Docket #0038 Date Filed: 6/28/2012

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
RESIDENTIAL CAPITAL, LLC, *et al*.,	Case No. 12-12020 (MG)
Debtors.	Jointly Administered
RESIDENTIAL CAPITAL, LLC; DITECH, LLC; DOA HOLDING PROPERTIES, LLC; DOA PROPERTIES IX (LOTS-OTHER), LLC; EPRE LLC; EQUITY INVESTMENTS I, LLC; ETS OF VIRGINIA, INC.; ETS OF WASHINGTON, INC.; EXECUTIVE TRUSTEE SERVICES LLC; GMAC – RFC HOLDING COMPANY, LLC; GMAC MODEL HOME FINANCE I, LLC; GMAC MORTGAGE USA CORPORATION; GMAC MORTGAGE, LLC; GMAC RESIDENTIAL HOLDING COMPANY, LLC; GMAC RH SETTLEMENT SERVICE, LLC; GMACM BORROWER LLC; GMACM REO LLC; GMACR MORTGAGE PRODUCTS, LLC; HFN REO SUB II, LLC; HOME CONNECTS LENDING SERVICES, LLC; HOMECOMINGS FINANCIAL REAL ESTATE HOLDINGS, LLC; HOMECOMINGS FINANCIAL, LLC; LADUE ASSOCIATES, INC.; PASSIVE ASSET TRANSACTIONS, LLC; PATI A, LLC; PATI B,	Case No. 12-AP-01671 (MG) Bankruptcy Case No. 12-02020 (MG) Jointly Administered



LLC; PATI REAL ESTATE HOLDINGS, LLC; RAHI A, LLC; RAHI B, LLC; RAHI REAL ESTATE HOLDINGS, LLC; RCSFJV2004, LLC; RESIDENTIAL ACCREDIT LOANS, INC.; RESIDENTIAL ASSET MORTGAGE PRODUCTS, INC.; RESIDENTIAL ASSET SECURITIES CORPORATION; RESIDENTIAL CONSUMER SERVICES OF ALABAMA, LLC; RESIDENTIAL CONSUMER SERVICES OF OHIO, LLC; RESIDENTIAL CONSUMER SERVICES OF TEXAS, LLC; RESIDENTIAL CONSUMER SERVICES, LLC; RESIDENTIAL FUNDING COMPANY, LLC; RESIDENTIAL FUNDING MORTGAGE EXCHANGE, LLC; RESIDENTIAL FUNDING MORTGAGE SECURITIES I, INC.; RESIDENTIAL FUNDING MORTGAGE SECURITIES II, INC.; RESIDENTIAL FUNDING REAL ESTATE HOLDINGS, LLC; RESIDENTIAL MORTGAGE REAL ESTATE HOLDINGS, LLC; RFC – GSAP SERVICER ADVANCE, LLC; RFC ASSET HOLDINGS II, LLC; RFC ASSET MANAGEMENT, LLC; RFC BORROWER LLC; RFC CONSTRUCTION FUNDING, LLC; RFC REO LLC; RFC SFJV-2002, LLC,

Plaintiffs,

v.

ALLSTATE INSURANCE COMPANY; ALLSTATE LIFE INSURANCE COMPANY; ALLSTATE LIFE INSURANCE COMPANY OF NEW YORK; ALLSTATE NEW JERSEY INSURANCE COMPANY; ALLSTATE BANK, f/k/a ALLSTATE FEDERAL SAVINGS BANK; ALLSTATE RETIREMENT PLAN; AMERICAN HERITAGE LIFE INSURANCE COMPANY; FIRST COLONIAL INSURANCE COMPANY; KENNETT CAPITAL, INC.; CAMBRIDGE PLACE INVESTMENT MANAGEMENT, INC.; FEDERAL HOME LOAN BANK OF BOSTON; FEDERAL HOME LOAN BANK OF CHICAGO; FEDERAL HOME LOAN BANK OF INDIANAPOLIS; HUNTINGTON BANCSHARES INC.; MASSACHUSETTS

MUTUAL LIFE INS. CO.; NEW JERSEY CARPENTERS HEALTH FUND; NEW JERSEY CARPENTERS VACATION FUND; BOILERMAKER BLACKSMITH NATIONAL PENSION TRUST; SEALINK FUNDING LTD.; STICHTING PENSIOENFONDS ABP; THRIVENT FINANCIAL FOR LUTHERANS; THRIVENT BALANCED FUND; THRIVENT CORE BOND FUND; THRIVENT INCOME FUND; THRIVENT LIMITED MATURITY BOND FUND; THRIVENT BALANCED PORTFOLIO; THRIVENT BOND INDEX PORTFOLIO; THRIVENT LIMITED MATURITY BOND PORTFOLIO; THRIVENT FINANCIAL DEFINED BENEFITS PLAN TRUST; UNION CENTRAL LIFE INSURANCE COMPANY; AMERITAS LIFE INSURANCE CORP.; ACACIA LIFE INSURANCE COMPANY; THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY; WESTERNSOUTHERN LIFE ASSURANCE COMPANY; COLUMBUS LIFE INSURANCE COMPANY; INTEGRITY LIFE INSURANCE COMPANY; NATIONAL INTEGRITY LIFE INSURANCE COMPANY; FORT WASHINGTON INVESTMENT ADVISORS, INC.; FINANCIAL GUARANTY INSURANCE CO.; ASSURED GUARANTY MUNICIPAL CORP.; FEDERAL HOUSING FINANCE AGENCY, AS CONSERVATOR FOR THE FEDERAL HOME LOAN MORTGAGE CORPORATION; FEDERAL DEPOSIT INSURANCE CORP. AS RECEIVER FOR CITIZENS NATIONAL BANK AND STRATEGIC CAPITAL BANK; JOHN DOES 1-1000,

Defendants.

OBJECTION OF NEW JERSEY CARPENTERS HEALTH FUND TO DEBTORS' MOTION TO EXTEND AUTOMATIC STAY OR, IN THE ALTERNATIVE, FOR INJUNCTIVE RELIEF ENJOINING PROSECUTION OF CERTAIN PENDING LITIGATION AGAINST DEBTORS' DIRECTORS AND OFFICERS AND NON-DEBTOR CORPORATE AFFILIATES

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New Jersey Carpenters Health Fund (the "Lead Plaintiff"), on behalf of itself and the class of persons and entities (the "Putative Class") it represents in the consolidated securities class action styled as *New Jersey Carpenters Health Fund, et al., on Behalf of Themselves and All Others Similarly Situated v. Residential Capital, LLC et al.*, pending in the United States District Court for the Southern District of New York, Case No. 08-CV-8781 (HB) (the "Class Action"), along with Plaintiff New Jersey Carpenters Vacation Fund and Plaintiff Boilermaker Blacksmith National Pension Trust, hereby submit this objection (the "Objection") to the *Debtors' Motion To Extend Automatic Stay or, in the Alternative, for Injunctive Relief Enjoining Prosecution of Certain Pending Litigation Against Debtors' Directors and Officers and Non-Debtor Corporate Affiliates* (the "Motion") [AP Docket No. 4][1] filed by the debtors and debtors-in-possession (the "Debtors") in the above-captioned chapter 11 bankruptcy cases (the "Bankruptcy Cases"), in their capacity as plaintiffs in the above-captioned adversary proceeding (the "Adversary Proceeding"), on May 25, 2012. Actual service of the Summons, Adversary Complaint and the Motion was not effectuated until approximately two (2) weeks later. As and for its Objection, Lead Plaintiff respectfully states as follows:[2]

PRELIMINARY STATEMENT

By the Motion, the Debtors ask the Court to shut down, during the pendency of the Bankruptcy Cases, the Class Action against various non-Debtor individuals and Ally Securities

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[1] References in this Objection to the dockets of the various court proceedings related hereto are denoted as follows:

[BK Docket No. __] denotes a reference to the docket in the Bankruptcy Cases.
[AP Docket No. __] denotes a reference to the docket in the Adversary Proceeding.
[DC Docket No. __] denotes a reference to the District Court docket in the Class Action.
[CA2 Docket No.__] denotes a reference to the Second Circuit docket in the Class Action.

[2] Lead Plaintiff served a document request upon the Debtors on June 12, 2012. See AP Docket No. 23. At or about 1:00 p.m. (ET) on the date of this Objection, the Debtors produced certain documents via a secure file link. As of the time of filing of this Objection, Lead Plaintiff has not had an opportunity to review such documents. Accordingly, Lead Plaintiff reserves its right to supplement this Objection upon review of the produced documents and/or production of additional documents responsive to the request.

(collectively the "Non-Debtor Defendants")[3] by either (a) extending the automatic stay under section 362 of the Bankruptcy Code to benefit the Non-Debtor Defendants or (b) issuing an injunction, pursuant to section 105 of the Bankruptcy Code, barring continuation of the Class Action against the Non-Debtor Defendants (either alternative, a "Third-Party Stay").

