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MBIA and other monolines lost billions insuring toxic mortgage-backed securities. So they went after the banks that securitized the loans. So far they're winning.

THE AVENGERS

Will they be the ones who make the banks pay for the mortgage mess?

By Nate Raymond

ONLOOKERS CROWDED the aisles and doorway of the Manhattan courtroom of Justice Eileen Bransten on October 5. The New York state court judge normally wouldn't have allowed a standing room audience. But with lawyers, investors, and court watchers coming from as far away as San Francisco and Cleveland to squeeze into room 442 at 60 Centre Street, Bransten made an exception. After all, she said, her ruling would have "a major impact on lots of people."

If anything, her words were an understatement.

The plaintiffs in the case, MBIA Inc. and Syncora Holdings Ltd., are just two of the monoline insurers who have launched a fusillade of litigation against big banks over toxic mortgage-backed securities. Insuring securities backed by bad loans has cost the monolines billions and pushed some of them into bankruptcy; now the insurers are fighting to recover their losses from the banks that made the loans and packaged them. Justice Bransten's ruling on this latest issue—to what extent MBIA and Syncora would have to prove fraud by defendants Bank of America Corporation and Countrywide Financial Corporation—will likely affect many of the almost three dozen other monoline suits against the banks.

In court that day, Countrywide counsel Mark Holland of Goodwin Procter argued that the insurance companies were unfairly blaming the banks for the fallout from an unprecedented national housing market crash. Quinn Emanuel Urquhart & Sullivan's Philippe Selendy, representing MBIA, retorted that Countrywide wanted the judge to rule that the crisis was "a 'get-out-of-jail-free' card that allows them to escape liability for their fraud and shift the costs to innocent parties."

Three months later, on January 3, Justice Bransten largely sided with the monolines. She ruled that MBIA and Syncora only needed to show that they wouldn't have insured the mortgage-backed securities if they had known about the alleged misrepresentations by Countrywide—now owned by Bank of America—in its mortgage securitizations. Like Bransten's other rulings in the monoline litigation, her decision provided ammunition for monolines like Assured Guaranty Ltd. in their own fights with the banks. (The decision is now on appeal.)

At press time a settlement increasingly seemed the likely result in MBIA's suit against Bank of America, which has its own pending suit against the monoline over the insurer's 2009 restructuring, set for trial in April. But even if MBIA and Bank of America make peace, another slew of suits—largely handled by firms such as Quinn Emanuel and Patterson Belknap Webb & Tyler—are still moving through the courts, and the risk of significant liability for the banks does not seem to be diminishing.

The monolines' progress so far contrasts with the struggles of regulators to hold Wall Street accountable for the excesses of the housing boom. Few criminal prosecutions have resulted from the subprime meltdown. The Securities and Exchange Commission's settlements with the banks have drawn scrutiny from at least one judge, who questions whether they went far enough. Class actions brought by investors in mortgage-backed securities have hit procedural roadblocks, and investors have fought among themselves over whether the biggest settlement proposed so far related to their contractual mortgage repurchase claims, an $8.5 billion accord with Bank of America, is big enough.

Amid the troubled lawsuits and investigations, will it be a group of battered insurers who hold the banks accountable in court for the financial crisis?

THE FIRST MONOLINES—known as such because they had just one line of business, backing bonds against possible defaults—were Ambac Financial Group, Inc., and Municipal Bond Insurance Association (now MBIA), born in the early 1970s with the goal of insuring municipal bonds. Over time, the monolines came to include companies such as Assured Guaranty, XL Capital Assurance Inc. (now Syncora), and CIFG Holding, Ltd., and they expanded their focus to insure structured finance securities, including securities backed by mortgages on residential real estate. What began as a niche grew rapidly during the housing bubble of the 2000s.

Then the bubble burst. When the mortgages in the securities soured, billions of dollars in claims by investor policyholders overwhelmed the monolines. By 2010 Ambac was paying out a reported $120 million a month on claims related to mortgage-backed securities. As of September, MBIA had incurred losses of more than $4.6 billion. Assured Guaranty says it has paid out $2.5 billion net of reinsurance.

