular hardship that

would be incurred in pursuing discovery on the issue of fraudulent concealment. There is no indication, for example, that some relevant fact witnesses were not previously deposed or that some relevant documents were not already asked for. What is involved here is a different legal theory than the one originally pursued without any indication that the underlying factual transactions and occurrences are different to any material degree (*see Harding v Filancia*, 144 AD2d 538 [2d Dept 1988]: *Smith v Industrial Leasing Corp.*, 124 AD2d 413 [3d Dept 1986]). Indeed, reviewing the "red-lined" copy of the Proposed Amended Complaint (which compares that document with the original Complaint) shows only relatively modest – and mostly stylistic – changes in the portion of the Complaint that presents much of the underlying alleged facts (*see* Proposed Amended Complaint, ¶¶1-65).

While it is true that allowing additional discovery will involve additional cost to Defendant, the fact that a defendant will have to spend more in discovery is not itself actionable prejudice (*Jacobson v Croman*, *supra)*. There is no showing, or even estimate, as to the amount of additional time that would be involved in further discovery on the issue of fraudulent concealment and, in any event, the court retains the authority to shift the costs of discovery in appropriate circumstances (*see* CPLR 3101).

In its memorandum of law, Defendant cites four potential areas for renewed discovery: (a) MBIA's underwriting practices, claimed to be relevant to an inquiry under Section 3105; (b) Bear Stearns' putative status as an insurance applicant; (c) the existence of a contractual relationship between Bear Stearns and MBIA giving rise to a duty to disclose; and (d) other securitizations by MBIA as evidence of "industry standard" diligence (Def. Opp. Mem. at 25). The first two areas need not be of concern since the Court is not allowing the inclusion of the Proposed Cause of Action No. 3. The third area – existence of a contractual relationship between MBIA and Bear Stearns – has already been the subject of discovery (specifically the Bid Letter and all that flowed therefrom). This leaves only one new area – other securitizations. To a certain extent, discovery already taken has involved testimony as to custom and practice and, in any event, this area of discovery does not seem likely to be particularly intensive, lengthy or expensive. To the extent that the Court previously limited discovery in light of the scope of MBIA's then extant pleading, the Court will take a fresh look, given the change in the scope of the pleading.

Defendant points out that it conducted discovery with an eye toward showing that MBIA did not rely on the September 26, 2006 email and attachments. While Defendant's adoption of this approach was certainly reasonable (and successful), the Court recognizes that it would be unfair to Defendant to preclude it from pursuing renewed depositions or documents in light of the amendment.

Mining the same vein, Defendant contends that the amendment would present new claims which it did not have prior notice of and did not have the ability to prepare for. But again, the proposed amendment involves a change in legal theory and

not any wholesale insertion of new facts.

Accordingly, the Court does not find that there is prejudice such as to preclude the granting of the proposed amendment to add a cause of action for fraudulent concealment, particularly since the Court will afford the parties the opportunity to conduct reasonable discovery on this theory of liability.

CONCLUSION

The Court will permit Plaintiff to interpose an amended complaint containing a cause of action for fraudulent concealment and that cause of action only. The Court will permit the parties to engage in discovery on this cause action and will conduct a status conference with counsel to establish an appropriate discovery schedule.

The Court has considered the following papers:

(1) Notice of Motion dated May 23, 2014;

(2) Affirmation of Thomas J. Lepri, Esq. dated May 23, 2014, together with the exhibits annexed thereto, submitted in support of Plaintiff's motion;

(3) Plaintiff's Memorandum of Law in Support of Motion dated May 23, 2014;

(4) Affirmation of Richard A. Edlin, Esq. dated June 30, 2014, together with the exhibits annexed thereto, submitted in opposition to Plaintiff's motion;

(5) Defendant's Memorandum of Law in Opposition to Motion dated June 30, 2014;

(6) Defendant's Compendium of Unreported Cases dated June 30, 2014;

(7) Affirmation of Marc L. Greenwald, Esq. dated July 21, 2014, together with the exhibits annexed thereto, submitted in further support of Plaintiff's motion; and

(8) Plaintiff's Reply Memorandum of Law dated July 21, 2014.

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

ORDERED that the motion by Plaintiff MBIA Insurance Corporation, pursuant to CPLR 3025(b) for leave to file the Proposed Amended Complaint is granted in part and denied in part; and it is further

ORDERED that said Plaintiff is granted leave to serve and file an Amended Complaint containing solely and only a cause of action for fraudulent concealment; and it is further

ORDERED that said Plaintiff is grant leave to serve and file an Amended Complaint substantially in the form submitted on the said motion, except that the said Amended Complaint shall not contain either the Proposed Cause of Action No. 1 or the Proposed Cause of Action No. 3; and it is further

ORDERED that the Amended Complaint provided for herein shall be served and filed by not later than September 30, 2014; and it is further

ORDERED that Defendant J.P.Morgan Securities LLC, f/k/a Bear, Stearns & Co., Inc. shall serve and filed its answer to the Amended Complaint by not later than October 10, 2014; and it is further

ORDERED that, upon joinder of issue as provided for herein, the parties are granted leave to pursue discovery with respect to the Amended Complaint; and it is further

ORDERED that counsel for the parties shall appear for a conference with this Court on October 24, 2014 at 9:30 a.m. to discuss discovery and any other relevant matters, which conference shall not be adjourned without the prior written consent of this Court; and it is further

ORDERED that, except as set forth above, the said motion is denied.

The foregoing constitutes the Decision and Order of this Court.

Dated: White Plains, New York
September 18, 2014

E N T E R:

ALAN D. SCHEINKMAN
Justice of the Supreme Court

APPEARANCES:

QUINN EMANUEL URQUHART & SULLIVAN, LLP
Attorneys for Plaintiff
By: Peter E. Calamari, Esq.
Richard I. Werder, Jr., Esq.
Marc L. Greenwald, Esq.
51 Madison Avenue, 22nd Floor
New York, New York 10010

GREENBERG TRAURIG, LLP
Attorneys for Defendant
By: Richard A. Edlin, Esq.
Eric N. Whitney, Esq.
Anastasia A. Angelova, Esq.
Misty L. Archambault, Esq.
200 Park Avenue
New York, New York 10166