The Motion seeks the extraordinary remedy of a Third-Party Stay by presenting a parade of horribles that supposedly will befall the Debtors if the Court does not impose a Third-Party Stay. The Debtors' arguments focus on what might happen or what they anticipate will happen without offering any evidence whatsoever that any of this supposed harm is happening or is about to happen, at least over the next number of months.

Specifically, the Debtors allege that there is a "significant risk" of collateral estoppel, *stare decisis*, and evidentiary prejudice; that they will be inundated with "burdensome and overwhelming" discovery; that the Debtors will be faced with as yet unasserted indemnification claims; and that insurance policies, only one of which is identified, and their proceeds that the Debtors maintain are property of the estate will be wasted. Such hyperbole, conclusory statements and speculation simply are not enough to justify the extraordinary relief of extending the automatic stay to, or otherwise enjoining litigation against, the Non-Debtor Defendants. As discussed more fully below, the Debtors have presented no legitimate need or legal basis for the relief sought in the Motion and their insistence that a Third-Party Stay of the Class Action is necessary to protect their ability to reorganize and prevent the nullification of the automatic stay is an illusory pretext for a variety of reasons:

[3] The Non-Debtor Defendants named in the Class Action are Ally Securities LLC, and certain of the Debtors' former directors and officers. Capitalized terms not otherwise defined in the Objection shall have the meaning ascribed to them in the Motion.

- First, a decision against any Non-Debtor Defendant, to the extent any such decision will occur in the near future, is not a *de facto* ruling against the Debtors because

    - the Non-Debtor Defendants' potential liability in the Class Action is not based upon or derivative of the Debtors' own liability;

    - the Class Action is stayed against the Debtors pursuant to section 362 of the Bankruptcy Code and decisions against the Non-Debtor Defendants will not result in collateral estoppel, *stare decisis*, or evidentiary prejudice against the Debtors; and

    - if the Class Action later proceeds against the Debtors through the assertion of a yet to be filed Class Proof of Claim, the Debtors will have the opportunity to raise independent defenses to liability and damages.

- Second, the imagined discovery burden from the Class Action is in fact non-existent because

    - There are no pending discovery requests in the Class Action to the Debtors and significant discovery has already taken place prior to the Debtors' Chapter 11 filing;

    - limited discovery regarding class certification requested from non-Debtor parties will already have closed prior to the hearing on the Motion;

    - class certification, the only issue currently being litigated in the Class Action, likely will not be decided—and thus merits discovery will not even be allowed to begin —until 2013; and

    - discovery from the Debtors is likely subject to the automatic stay, and thus cannot proceed absent this Court's approval.

- Third, the Debtors' stated concerns regarding indemnification of the Non-Debtor Defendants are both overstated and insufficient to justify the extraordinary relief requested because

    - any claims by the Non-Debtor Defendants for indemnification would be, at best, contingent,

unliquidated general unsecured claims subject to expungement pursuant to section 502(e)(1)(B) of the Bankruptcy Code;

- the purported indemnification obligations are not absolute and the Non-Debtor Defendants are likely precluded from seeking indemnity for liability they incur in the Class Action; and

- the Debtors' solvent non-Debtor parent, Ally Financial, Inc. ("AFI") owes substantial indemnification obligations directly to and, upon information and belief, carries significant insurance coverage for the benefit of, the Debtors' former directors and officers.

- Finally, because the Debtors have not presented any meaningful evidence as to the full nature and extent of insurance coverage potentially applicable to the Class Action, it is impossible to fully assess the Debtors' claim that permitting the Class Action to continue will inappropriately deplete wasting insurance policies. However, given the availability of alternative sources of indemnity and insurance coverage, it is unlikely that the limited activity that will take place in the Class Action will have any meaningful impact on the relevant insurance policies over the next number of months.

In reality, the Third-Party Stay is intended to be a short-term bridge designed to mitigate the exposure of the Debtors' ultimate parent, AFI, and AFI's direct non-Debtor subsidiaries, during the Bankruptcy Cases, until the Debtors confirm a liquidating Chapter 11 plan that, according to AFI and the Debtors, would include sweeping third-party releases and injunctions permanently enjoining the Class Action and the other RMBS-related actions against the Non-Debtor Defendants.

Finally, the mere status of a non-debtor as a former director or officer or an affiliate is insufficient justification for staying third party litigation against non-debtor parties. Rather, the Debtors must demonstrate clearly and convincingly through evidence that the failure to enjoin the Class Action would imminently and seriously adversely affect or impact the bankruptcy estate or the Debtors' ability to reorganize. The Debtors do not satisfy this heavy burden, nor do

they identify any activity that is taking place or will take place in the near future that warrants the unique injunctive relief requested in the Motion.[4]

Accordingly, for these reasons and as detailed below, the Motion must be denied.

THE CLASS ACTION

The Lead Plaintiff initially commenced the Class Action, in the New York Supreme Court, County of New York on September 22, 2008. The Class Action was removed to the United States District Court for the Southern District of New York (the "District Court") on October 14, 2008. Among other defendants, Debtors Residential Capital, LLC ("ResCap"), Residential Funding, LLC ("RF"), and Residential Accredited Loans, Inc. ("RALI" and collectively with ResCap and RF, the "Debtor Defendants"), are named as defendants in the Class Action, along with Ally Securities and certain former directors and officers of the Debtors: Bruce J. Paradis, Kenneth M. Duncan, Davee L. Olson, Ralph T. Flees, Lisa R. Lundsten, James G. Jones, David M. Bricker, and James N. Young (collectively the "Former D&O Class Action Defendants"). Each of the Non-Debtor Defendants is a proposed beneficiary of the Third-Party Stay. In addition, a number of entities wholly unrelated to the Debtors are named as defendants in the Class Action.

In the Class Action, Lead Plaintiff alleges that (among other allegations not pertinent to the Motion) the offering documents for certain residential mortgage-backed securities ("RMBS") created and underwritten by certain of the defendants omitted material facts and contained misstatements of material facts, and asserts causes of action under sections 11, 12(a)(2), and 15 of the Securities Act of 1933 (the "'33 Act"), 15 U.S.C. §§ 77k, 771(a)(2), and 77o. As a

[4] Additionally, Lead Plaintiff does not concede that this Court has subject matter jurisdiction in the first instance to enjoin the Class Action. See In re Gillman v. Continental Airlines (In re Continental Airlines), 203 F. 3d 203, 214 n. 12 (3d Cir. 2000) (noting that jurisdiction to enjoin direct, independent third-party actions against non-debtors cannot be presumed).

remedy for these alleged material misstatements and omissions, Lead Plaintiff seeks (on behalf of itself and the Putative Class), rescission of RMBS purchases or a rescissory measure of damages, among other remedies.

On May 18, 2009, Lead Plaintiff filed the *Consolidated First Amended Securities Class Action Complaint* (as amended, the "Class Complaint"). On March 31, 2010, the District Court granted in part and denied in part a motion to dismiss the Class Complaint. On July 30, 2010, several parties moved to intervene (the "Motions to Intervene") in the Class Action, on behalf of purchasers of certain of the RMBS offerings. On August 16, 2010, Lead Plaintiff moved for certification of the Putative Class. On December 22, 2010, the District Court granted the Motions to Intervene, and on January 3, 2011, the parties filed an amended Class Action Complaint including the intervening plaintiffs.

Subsequently, on January 18, 2011, the District Court denied the motion to certify the Putative Class. On April 29, 2011, the United States Court of Appeals for the Second Circuit granted Lead Plaintiff's motion for leave to appeal the denial of class certification pursuant to Fed. R. Civ. P. 23(f). On April 30, 2012, the Second Circuit affirmed the District Court's denial of class certification, without prejudice to the filing of a revised motion for class certification before the District Court.

On May 7, 2012, the District Court granted Lead Plaintiff's request for new briefing on the issue of class certification and reopened discovery on the limited issue of class certification for sixty days, with said limited discovery to end on July 6, 2012 (prior to the hearing on the Motion). Briefs of no more than ten pages, on any new issues relating to class certification, must be filed on or before August 6, 2012. All other discovery is stayed pending a decision on the

renewed class certification motion. See Exhibit 1 to Declaration of Michael S. Etkin ("Etkin Declaration") being filed contemporaneously herewith.

THE MOTION AND SUPPORTING DECLARATIONS

The Debtors commenced the Adversary Proceeding and filed the Motion on May 25, 2012, seeking the Third Party Stay until the effective date of a yet to be filed chapter 11 plan of reorganization or liquidation. Contemporaneously therewith, the Debtors filed four declarations in support of the Motion:

(1) *Declaration of Joel C. Haims* (the "Haims Declaration") [AP Docket No. 5] attaching as exhibits copies of the complaints in each lawsuit comprising the RMBS-related actions, including the Class Action.