The monolines' own AAA credit ratings—crucial for reassuring muni bond investors that the firms can pay out claims—vanished. In some cases, their ratings went to junk status. The insurers were forced to take drastic steps. In February 2009 MBIA split into two separate companies: One entity would handle municipal bond insurance; the other took the troubled structured finance business. Ambac faced a similar fate. In March 2010 the insurer separated $64 billion in structured finance policies into a segregated account at the order of Wisconsin insurance regulators. Its holding company filed for Chapter 11 bankruptcy protection in November 2010.

Financial Guaranty Insurance Company, another monoline, filed for Chapter 11 in August 2010.

(These moves didn't go over well with the banks, which were trying to collect on policies for their own mortgage-related investments. Eighteen banks brought in Sullivan & Cromwell to sue MBIA in May 2009 for fraudulently conveying $5 billion in assets to its municipal bond arm. MBIA denies the claims and has since settled with all but four banks.)

As more and more mortgage-backed securities went bad, monolines lawyered up to investigate the toxic investments. Court records show that in fall 2007, MBIA hired Weil, Gotshal & Manges and Cadwalader, Wickersham & Taft to advise it on potential claims against Countrywide and Residential Funding Company LLC, the mortgage arm and securitization sponsor of what is today Ally Financial Inc. As a party to the securitizations, MBIA had contractual rights under two separate sets of agreements: one that governed the securitizations' structure and another that covered how the insurance policies worked. Within those agreements lay a potential escape hatch to recover from their losses. The documents provided for representations and warranties about the mortgages being securitized, such as the homeowners' income, employment, and credit scores. The agreements also stipulated that if a mortgage did not meet those standards, a monoline or trustee could demand that the bank buy back or replace the mortgage.

The trick, then, was to figure out how many mortgages didn't live up to the reps and warranties and needed "put-back," as lawyers later came to call the claim. Under its servicing and insurance agreements, MBIA's lawyers believed that the insurer had a right to demand access to the underlying documents and mortgage files related to the securitizations. After MBIA gained what it says was limited access, consultants hired to analyze samples of the mortgage files found big problems. With Residential Funding, for example, reviews of 7,913 loan files found that more than 88 percent of the mortgages did not meet the standards described in the contracts, according to MBIA's later court filings.

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MBIA and the other monolines demanded that the banks repurchase hundreds of thousands of troubled mortgages. But the banks resisted. Some loans were still performing despite alleged breaches, which could stem from missing paperwork. More fundamentally, the banks claimed that the monolines had known exactly what they were insuring. Barry Levin, an Orrick, Herrington & Sutcliffe partner who represents Credit Suisse Group AG in suits by MBIA, Ambac, and Assured, calls the monolines "extremely sophisticated" deal participants in the securitization machine who had access to all relevant information when they agreed to insure the securitizations. Yet by their own accounts, the monolines did no independent due diligence on the loans, relying instead on what banks told them. "And now that the market has collapsed, they decided to try to shift their losses to others," Levin says.

MBIA sued Countrywide for fraud and breach of contract in New York state court on September 30, 2008, just two weeks after Lehman Brothers Holdings Inc. collapsed. The lawsuit was the first of many. In November 2008 Ambac launched a federal suit against an arm of Bear, Stearns & Co., Inc., now owned by JPMorgan Chase & Co. A month later MBIA sued Residential Funding after the insurer had already paid out $264 million in claims to investors in five GMAC securitizations. By the beginning of 2012, another four monolines had joined MBIA and Ambac in filing at least 32 lawsuits in federal and state courts in New York, California, Washington, D.C., and Texas.

A **SMALL COTERIE OF FIRMS** is representing the monolines. "There's a fraternity of lawyers handling these cases on behalf of the monoline plaintiffs, and we are in regular contact to compare notes and share ideas," says Jacob Buchdahl of Susman Godfrey. While some of these firms, such as Debevoise & Plimpton, Cadwalader, and Kutak Rock, had transactional experience related to securitizations or to the monolines, more often the monolines have turned to firms with few if any banking conflicts: Quinn Emanuel, Patterson Belkap, Susman Godfrey, and Boies, Schiller & Flexner.