(2) *Declaration of Jeffrey A. Lipps* (the "Lipps Declaration") [AP Docket No. 6]. Jeffrey A. Lipps ("Lipps") which makes various statements regarding, among other things, the procedural posture and current status of the Class Action and the alleged discovery burden on the Debtors if the MBS Actions are generally permitted to continue against the Non-Debtor Defendants.

(3) *Declaration of James Whitlinger* (the "Whitlinger Declaration") [AP Docket No. 7] which makes statements regarding, among other things, the Debtors' objectives in bankruptcy, the Debtors' proposed means of achieving those objectives, and the alleged effects on the Debtors' estate of permitting the MBS Litigation generally to continue against the Non-Debtor Defendants. (Whitlinger Declaration at ¶¶ 3–21.)

The Whitlinger Declaration attaches three documents as exhibits: (a) the *Amended and Restated Limited Liability Company Agreement of Residential Capital, LLC* (the "ResCap LLC Agreement") [AP Docket No. 7 Ex. A]; (b) the *Amended and Restated Operating Agreement* among General Motors Corporation ("GM"), AFI (f/k/a GMAC LLC), and ResCap (the "Operating Agreement") [AP Docket No. 7 Ex. B]; and (c) a *BPL for Financial Institutions* insurance policy issued by Federal Insurance Company (the "E&O Policy") [AP Docket No. 7 Ex. C] for the period from December 31, 2007 to December 31, 2008. No other documents relating to indemnification obligations and no other insurance policies are referenced or provided.

(4) *Declaration of Anne Janiczek* (the "Janiczek Declaration") [AP Docket No. 8]. Anne Janiczek ("Janiczek") which discusses her understanding of

> the roles and responsibilities of three employees of the Debtors and further posits, based in large measure on her reading of the Lipps Declaration, that these employees' "possible" involvement in the "anticipated" discovery related to the MBS Actions generally would adversely impact the Debtors' efforts to restructure. (Id. at ¶¶ 11, 16, 19–20.) Significantly, none of these three individuals is a Non-Debtor Defendant.

OBJECTION

The actual circumstances of these Bankruptcy Cases and the status of and claims asserted in the Class Action do not warrant imposition of a Third-Party Stay in either alternative form requested by the Debtors. Extension of the automatic stay to cover non-Debtor parties is appropriate only in unusual circumstances, and as discussed more fully below, no such circumstances exist here.

I. THERE IS NO BASIS TO EXTEND THE AUTOMATIC STAY TO THE NON-DEBTOR DEFENDANTS.[5]

Upon commencement of a debtor's bankruptcy case, the automatic stay immediately and automatically stays all "action[s] or proceeding[s] against the debtor" and all actions "to obtain possession . . . or to exercise control over property of the estate." 11 U.S.C. §§ 362(a)(1), (3). The automatic stay protects only debtors and their property—not non-debtors or their property. See, e.g., Teachers Ins. and Annuity Assoc. of Am. v. Butler, 803 F.2d 61, 65 (2d Cir. 1986) ("It is well-established that stays pursuant to § 362(a) are limited to debtors and do not encompass non-bankrupt co-defendants."). Nevertheless, courts occasionally extend the automatic stay to

[5] As courts have held that the power to extend the automatic stay derives from the general equitable powers afforded to Bankruptcy Courts under section 105 of the Bankruptcy Code, the respective jurisprudences of stay extension and temporary injunctive relief necessarily overlap to some extent. See, e.g., Teachers Ins. and Annuity Assoc. of Am. v. Butler, 803 F.2d 61, 65 (2d Cir. 1986) (examining "whether pursuant to its general equity powers under 11 U.S.C. § 105, the bankruptcy court properly extended the automatic stay to the non-bankrupt general partners"); In re United Health Care Org., 210 B.R. 228 (S.D.N.Y. 1997) (observing that "'[s]everal courts have held that under specific circumstances non-debtors may be protected by the automatic stay'" and that "[t]he source of the authority to issue such an injunction is 11 U.S.C. § 105, which provides bankruptcy courts with general equity powers . . . .") (internal citation omitted). In the interest of clarity and completeness, this Objection addresses the two alternative theories separately, tracking the organization of the Motion.

non-debtors under "unusual circumstances." See A.H. Robins Co. v. Piccinin, 788 F.2d 994, 999 (4th Cir. 1986), cert. denied, 479 U.S. 876 (1986).

The unusual circumstances necessary to warrant extension of the automatic stay are narrowly defined by case law, and "[s]omething more than the mere fact that one of the parties to the lawsuits has filed a Chapter 11 bankruptcy must be shown in order that proceedings be stayed against non-bankrupt parties.'" Matter of Johns-Manville (GAF Corp. v. Johns-Manville), 26 B.R. 405, 410 (Bankr. S.D.N.Y. 1983) (citing Royal Truck & Trailer v. Armadora Maritima Salvadoreana, 10 B.R. 488, 491 (N.D. Ill. 1981)). Courts may extend the automatic stay under section 362(a)(1) of the Bankruptcy Code to non-debtor parties where "the debtor and the non-bankrupt party can be considered . . . as having a unitary interest[,]" In re North Star Contracting Corp., 125 B.R. 368, 370 (S.D.N.Y. 1991), but will do so "only when a claim against the non-debtor will have an *immediate* adverse economic consequence for the debtor's estate." In re Queenie, Ltd., 321 F.3d 282, 287 (2d Cir. 2003) (emphasis in original).

1. Extension of the Automatic Stay Under Section 362(a)(1) Is Not Appropriate Because There Is No Identity of Interest Between the Debtors and the Non-Debtor Defendants.

The Debtors presume an identity of interest exists between the Debtors and the Non-Debtor Defendants, warranting extension of the automatic stay under section 362(a)(1) of the Bankruptcy Code, because, they claim, continuation of the Class Action would (a) result in decisions against third parties that amount to decisions against the Debtors, (b) impose onerous discovery burdens on the Debtors, and (c) trigger the Debtors' indemnification obligations to the Non-Debtor Defendants. See Motion at 22. Each of these proffered reasons rests upon highly generalized mischaracterizations of the relief sought in the Class Action, the actual status of the Class Action and the potential effects thereof. The facts simply do not support the Debtors' presumption and arguments based on those presumptions.

a. Prosecution of the Class Action will not result in decisions or a judgment against the Debtors.

Courts may extend the automatic stay to non-debtor litigants where "there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor." A.H. Robins, 788 F.2d at 999. However, where (as here) a party holds an independent direct claim against a non-debtor for violating the federal securities laws, "there is no compelling basis by which a court must extend the automatic stay provisions of § 362 to the non-debtor co-defendants." In re First Cent. Fin'l Corp., 238 B.R. 9, 18 (Bankr. E.D.N.Y. 1999) (quoting Duval v. Gleason, 1990 WL 261364, *4 (N.D. Cal. 1990)); see also Holland v. High Power Energy, 248 B.R. 53, 58 (S.D. W.Va. 2000) (automatic stay is inapplicable when a third party has "obligations that are 'independent' and primary, not derivative of those of the debtor."); In re Phar-Mor Securities Litig., 166 B.R. 57, 62 (W.D. Pa. 1994) ("the Code was not intended to stay action . . . where the non-debtor's liability rests upon his own breach of duty"); Chesapeake Crossing Associates v. TJX Companies, Inc., 1992 WL 469801, *4 (E.D. Va. 1992) ("a third party defendant will not be covered under the stay . . . where the non-debtor's liability rests upon his own breach of duty").

The Debtors assert that the Non-Debtor Defendants' potential liability in the Class Action is based upon and derivative of the Debtors' own liability, and that permitting the Class Action to continue against the Non-Debtor Defendants would thus create the risk of collateral estoppel, *stare decisis*, and evidentiary prejudice against the Debtors. The Debtors base this assertion on conclusory statements that "[t]he allegations and claims against the Non-Debtor [Defendants] are 'inextricably interwoven' with the allegations and claims against the Debtors[,]" and that a

decision against a Non-Debtor Defendant in the Class Action would, perforce, constitute a decision against the Debtors. (Motion at 23.)

While it is logically true that a finding of '33 Act liability against a Non-Debtor Defendant would turn partly on the same factual nucleus as a '33 Act claim against a Debtor—an untrue statement of material fact in the registration statement or an omission of a material fact required or necessary to make statements in the registration statement not misleading—such a similar factual nucleus does not support the extraordinary injunctive relief the Debtors request for three reasons. First, the Non-Debtor Defendants' potential liability in the Class Action is not based upon or derivative of the Debtors' own liability. Second, decisions against the Non-Debtor Defendants will not result in collateral estoppel, *stare decisis*, or evidentiary prejudice against the Debtors. Third, if a Class Proof of Claim is asserted against the Debtors in the Bankruptcy Cases, the Debtors will have the opportunity to raise independent defenses to their own liability under the '33 Act. Accordingly, a finding or judgment against a Non-Debtor Defendant would not constitute a *de facto* finding or judgment against the Debtors. Moreover, it should be noted that the Debtors point to no potential finding or ruling that will occur in the Class Action in the near future other than class certification which will certify the class only as to the claims against the Non-Debtor Defendants.