The lawsuits drew interest among investors such as Manal Mehta, a partner at San Francisco-based hedge fund Branch Hill Capital. Mehta, a former Morgan Stanley trader who describes himself as left-leaning, two years ago started buying stock first in MBIA and then in Assured Guaranty, after deciding that investing in the monolines was the surest way to profit from the banks' mortgage-backed securities liabilities. "Two years ago, people said this wasn't real, that they were suing and weren't going to recover anything," he says. But as favorable rulings have piled up, Mehta has become more sure of his bet.

The numbers in two Bank of America settlements—one with investors and another with a monoline—also back Mehta's hunch that the insurers are on track to land bigger recoveries than other plaintiffs. Last June, Bank of America reached an $8.5 billion settlement with investors in private label mortgage-backed securities following negotiations between Gibbs & Bruns, who represented a group of institutional investors, and the bank's lawyers at Wachtell, Lipton, Rosen & Katz. Lawyers for investors not at the negotiating table have since challenged the settlement as too small; it equates to just 4 cents on the dollar when compared to the amount outstanding at the time, $221 billion. In contrast, lawyers for Assured Guaranty at Patterson Belknap and Debevoise helped their client land a settlement of at least $1.1 billion in April 2011 with BofA that was equal to 21 percent of the $5.2 billion still owed by homeowners in the mortgage securitizations that Assured Guaranty had insured.

With each court ruling, Mehta figures, the cost of settling increases for the banks. And there have been a lot of court rulings that favor the monolines.

The first big decision came in July 2009. Justice Bransten largely disregarded a motion by Countrywide to dismiss parts of MBIA's suit accusing it of fraud in misrepresenting which loans went into the securitizations. Her ruling had big reverberations. In the two years that followed, state and federal judges in New York cited the decision and allowed several other suits by MBIA, Syncora, and Ambac alleging fraud to move forward against units of Ally Financial, Morgan Stanley, JPMorgan Chase, and Bank of America. Keeping the fraud claims alive meant that the monolines not only could seek punitive damages but also potentially probe the business operations that allowed the allegedly flawed loan processes in the first place.

When a state appellate court affirmed Justice Bransten's decision in June 2011, it effectively killed the banks' hopes of narrowing the suits. By then, the series of fraud decisions had emboldened lawyers for the monolines to dig deeper in their quests for damages. In February 2011 Patterson Belknap partners Philip Forlenza and Erik Haas unleashed a 165-page suit in New York state court against the former Bear Stearns, now J.P. Morgan Securities LLC. The suit claimed that Bear Stearns had tricked their client Ambac into insuring a mortgage pool underwritten by the bank that was a "SACK OF SHIT," as one Bear Stearns deal manager termed it in an e-mail.

"And it gets worse," the Patterson lawyers wrote. Although JPMorgan had refused to pay up on Ambac's put-back claims after acquiring Bear in March 2008, the lawsuit claimed that the bank had quietly pocketed sums it recovered from the loans' originators while leaving the bad loans in the securitizations. Greenberg Traurig lawyers representing Bear's mortgage arm, EMC Mortgage Corporation, call those claims a "conspiracy-theory fiction, with a commensurate amount of truth" in court papers.

The suit is still pending. In a sign of confidence, Forlenza and Haas have filed new complaints in suits for Syncora and Assured Guaranty against EMC and JPMorgan that tacked fraud claims onto what had originally been simpler breach-of-contract suits. The new state court complaint that Assured filed in November cited no less than 35 confidential witnesses, including former employees at Bear Stearns, who the insurer said would back its claims that the bank's representations about quality control and due diligence were "false and misleading." JPMorgan denies the allegations.

Other rulings have similarly encouraged the monolines. The banks have struck out three times in trying to convince judges that the insurers need to go loan-by-loan to prove breaches of contract rather than prove their cases based on a sampling of loans. Justice Bransten first signed off on the idea in December 2010 in MBIA's suit against Countrywide, and federal district court judges Paul Crotty and Jed Rakoff later followed in suits against units of Flagstar Bancorp and JPMorgan.

In the latest monoline victory, Justice Bransten again leads the pack, declaring that MBIA and Syncora did not have to prove that Countrywide's misrepresentations caused a mortgage to go sour. The monolines' lawyers will no doubt seize on the decision for other cases. Lawyers have already teed the causation issue up for judges Crotty and Rakoff. "Everyone's paying attention to everyone else's case and every reported decision," Susman's Buchdahl says.