(i) The Non-Debtor Defendants' potential liability in the Class Action is not based upon or derivative of the Debtors' own liability.[6]

The Class Action seeks recovery under sections 11, 12, and 15 of the '33 Act. Sections 11 and 12 impose direct liability on a variety of parties for the sale of securities based

[6] Section 15 imposes joint and several liability on certain "control persons" of parties found liable under section 11 or 12, subject to certain defenses. See 15 U.S.C. § 77o. However, to the extent that the Class Action asserts section 15 claims against the Non-Debtor Defendants in their capacity as "control persons" of any of the Debtors, the Debtors would not be bound by any judgment because they are not parties to the Class Action.

upon a registration statement (section 11) or prospectus (section 12) containing a material misstatement or omission.

Claims arising under section 11 of the '33 Act are direct, not derivative, as against

> (1) every person who signed the registration statement;
>
> (2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;
>
> (3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;
>
> (4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him; [and]
>
> (5) every underwriter with respect to such security.

See 15 U.S.C. § 77k(a)(1)–(5).

Claims arising under section 12 of the '33 Act are direct, not derivative, as against

> Any person who--
>
> (1) offers or sells a security in violation of section 5, or
>
> (2) offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof

> that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

See 11 U.S.C. § 77*l*(a)(1)–(2).

Thus, a finding of liability against the Non-Debtor Defendants under section 11 or 12 of the '33 Act does not require or presuppose a finding of liability against any other party, including the Debtors. Claims against the Non-Debtor Defendants under sections 11 and 12 stand on their own.

(ii) There is no risk of collateral estoppel, stare decisis, or evidentiary prejudice against the Debtors.

The Debtors also assert that, absent a Third-Party Stay, they may be collaterally estopped from litigating issues decided in the Class Action regarding control person liability under section 15 of the '33 Act.[7] That argument is without merit. Collateral estoppel may not be applied against a party in a subsequent proceeding where the party did not have a full and fair opportunity to litigate the claim or issue in the prior proceeding. Allen v. McCurry, 449 U.S. 90, 96–97 (1980); Haring v. Prosise, 462 U.S. 306, 313 (1983). As the United States Supreme Court held in Montana v. United States, 440 U.S. 147, 153 (1979):

> [u]nder collateral estoppel, once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action *involving any party to the prior litigation*.

Id. (emphasis added).

Here, the automatic stay precludes the commencement or continuation of any action against the Debtors, even where the Debtors were named as defendants when the Class Action was commenced prior to the Petition Date. The Debtors are no longer parties to the Class Action

[7] The Debtors do not appear to make, and they cannot make, that argument with respect to claims under sections 11 and 12 of the '33 Act.

and the Class Action cannot proceed against the Debtors absent relief from the automatic stay. Thus, the Debtors cannot be collaterally estopped from later litigating any issue.

The decision by the Third Circuit in Pacor, Inc. v. Higgins, 743 F.2d 984 (3d Cir. 1984), is instructive. In Pacor, the lead plaintiffs commenced a lawsuit against Pacor in state court seeking damages relating to exposure to asbestos supplied by Pacor. Pacor filed a third-party complaint impleading the Johns-Manville Corporation. Subsequently, Johns-Manville filed a chapter 11 bankruptcy petition. The state court case was severed and Pacor moved for removal of the state court case to the bankruptcy court. Following remand by the bankruptcy court and affirmance by the district court, the Third Circuit held:

> Our examination of the Higgins-Pacor-Manville controversy leads us to conclude that the primary action between Higgins and Pacor would have no effect on the Manville bankruptcy estate, and therefore is not "related to" bankruptcy within the meaning of section 1471(b). At best, it is a mere precursor to the potential third party claim for indemnification by Pacor against Manville. **Yet the outcome of the Higgins-Pacor action would in no way bind Manville, in that it could not determine any rights, liabilities, or course of action of the debtor. Since Manville is not a party to the Higgins-Pacor action, it could not be bound by res judicata or collateral** estoppel . . . . Even if the Higgins-Pacor dispute is resolved in favor of Higgins (thereby keeping open the possibility of a third party claim), Manville would still be able to relitigate any issue, or adopt any position, in response to a subsequent claim by Pacor.

Id. at 995 (citations omitted) (emphasis added). Likewise, here, the Debtors, who are no longer defendants here and against whom the Class Action cannot proceed, cannot be bound by collateral estoppel.

Moreover, "corporations are treated as entities separate from their officers, directors and shareholders for purposes of preclusion just as for other purposes. Without more, judgments intended in actions against any one of them are not binding on the other." CHARLES ALAN WRIGHT, ARTHUR R. MILLER, AND EDWARD COOPER, FEDERAL PRACTICE AND PROCEDURE

§ 4460, at 533 (1981); REST. (2D) JUDGMENTS § 59 (a "judgment in an action involving a party who is an officer, director, stockholder or member of a non-stock corporation [has no] preclusive effects on the corporation itself" except in limited circumstances not present here). The Debtors will not be bound by any decision against the Non-Debtor Defendants in the Class Action, and thus will be able to relitigate any issue or adopt any position in any subsequent litigation. Reliance Acceptance Group Inc. v. Levin (In re Reliance Acceptance Group Inc.), 235 B.R. 548, 558 (D. Del. 1999) (rejecting the debtor's claim that the estate was at risk, as the debtor was not a party to the shareholder litigation and thus could not be bound by any finding in that action). The Reliance court also found Section 27 of the REST. (2D) JUDGMENTS,[8] which sets forth the traditional rule of issue preclusion, unsupportive of the debtor's argument because the estate was not a party to the action giving rise to the judgment.

(iii) The Debtors will retain the opportunity to assert independent defenses to liability in the Class Action notwithstanding any decision against the Non-Debtor Defendants.

Each defendant in a '33 Act lawsuit is entitled to assert its own defenses to liability. See 15 U.S.C. §§ 77k(b)(3) (due diligence defense to section 11 liability for persons other than the issuer of a security), 77l(a)(2) ("reasonable care" defense to section 12 liability).[9] For example, it is entirely possible for a Non-Debtor Defendant to be found liable under section 11 while a

[8] Section 27 provides the traditional rules on issue preclusion

> when an issue of fact or law is actually litigated and determined by a valid and final judgment, the determination is conclusive in a subsequent action between the parties, whether the same or a different claim.

[9] The Debtors speculate that, to prove these defenses, the Non-Debtor Defendants "will need to obtain information and evidence, including testimony, from the [D]ebtor entities." (Lipps Declaration at ¶ 51.) It is entirely uncertain whether individual Non-Debtor Defendants would require information and evidence from the Debtors—particularly testimony, as none of the Non-Debtor Defendants are current directors or officers of the Debtors—to demonstrate their own personal knowledge. Non-Debtor affiliate Defendants likewise may have the requisite information in their own possession. In either instance, the point is an irrelevant distraction: as discussed below, there are no and can be no discovery requests issued to the Debtors in the near term by virtue of the status of the Class Action and, in order to take discovery from the Debtors at any point, Lead Plaintiff believes it will be both appropriate and necessary to first obtain relief from the automatic stay.

Debtor avoids liability by operation of the due diligence defenses set forth in 15 U.S.C. § 77k(b)(3). Thus, regardless of the ultimate disposition of the Class Action against the Non-Debtor Defendants, the Debtors would have the ability not only to relitigate any issue decided against any Non-Debtor Defendant, but also to assert independent defenses to liability, notwithstanding any finding of liability against the Non-Debtor Defendants.

A defendant against whom section 11 or 12 liability is asserted also has the opportunity to demonstrate that the plaintiff's loss did not stem, in whole or in part, from the deficiencies in the registration statement. See 15 U.S.C. §§ 77k(e), 77*l*(b). To the extent that a defendant disproves loss causation, that defendant avoids section 11 or 12 liability. See 15 U.S.C. §§ 77k(e), 77l(b). Thus, even if the Class Action, years down the road, results in a judgment of liability against the Non-Debtor Defendants, the Debtors would retain the opportunity to disprove loss causation in connection with the resolution of any Class proof of claim if necessary.

Because Lead Plaintiff's claims against the Non-Debtor Defendants are direct, not derivative, and will not prejudice the Debtors in future proceedings, extension of the stay is not warranted.

b. Continuation of the Class Action will not and cannot impose any discovery burdens on the Debtors.