The insurers are now engaged in a discovery campaign that has taken them around the country. In 2011 MBIA issued thousands of subpoenas seeking employment records for homeowners throughout the country to determine if they really had the jobs and incomes they had claimed when Countrywide sold them mortgages. Confidential witnesses increasingly are being cited in the monolines' complaints; in a January 19 letter to the judges overseeing Syncora's and Ambac's suits against JPMorgan, Haas described various whistle-blowers who had met with Patterson Belknap. The evidence the firm gathered in its case for MBIA against Credit Suisse got the attention of the Securities and Exchange Commission, which has subpoenaed Patterson Belknap.

Eileen Foster, a former Countrywide Financial executive who says she alerted senior management to fraud in its mortgage practices, told *60 Minutes* in December that the U.S. Department of Justice had never interviewed her during its investigations. That same month, Quinn Emanuel got the okay to depose her for MBIA's suit against her former employer. Another monoline, FGIC, is also seeking to depose her, according to her lawyer, Irvine, California, solo practitioner Matthew Tonkovich.

Still, for all the monolines' success in court, awards are scant, and obstacles remain. At least one judge has complained of the years the

TAKING AIM AT THE BANKS

Monoline insurers have filed more than 32 suits against banks over mortgage-backed securities gone bad. The cases below are among the most closely watched, either because of the damages at stake or because of how far the litigation has advanced.

SUIT	DAMAGES SOUGHT	MONOLINE COUNSEL	BANK COUNSEL	CLAIMS	STATUS
MBIA v. Countrywide (Bank of America)	$3 billion	Quinn Emanuel	Goodwin Procter (Countrywide); O'Melveny & Myers (BofA)	Fraud, breach of contract	A New York state appellate court greenlit MBIA's fraud claims in June 2011. Justice Eileen Bransten in January held that MBIA only had to show it wouldn't have insured the securitizations had it known of Countrywide's alleged fraud.
MBIA v. Residential Funding (Ally)	$871 million	Cadwalader	Carpenter Lipps & Leland	Fraud, breach of contract	Discovery is proceeding after a New York state court judge denied a motion to dismiss in December 2009.
Ambac v. EMC Mortgage (J.P. Morgan Securities)	$641 million	Patterson Belknap	Greenberg Traurig (EMC); Sullivan & Cromwell (J.P. Morgan Securities)	Fraud, breach of contract	Discovery is proceeding in New York state court after federal district court judge Richard Berman dismissed a federal version of the suit on diversity grounds.
FGIC v. Ally Financial	$549 million*	Jones Day	Orrick	Fraud, breach of contract	Ally has removed the suits to federal district court in Manhattan.
MBIA v. Credit Suisse	$296 million	Patterson Belknap	Orrick	Fraud, breach of contract	In October New York state court judge Shirley Kornreich reversed her own decision dismissing MBIA's fraud claims. Credit Suisse has appealed.
Syncora v. J.P. Morgan Securities	$168.6 million	Patterson Belknap	Greenberg Traurig; Sullivan & Cromwell	Fraud, breach of contract	Filed in New York state court, the suit is moving parallel to a federal suit brought by Syncora against EMC.
Assured Guaranty v. Flagstar Bancorp	$82.4 million	Susman Godfrey	Arnold & Porter	Breach of contract	At press time, trial was set to begin before federal district court judge Jed Rakoff in Manhattan as early as February 15.

*Total damages sought in eight separate lawsuits filed by FGIC against units of Ally cases have taken to progress. Frequent motions by the banks, coupled with multiple appeals on pretrial issues, have slowed the cases considerably. "The banks' major strategy seems to be to drag these out as long as possible," says Isaac Gradman, a litigation consultant in San Francisco and former associate at Howard Rice Nemerovski Canady Falk & Rabkin who frequently blogs about MBS cases.

Some of the delays can be blamed on the monolines' fraud claims; motion practice related to those fraud claims continues to bog down many cases. Assured Guaranty, in contrast, left those claims out of several of its suits, and at press time Susman lawyers representing Assured and Arnold & Porter lawyers for Flagstar were preparing for trial in a suit filed in federal district court in Manhattan only last April. "It's been a whirlwind discovery period, with document discovery, depositions, and expert reports completed in just a few months," Buchdahl says.