The Debtors hypothesize that, without a Third-Party Stay, continued adjudication of the Class Action will create a discovery burden on the Debtors so onerous that it will potentially derail their restructuring efforts. (Motion at 26–27.) The Debtors speak in sweeping hyperbole, referring to the discovery as "Herculean," speculating that the discovery would "frustrate the Debtors' restructuring efforts," and stating that the automatic stay would be "eviscerated" absent a Third-Party Stay. (Id. at 26–27, 32.) The simple reality is that the only discovery that is taking

and can take place in the Class Action is not directed to the Debtors and is limited to the issue of class certification, and will be complete by July 6, 2012. Moreover, any discovery directed to the Debtors should require relief from the automatic stay. In any event, to the extent that discovery in the Class Action continues at some point in the future, such discovery will not materially burden the Debtors because significant discovery has already taken place pre-petition and the Court can nevertheless revisit the issue of whether injunctive relief or limitations on discovery of the Debtors is appropriate at that point in time.

(i) Merits discovery is not likely to take place at all in the Class Action during the pendency of the Bankruptcy Cases.

Although the Debtors' attempt to aggregate all of the various MBS Actions, including the Class Action, for purposes of the Motion, it is clear that the status of the cases that are the subject of the Motion are very different and that the cases are at varying stages of discovery. The Debtors do acknowledge, however, that, in the Class Action (commenced more than three years ago), extensive discovery has already taken place. The Debtors also elude to the fact that the District Court has ordered new briefing on class certification, with additional class certification-related discovery ending on July 6, 2012 (before the hearing on the Motion). Briefs on any new issues are due on August 6, 2012. All other discovery is stayed by the District Court and it is unlikely that the issue of class certification will be decided by year-end, when the Debtors anticipate emerging from chapter 11. Accordingly, the heavy discovery burden trumpeted by the Debtors during the pendency of the Bankruptcy Cases is non-existent with respect to the Class Action.

(ii) Discovery from the Debtors Would Be Subject to Court Approval.

As a practical matter, the automatic stay is in place with respect to the Debtors. If Lead Plaintiff, a Non-Debtor Defendant, or any other party to the Class Action seeks to take discovery

from the Debtors at some future time while the Bankruptcy Cases are still pending, that party should (or would) first need to seek stay relief authorizing it to conduct such discovery or the Debtors could then seek appropriate protection from the Bankruptcy Court if warranted. In either event, the Court will have an opportunity to consider the potential burden that discovery could impose upon the estate if and when that issue becomes ripe for adjudication, rather than prematurely imposing a blanket Third-Party Stay based upon the Debtors' mere conjecture about anticipated, theoretical discovery burdens.

(iii) There will be no burden on or distraction of any individual employee of the Debtors by reason of the prosecution of the Class Action.

The individual Non-Debtor Defendants, unlike the non-debtor defendants in other cases cited by the Debtors, are not currently officers or directors of the Debtors. For example, in the Matter of Johns-Manville (Johns-Manville v. Asbestos Litig. Group), 26 B.R. 420, 426 (Bankr. S.D.N.Y. 1983), aff'd, 40 B.R. 219 (S.D.N.Y. 1984), rev'd in part on other grounds, 41 B.R. 926 (S.D.N.Y. 1984), many of the individual non-debtor defendants were "key operating personnel . . . presently working for the company at very high levels in numerous divisions" and the claims against them were derivative in nature. All of the Former D&O Class Action Defendants are no longer affiliated with the Debtors. Thus, the typical concern that a debtor's critical restructuring personnel will be distracted by ongoing litigation in which they are named as defendants, e.g., North Star, 125 B.R. at 371, simply does not exist here. The Debtors' assertions that certain of their personnel—*none of whom are named as defendants in the Class Action*—would be distracted from their responsibilities to the Debtors' restructuring is misguided because, as discussed above, the Class Action cannot and will not require any further discovery from the Debtors for quite some time, if at all, and any such discovery can be monitored and restricted by this Court if and when necessary.

c. Continuation of the Class Action against the Non-Debtor Defendants will not result in immediate, absolute indemnification obligations for the Debtors.

Where a non-debtor party "is entitled to *absolute* indemnity by the debtor on account of *any* judgment that might result against them in the case[,]" extension of the automatic stay may be appropriate. A.H. Robins, 788 F.2d at 999 (emphasis added). Here, we are dealing with securities, not product liability, litigation and no such absolute right of indemnity exists. In the first instance, the existence of a right of indemnity is not, in and of itself, grounds for extension of the automatic stay. See, e.g., In re Codfish Corp., 97 B.R. 132, 135 (Bankr. D.P.R. 1988); In re All Seasons Resorts, Inc., 79 B.R. 901, 904 (Bankr. C.D. Cal. 1987) ("Although there is a closeness between debtor and co-defendants by reason of their officer and agent status and their right to indemnification . . . the magnitude of the harm to debtor if no stay is in force does not approach the scope of the potential injuries besetting the debtors in Robins and Johns-Manville."); see also In re First Alliance Mortg. Corp., 264 B.R. 634, 660 (C.D. Cal. 2001) ("At this point whether the individuals would be able to seek . . . indemnification . . . is at best an open question"). The possibility of a contingent, unliquidated indemnity claim at some unspecified future time is not grounds for extension of the automatic stay. Steel Workers Pension Trust v. Citigroup, Inc., Case No. 03-CV-2171, 2003 U.S. Dist. Lexis 12392, at *8-*9 (E.D. Pa. July 17, 2003) ("[M]ere potential impact upon the debtor's estate is insufficient. Contingent liability will not suffice"). Here, the Debtors' potential indemnification liability is contingent and unknown (if the Non-Debtor Defendants are entitled to indemnification at all), and the Debtors have not demonstrated that they owe any indemnity obligation to AFI or its affiliates, including Ally Securities (a Non-Debtor Defendant).

(i) Any indemnity obligation the Debtors may owe to the Non-Debtor Defendants represents, at best, a contingent, unliquidated general unsecured claim.

All of the claims and causes of action asserted in the Class Action arise out of transactions that occurred prior to the Petition Date. See Lipps Declaration at ¶ 73 (noting that the Class Action stems from securitizations undertaken in 2005–2007). According to the Debtors, the Non-Debtor Defendants' rights to indemnification derive from the ResCap LLC Agreement and the Operating Agreement, both pre-petition agreements. Accordingly, any indemnification claim asserted by a Non-Debtor Defendant is, at best, a general unsecured pre-petition claim subject to the same review and allowance procedures as any other general unsecured pre-petition claim. In addition, any such claims would be subject to expungement as contingent and unliquidated pursuant to section 502(e)(1)(B) of the Bankruptcy Code.[10]

(ii) The Non-Debtor Defendants likely are precluded from seeking indemnification for liabilities they incur in the Class Action.

It is well settled that complete indemnification of liability for violations of the federal securities laws is contrary to public policy and may not be pursued. See e.g., Laventhol, Krekstein, Horwath & Horwath v. Horwitch, 637 F.2d 672, 676 (9th Cir. 1980) ("In extending liability to underwriters and those who prepared misleading statements, the purpose of the ['33] Act is regulatory rather than compensatory, and permitting indemnity would undermine the statutory purpose of assuring diligent performance of duty and deterring negligence."); Heizer Corp. v. Ross, 601 F.2d 330, 334 (7th Cir. 1979) ("A securities wrongdoer should not be permitted to escape loss by shifting his entire responsibility to another party."); Globus v. Law Research Service, Inc., 418 F.2d 1276 (2d Cir. 1969); see also Eichenholtz v. Brennan, 52 F.3d

[10] It should be noted that the Debtors have indicated that they will seek to subordinate any class action claim filed by Lead Plaintiff in these Bankruptcy Cases pursuant to section 510(b) of the Bankruptcy Code. If successful, claims for indemnification would likewise be statutorily subordinated and therefore likely have no economic impact on the Debtors' estates.

478, 484-85 (3d Cir. 1995) (citation omitted); Stowel v. Ted S. Finkel Inv. Servs., Inc., 641 F.2d 323, 325 (5th Cir. 1981); cf. Greenwald v. Am. Medcare Corp., 666 F.Supp. 489, 493 (S.D.N.Y. 1987) (permitting a director's cross-claim for post-settlement indemnification to proceed, provided he proved that he was without fault). Therefore, even if some limited right to indemnification potentially exists, it is clearly not absolute as it relates to the claims asserted in the Class Action.

(iii) The Debtors have presented no evidence that they owe an indemnity obligation to AFI or its affiliates, including Ally Securities.

The Debtors assert, through the Whitlinger Declaration, that the Operating Agreement "provide[s] for indemnification to non-debtor affiliate entities in certain circumstances." (Whitlinger Declaration at ¶ 24)(emphasis added). However, such circumstances are not present here. The Operating Agreement does not entitle AFI or Ally Securities to indemnity for direct liabilities incurred by AFI or its affiliates, including Ally Securities, in the course of their own business. Rather, ResCap's only indemnification obligations under the Operating Agreement are as follows:

> ResCap will, to the fullest extent permitted by law, indemnify, defend and hold harmless the GM Affiliates and the GMAC Affiliates[11] from and against any losses related to ResCap Indemnifiable Liabilities.

(Operating Agreement at § 3(c).) The Operating Agreement, in turn, defines the "ResCap Indemnifiable Liabilities" subject to indemnification by ResCap as

> all Liabilities of ResCap or any of its Subsidiaries to the extent such Liabilities (a) relate to, (b) arise out of or (c) result principally from any of the following items:

[11] The GMAC Affiliates include GM, AFI, and their affiliates other than ResCap and its subsidiaries. (Operating Agreement at 2.)

> (i) the failure of ResCap or any of its Subsidiaries to pay, perform or otherwise promptly discharge any Liabilities of ResCap or such Subsidiary, as the case may be, in accordance with their terms; or
>
> (ii) the ResCap Business [defined as all businesses and operations (whether or not such businesses or operations are terminated, divested, or discontinued) of ResCap or its Subsidiaries as conducted from time to time].

(Operating Agreement at 4.)

Ally Securities is a wholly owned direct subsidiary of AFI, not of ResCap. See SEC Form X-17A-5 of Ally Securities for the period ending December 31, 2011. Because AFI and its non-Debtor subsidiaries are not subsidiaries of ResCap, their activities are not part of the ResCap Business. Moreover, the direct liabilities incurred by AFI and its non-Debtor subsidiaries—such as liability under sections 11 and 12 of the '33 Act—do not fit within the definition of ResCap Indemnifiable Liabilities. Likewise, actions undertaken by AFI and its non-Debtor subsidiaries in the underwriting, documentation, packaging, and sale of residential mortgage loans to the securitization trusts were undertaken in AFI's and its subsidiaries' capacity as lenders and originators of mortgages, and any liability incurred by AFI or its subsidiaries as a result of those actions cannot be shoehorned into the definition of ResCap Indemnifiable Liabilities. AFI and its non-Debtor subsidiaries (including Ally Securities) thus are not entitled to indemnification by the Debtors for such losses under the terms of the Operating Agreement.

In fact, the Debtors may actually be entitled to indemnification from AFI for losses the Debtors incur as a result of actions taken by AFI or its subsidiaries, including Ally Securities, in the course of their businesses. The Operating Agreement requires AFI to indemnify ResCap for, among other things, losses incurred by ResCap related to, arising out of, or resulting principally from the "GMAC Affiliate Business[,]" defined in turn as "all businesses and operations

(whether or not such businesses or operations are terminated, divested or discontinued) of [GM, AFI, and their affiliates, other than ResCap and its subsidiaries] as conducted from time to time."). (Operating Agreement at 2–3.) As noted above, the underwriting, documentation, packaging, and sale of residential mortgage loans originated by AFI and its non-Debtor subsidiaries to the securitization trusts were the business of AFI and its subsidiaries. Likewise, Ally Securities' underwriting of RMBS issuances was a function of Ally Securities, not of the Debtors. Liabilities of the Debtors arising out of these activities thus may actually be indemnifiable by AFI—not the inverse.[12]

2. Extension of the Automatic Stay Under Section 362(a)(3) Is Not Appropriate Because the Class Action Does Not Threaten To Deplete Estate Property.

The Debtors have stated, again in conclusory fashion, that continuing the Class Action against the Non-Debtor Defendants "could adversely impact—and deplete—property that the Debtors[] submit is part of their estate," namely the E&O Policy and the proceeds thereof. (Motion at 34.) The facts, as currently revealed, do not support that conclusion. Moreover, the Debtors have only seen fit to produce one E&O Policy, in the name of AFI's predecessor, despite that there are clearly a number of insurance policies that potentially cover the claims asserted in the Class Action.[13]

[12] To the extent that liabilities resulting from these activities fit within the definition of ResCap Indemnifiable Liabilities, such activities nevertheless also relate to the GMAC Affiliate Business, creating a potentially circular loop of indemnity wherein the Debtors' indemnification obligations to AFI may be offset by AFI's indemnification obligations to the Debtors, resulting in no net obligation on the part of the Debtors.

[13] Lead Plaintiff has requested copies of all potentially relevant insurance policies, but as of the date of the submission of this Objection, no additional policies have been produced. As set forth in note 2, supra, Lead Plaintiff reserves its rights to supplement this Objection upon production of the relevant insurances policies.

a. AFI, the Debtors' non-Debtor parent, is obligated to indemnify the Debtors' current and former directors and officers and to maintain insurance coverage for such obligations.

The *Settlement and Plan Support Agreement* dated as of May 14, 2012, by and among the Debtors and AFI (on behalf of its direct and indirect subsidiaries other than the Debtors and the Debtors' direct and indirect subsidiaries) (the "AFI PSA") [BK Docket No. 6 Ex. 8], provides that

> AFI stands by and re-affirms its indemnification obligations under its Amended and Restated Certificate of Incorporation regarding ResCap's current and former Directors and Officers to the full extent of Delaware law.

AFI PSA at § 2.2(a).

With respect to AFI's indemnity obligations to officers and directors of entities other than AFI itself, the *Amended and Restated Certificate of Incorporation of Ally Financial, Inc.* (the "AFI Charter"), the most recent publicly available version of which is annexed to the Etkin Declaration as Exhibit 6,[14] provides as follows:

> To the fullest extent permitted by the [General Corporation Law of the State of Delaware] or applicable Law, and to the extent of its assets legally available for this purpose, the Corporation [(AFI)] shall indemnify and hold harmless each person who was or is made a party or is threatened to be made a party to or is involved in or participates as a witness with respect to any action, suit or proceeding, whether civil, criminal, administrative or investigative (each a "Proceeding"), **by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was a director or an officer, or is or was serving at the request of the Corporation as a manager, director, officer, employee,**

[14] The most recent version of the AFI Charter readily available from SEC filings is annexed as Exhibit 3.1 to AFI's Form 8-K filed with the SEC on March 25, 2011. In its *Amendment No. 6 to Form S-1* ("Form S-1/A") filed with the SEC on April 12, 2012, AFI references the AFI Charter as Exhibit 3.1. A footnote to the reference indicates that the exhibit is "To be filed by amendment." (Form S-1/A at II-3, II-8.) However, the AFI Charter provides that any amendment to the indemnification provisions in Article VIII thereof "shall be prospective only, and shall not adversely affect any limitation on the personal liability, any indemnification right or any insurance coverage of a director of the Corporation existing at the time of such repeal or modification." (AFI Charter at Art. VII.A.4.)

> **fiduciary or agent of another entity** (collectively, the "Indemnified Persons") from and against any and all loss, cost, damage, fine, expense (including reasonable fees and expenses of attorneys and other advisors and any court costs incurred by any Indemnified Person) or liability actually and reasonably incurred by the person in connection with the Proceeding, if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the Corporation and except that no indemnification shall be made in respect of any claim, issue, or matter as to which such person has been adjudged to be liable to the Corporation, unless, and only to the extent that, the Court of Chancery of the State of Delaware or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper. The termination of any Proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith or in a manner such person reasonably believed to be in or not opposed to the best interests of the Corporation.

(AFI Charter at Art. VIII.D) (emphasis added). The AFI Charter further requires AFI to advance expenses, including defense costs, to Indemnified Persons, and to maintain insurance[15] covering both (a) AFI, for losses as to which AFI indemnifies the Indemnified Persons and (b) Indemnified Persons, for losses as to which AFI cannot indemnify. (Id. at Art. VIII.E, H.) Accordingly, the Former D&O Class Action Defendants appear to be entitled to advancement of defense costs and indemnity from losses from AFI and its insurance policies independent of any coverage maintained by the Debtors.

Despite AFI's clear obligation to indemnify the Debtors' former directors and officers named as defendants in the Class Action and maintain insurance for their benefit, the Motion and the various declarations in support thereof neither (a) mention AFI's indemnification obligations

[15] As of March 25, 2011 (the date the AFI Charter was filed with the Secretary of State of the State of Delaware), had obtained and fully paid the premium for a six-year, $105 million tail policy covering the former managers of GMAC LLC, AFI's predecessor entity. (Id. at Art. VIII.I.) It is unclear from the AFI Charter whether this policy covers all Indemnified Persons.

to the Debtors' current or former directors or officers nor (b) include copies of the AFI Charter or any of AFI's other insurance policies applicable to such obligations. The existence of these broad indemnity obligations on the part of the highly solvent[16] non-Debtor, AFI—as well as the requirement in the AFI Charter that AFI maintain insurance coverage for both AFI and the individuals AFI is required to indemnify for both losses and expenses—belies the Debtors' conclusory assertion that a risk of depletion of the Debtors' insurance exists here at all.

b. The E&O Policy itself, let alone the proceeds of that policy, does not appear to be the Debtors' property.