Neither Buchdahl nor a spokeswoman for Assured would comment on why it has not alleged fraud in most of its suits. But given that Assured today ranks as the healthiest of the monolines—and the only one still issuing policies—it may see a day in the future when it wants a relationship with the banks. James Michener, Assured's general counsel, told the New York State Assembly in February 2011 that Assured had held off from suing Countrywide since "we have tried to make the put-back process work" with out-of-court requests for mortgage repurchases. "Their strategy has been to try to be the good guy," says Mehta, who holds shares of Assured.

Delay isn't the only problem standing in the way of big settlements. Suits filed by the monolines over more complicated financial instruments have struggled. In 2009 Quinn Emanuel, on behalf of MBIA, sued Merrill Lynch & Co., Inc., over $5.7 billion in credit default swaps the insurer issued on collateralized debt obligations. Merrill's counsel at Skadden, Arps, Slate, Meagher & Flom knocked that suit out through rulings at both the lower and appellate court levels in the New York state courts. MBIA sought to file an amended complaint with new allegations in June 2011, then wound up settling for an undisclosed sum a month later with Merrill, which Bank of America today owns.

And while most court precedent so far favors the monolines, one state court judge in New York, Justice Shirley Kornreich, has taken a different view of the merits of their cases. Her docket includes all three of the monolines' suits against Credit Suisse, and those cases have resulted in some of the biggest legal hiccups so far for their put-back crusade. Initially, she handed them a win—denying a motion by Orrick's Levin to dismiss MBIA's fraud claims against Credit Suisse—that put her in line with other judges in the New York courts. But when she got to Ambac's very similar case in April 2011, she dismissed Ambac's fraud claims—and withdrew her MBIA decision, too. In October, in the wake of the Countrywide appellate ruling that let MBIA bring fraud claims against the bank, MBIA's lawyers at Patterson Belknap convinced her to change her mind one more time, allowing fraud claims against Credit Suisse. But the incident marked Justice Kornreich as a judge moving in a different direction from her colleagues on the bench.

Banks are also positioning themselves for Armageddon with bankruptcy backup plans. In lawsuits against Countrywide, Bank of America's lawyers at O'Melveny & Myers have fought to avoid court rulings that hold that the parent has successor liability for its troubled stepchild. That strategy appears designed to allow Bank of America to send Countrywide into bankruptcy protection if the liabilities get too big. (Justice Bransten stands alone in allowing MBIA to pursue claims against Bank of America; the bank's decision not to appeal prevented a more disastrous higher court decision on the subject.) Ally Financial appears to have a similar idea in mind with its own mortgage origination unit, Residential Capital, LLC. FGIC's lawyers at Jones Day noted the "significant possibility" of a ResCap bankruptcy filing when they launched eight lawsuits seeking at least $549 million against ResCap and other Ally subsidiaries beginning in November. Ally, which turned to Orrick for its defense in the suits, declined to comment on ResCap's future.

Other judges have followed Justice Bransten's lead in keeping alive fraud claims against the banks—emboldening the monolines to expand their allegations.

EVEN WITH ALL THE POTENTIAL roadblocks to booking recoveries, though, the monolines are hopeful. In November, MBIA said it expected at least $2.8 billion in potential settlements or awards for breach of contract claims—an amount recorded prior to a December settlement in its suit with Morgan Stanley. Assured Guaranty estimates that it will recover $1.48 billion from banks other than Bank of America via its rep and warranty claims.

The monolines have added new banks to their hunt too: UBS AG in November received a letter from the monolines' trade group, the Association of Financial Guaranty Insurers, that criticized its disclosures of potential mortgage-backed securities liabilities. In a statement UBS said the letter's claims were "inaccurate" and called many of the put-back demands "unfounded."

Those contentions did not stop Assured Guaranty from firing off a breach of contract suit against UBS, whose toxic investment products had already resulted in $308 million in insurance claims. At its side was Quinn's Selendy, fresh off his causation win.

Will it be the last suit he files for a monoline? Selendy declined to say. But with at least a year left before the statute of limitations runs out on bringing fraud lawsuits on the last generation of securitizations, monolines have plenty of time left for more suits. There are still plenty of other troubled loans for them to sue over.

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