The sole piece of evidence that the Debtors have presented in support of the assertion that the Class Action impacts property of the estate is the E&O Policy, a single line of coverage applicable to just one of the several years relevant to the Class Action with a $25,000,000 retention or deductible. By the Debtors' own admission, other coverage is available, including excess liability policies, see Motion at 17, but the Debtors have neither provided copies of those policies, see, n. 10, supra, nor explained what types of coverage they or any other available insurance policies offer. Absent such information, it is impossible to ascertain whether the E&O Policy is actually representative of *all* potentially applicable insurance coverage. At a minimum, it appears that AFI owns the E&O Policy (not the proceeds) and, as discussed above, owes broad indemnification obligations to and maintains insurance coverage for the benefit of the Non-Debtor Defendants. The Court should not grant the extraordinary relief sought by the Debtors in the absence of a full analysis of all available insurance coverage.

One can only surmise that there was a tactical or strategic reason lurking behind the Debtors' choice to provide the Court and the defendants in the Adversary Proceeding only the

[16] AFI had $13.1 billion of cash and cash equivalents and $19.7 billion of total equity as of March 31, 2012. See SEC Form 10-Q of AFI for the quarterly period ended March 31, 2012 at 5.

E&O Policy. Moreover, the Debtors state that only "Ally Financial has tendered certain of the MBS Actions to the insurers for coverage under the E&O insurance policies . . ." Motion at 17. The Debtors do not identify which MBS Actions and the obvious implication is that the other Non-Debtor Defendants have not tendered any of the MBS Actions to the E&O insurance carriers. Indeed, AFI is not even a defendant in the Class Action.

Also worthy of note is the Debtors' argument regarding the potential creation of indemnification claims as a basis for the extraordinary injunctive relief they are requesting which indemnification claims would not exist at all to the extent any of the Non-Debtor Defendants are covered by insurance. Thus, the estate benefits from the use of insurance to defend the Non-Debtor Defendants in the MBS Actions by eliminating potential indemnification claims. Pursuant to the ResCap LLC Agreement, the Debtor Residential Capital, LLC is even obligated to ". . . take all necessary or desirable action to cause such insurers to pay, on behalf of the Covered Persons, all amounts payable as a result of such proceeding in accordance with the terms of such policy." See Section 18(f)(i) of the ResCap LLC Agreement. Thus, by attempting, through the Motion, to create a priority for themselves to the proceeds of at least one insurance policy to the exclusion of the other insureds, which priority does not contractually exist, the Debtors are both inventing a superior property right and at the same time violating their obligations under the ResCap LLC Agreement.

Finally, Debtors' entire argument as it relates to the E&O Policy is a red herring because coverage for securities claims does not even appear to exist under the terms of that policy. The E&O Policy only covers Wrongful Acts, as defined therein, committed by an Insured while performing Professional Services. A review of the definition of Professional Services reveals

that the E&O Policy will not apply to securities claims. Moreover, the E&O Policy contains multiple exclusions that also appear to bar coverage for securities claims.

Generally, while an insurance policy may be deemed property of a debtor's estate, whether or not the proceeds are depends upon the coverage under the policy. In re Louisiana World Exposition, Inc., 832 F.2d 1391, 1399 (5th Cir. 1987). The Louisiana World court held that the proceeds of the policy were not property of the estate. In that case, the policies provided both liability coverage for the directors and officers and separately provided for indemnification coverage. "Each policy . . . provided a single total amount of coverage which was applicable to both the indemnification and the liability protections jointly, so that payment under either reduced the amount of coverage remaining available under both." Id. at 1398. This type of coverage is normal for directors and officers and is purchased as "an inducement and a type of compensation." Id.

> [I]n undertaking a property of the estate analysis under § 541 of the Bankruptcy Code, several courts have made a distinction between insurance policies owned by a debtor, and the proceeds payable under the policies. See In re Goodenow, 157 B.R. 724, 725 (Bankr. D. Me. 1993). Specifically, where the debtor owns the policies but has no interest in the proceeds, the proceeds are not property of the estate. See In the Matter of Edgeworth, 993 F.2d 51, 56 (5th Cir. 1993). ("When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate."); In re First Central Financial Corp., 238 B.R. 9, 16 (Bankr. E.D.N.Y. 1999) (discussing the goal of a D&O insurance policy as the "protection of individual directors and officers.") … the fact that [the debtor] obtained and owns the Policies here is not determinative. Instead, the court must focus on who has the rights against the Proceeds.

In re CHS Electronics, Inc., 261 B.R. 538, 541-42 (Bankr. S.D. Fla. 2001).[17]

[17] The coverage under the CHS policies extended only to the exposure of the officers and directors and was payable only for that purpose. The directors and officers held the property interest, not the estate. Rather than grant a property interest in the proceeds of the policies, the CHS court allowed payment of claims under the policy to reduce coverage provided to the debtor.

If the officers and directors own a portion of the proceeds, "that portion cannot be deemed property of the Estate; and perforce there can be no justification for shielding such portion under the bankruptcy court's injunctive orders, the reach of which extends only to property of the Estate." In re Vitek, Inc., 51 F.3d 530, 536 (5th Cir. 1995).

As the Court stated in In re Granite Partners, L.P., 194 B.R. 318, 337-338 (Bankr. S.D.N.Y. 1996):

> The issuance of the injunction involves consideration of many factors. These include whether the suits threaten the debtor's insurance coverage or increase the debtor's indemnification liability, as well as the other factors the two courts discussed. **This implies that the mere threat to the policy does not implicate the automatic stay, and that the Court should not extend the automatic stay if that is the only "injury" that the debtor can show. In this regard, the debtor's insurance policy is property of the estate as is its contractual right to indemnification coverage under the policy. The directors' and officers' contractual right to liability coverage, however, is not. We are not convinced that an action by a third party to recover a judgment against another third party, whose liability may be covered under an insurance policy that also grants the debtor separate rights, implicates the automatic stay.**
>
> * * *
>
> **Directors and officers contemplating a corporate bankruptcy could insulate themselves from most post-bankruptcy lawsuits -- if they had not already done so -- simply by purchasing the precise type of insurance designed to protect them in the event of such a lawsuit. This is not the kind of "insurance" the policy is designed to afford.**

(Emphasis added.)

After a detailed analysis of the varying case law among the circuits, the District Court for the Southern District of New York held that proceeds of a directors and officers liability policy were not property of a debtor's estate because "no recognizable equitable and legal interest in the proceeds from the D&O policy has arisen . . . Without legal and equitable interest in the proceeds, [the debtor's] estate cannot be ascribed to hold a property interest in those proceeds."

In re Adelphia Communications, 298 B.R. 49, 53-54 (S.D.N.Y. 2003). The court's rationale was based upon the fact that despite the presence of entity coverage under the D&O Policy, the debtor had made no payments on account of indemnification claims by the individual insureds and therefore had no claim to the proceeds. Id., at 53. As a result, the debtor in Adelphia Communications had no interest in the proceeds and the proceeds were not property of the estate. Similarly, here, the Debtors have not demonstrated any viable interest in the proceeds of any policy sufficient to bring the proceeds within the property of the estate. Indeed, the Debtors have not even produced all of their relevant insurance policies to determine the extent of any coverage, and coverage under the E&O Policy provided is murky at best.

II. THERE IS NO BASIS FOR AN INJUNCTION UNDER SECTION 105 BARRING PROSECUTION OF THE CLASS ACTION AGAINST THE NON-DEBTOR DEFENDANTS.

To obtain injunctive relief under section 105(a) of the Bankruptcy Code, a chapter 11 debtor must demonstrate (1) a reasonable likelihood of a successful reorganization, (2) the risk of imminent, irreparable harm to its estate or ability to reorganize, (3) that the threatened injury to the debtor absent the injunction outweighs the threatened harm an injunction might cause the party to be enjoined, and (4) that the granting of the injunction will not disserve the public interest. In re United Health Care Org., 210 B.R. 228, 233 (S.D.N.Y. 1997); see also In re Zale Corp., 62 F.3d 746, 765 (5th Cir. 1995) (ordinary standard for a preliminary injunction applies to injunctions under section 105); In re Commonwealth Oil Refining Co., 805 F.2d 1175, 1188-89 (5th Cir. 1986).

The requirements of an injunction are "conjunctive and all of them must be established in order to obtain the relief sought." In re Provincetown Boston Airline, 52 B.R. 620, 625 (Bankr. M.D. Fla. 1985). "'Injunctive relief is an extraordinary and drastic remedy, not to be granted routinely, but only when the movant, by a clear showing carries the burden of persuasion.'" In re

Continental Air Lines, Inc., 61 B.R. 758, 782 (S.D. Tex. 1986) (citation omitted). "The 'movant must make out a clear showing of hardship and adverse impact on the reorganization case if there is even a fair possibility that the stay will prejudice an adverse party.'" Id. at 781 (citation omitted). The movant must establish that the damage it will suffer if the injunction is denied "'plainly outweighs any foreseeable harm to the [non-movant].'" Johns-Manville, 26 B.R at 415 (citation omitted). See Sabratek Corp v. LaSalle Bank, N.S. (In re Sabratek Corp.), 257 B.R. 732 (Bankr. D. Del. 2000), where the court declined to enjoin a state court matter between non-debtor parties, which did not involve property of the estate, because there was no showing of irreparable harm.

Some courts have determined that an even more stringent standard should govern when a debtor seeks to enjoin an action against executive officers in a securities class action context, as is the case here. Indeed, the current climate of rampant executive malfeasance and corporate fraud mandates such a stringent standard. In Duval, supra, the court reasoned:

> Unlike a products liability action in which a suit against an officer is effectively one against the corporation itself, the present securities action seeks to attach liability for the specific fraudulent acts of named individuals. **Thus the securities laws allow for the independent liability of the officers or other parties involved, and proceedings like the present may go forward without the participation of the corporation.** To hold otherwise would allow the Bankruptcy Act to create a sizable loophole through which malfeasant corporate officers and directors and their insurers could escape, at least temporarily, all civil prosecutions of their individual fraudulent acts by having the corporation file a bankruptcy petition. **We cannot agree that the protections afforded by the Bankruptcy Act were intended to be so all encompassing as to shield such non-debtor third parties.**

Duval, 1990 WL 261364 at *4 (emphasis added); see also GATX Aircraft Corp. v. M/V Courtney Leigh, 768 F.2d 711, 716 (5th Cir. 1985); Williford v. Armstrong World Indus., Inc.,

715 F.2d 124, 128 (4th Cir. 1983); Morgan v. Kobrin Sec. Inc., 649 F. Supp. 1023, 1032 (N.D. Ill. 1986).

Under relevant case law in this District, the Debtors have not satisfied—and cannot satisfy—the requirements for a Section 105 injunction, and the Motion must be denied.

1. The Debtors Have Not Demonstrated a Reasonable Likelihood of a Successful Reorganization.

The Debtors intend for the Bankruptcy Cases to proceed on an extremely expedited timetable. See Whitlinger Declaration at ¶ 6 (noting that the Debtors intend to confirm a chapter 11 plan by the end of the year). However, the chapter 11 plan that the Debtors and AFI envision would apparently include sweeping third-party releases and injunctions, absolving the Non-Debtor Defendants and others of liability for their own conduct without the consent of parties in interest such as Lead Plaintiff and the Putative Class (which consent will not be given) and without requiring them to provide any consideration at all—much less the "substantial contribution" that is one of several prerequisites to Court approval of third-party releases. See, e.g. In re Metromedia Fiber Network, Inc., 416 F.3d 136 (2d Cir. 2005). The Debtors and AFI cannot circumvent this requirement simply by conditioning the plan proposed in the AFI PSA on the inclusion of third-party releases. See In re Adelphia Commc'ns Corp., 368 B.R. 140, 269 (Bankr. S.D.N.Y. 2007). While the Debtors may ultimately develop a plan structure whereby the Non-Debtor Defendants provide some benefit to the estate, the plan envisioned in the AFI PSA is likely not confirmable, and creates a severe risk of derailing the Debtors' reorganization.

2. There Is No Imminent and Irreparable Harm to the Debtors Sufficient To Justify the Unusual Remedy of a Third-Party Stay.

The Debtors have failed to meet their heavy burden of showing imminent and irreparable harm. Irreparable harm in the context of a reorganization is shown where the failure to enjoin the actions "would embarrass, burden, delay or otherwise impede the reorganization." Alert

Holdings, Inc. v. Interstate Protective Servs., Inc., 148 B.R. 194, 200 (Bankr. S.D.N.Y. 1992); In re Continental Airlines, 177 B.R. 475, 481 n.6 (D. Del. 1993) (the debtor must show that the Securities Litigation "'would so consume the time, energy and resources of the debtor that it would substantially hinder the debtor's reorganization effort'"). Strict proof, not conclusory allegations are needed to sustain this burden. Dore & Assocs. Contracting, Inc. v. American Druggists' Ins. Co., 54 B.R. 353, 358 (Bankr. W.D. Wis. 1985) ("Speculative and conclusory allegations are clearly insufficient."); In re Phar-Mor, Inc. Sec. Litig., 166 B.R. 57, 62-63 (W.D. Pa. 1994) (in denying a request for an injunction under section 105 of the Bankruptcy Code, the court found the allegation that pursuit of an action against debtors' auditor would delay the reorganization was "mere speculation [that did] not constitute the type of proof required to entitle the Debtors to an injunction").

Here, Debtors have provided this Court with absolutely no evidence of imminent irreparable harm, the *sine qua non* for the issuance of the extraordinary injunctive relief that the Debtors seek for the benefit of the Non-Debtor Defendants. There is no threat to the reorganization process by the continuation of the Class Action. Indeed, the Debtors only allege some anticipated or speculative harm that may occur in the future. The declarations submitted by the Debtors to attempt to substantiate the alleged distraction of their employees (not defendants in the Class Action) from the reorganization process fall well short.

The two leading cases extending the stay under section 105 of the Bankruptcy Code to non-debtor co-defendants are easily and fundamentally distinguishable from the instant case. In both A.H. Robins v. Piccinin, 788 F.2d 994 (4th Cir. 1986), *cert. denied*, 479 U.S. 876, 107 S. Ct. 251, 93 L. Ed. 2d 177 (1986), and Matter of Johns-Manville (Johns-Manville v. Asbestos Litig. Group), 26 B.R. 420 (Bankr. S.D.N.Y. 1983), aff'd, 40 B.R. 219 (S.D.N.Y. 1984), rev'd in

part on other grounds, 41 B.R. 926 (S.D.N.Y. 1984), the non-debtor co-defendants were faced with truly "unusual circumstances." Both cases involved thousands of tort actions pending against non-debtor co-defendants which were derivative of the claims against the Debtors and with whom the debtors would be held jointly and severally liable. See A.H. Robins, 788 F.2d at 994; Johns-Manville, 26 B.R. at 422. The time and effort needed to defend such a massive number of suits and the obvious drain on the estate's assets provided the justification for the court's extension of the stay. These "unusual circumstances," A.H. Robins, 788 F.2d at 999, are "'the [s]omething more than the mere fact that one of the parties to the lawsuits has filed a Chapter 11 bankruptcy petition [that] must be shown in order that proceedings be stayed against non-bankrupt parties.'" Matter of Johns-Manville (GAF Corp. v. Johns-Manville), 26 B.R. 405, 410 (Bankr. S.D.N.Y. 1983), citing Royal Truck & Trailer v. Armadora Maritima Salvadoreana, 10 B.R. 488, 491 (N.D. Ill. 1981).

Likewise, the imagined distraction to the Debtors' current employees is no more than another red herring as explained below. Indeed, in the Northwest Airlines Chapter 11 proceeding, Judge Gropper denied the debtors' motion to enjoin both securities and ERISA class action litigation. In rendering his decision, Judge Gropper recognized that the subject class actions were typical of those filed against the directors and officers of a corporate debtor. See Transcript of March 7, 2006 hearing (the "Northwest Tr."), at 65, lines 5 to 10 (a copy of the transcript reflecting Judge Gropper's decision is annexed to the Etkin Declaration as Exhibit 7). In responding to the debtors' argument that their officers and directors will be distracted by the securities and ERISA litigation, Judge Gropper correctly determined that the record before the Court "does not justify a blanket injunction." Northwest Tr. at 66:18–25. Acknowledging that some cases have extended the automatic stay to non-debtors but only when the debtor therein has

shown "true irreparable injury and a balance of the harm that demonstrates an immediate need for relief," Judge Gropper concluded that such "relief has not been routinely granted in routine class actions, and the law should not be so extended." Id. at 67:21–68:9 (citations omitted). Clearly, Judge Gropper's reasoning is persuasive here. Indeed, Judge Gropper noted that if such relief were appropriate in a case like Northwest, it would then be appropriate in any corporate Chapter 11 proceeding where officers and directors of a debtor are being sued. In rejecting the extension of the stay in Northwest, Judge Gropper stated:

> if I stay their action, I think the result would be that any class action brought against any large company in bankruptcy would be stayed.

Northwest Tr. At 35:3–6.

At the initial case conference regarding the Adversary Proceeding, the Court reminded the parties that the Court had previously dealt with a request for a section 105 injunction to enjoin non-debtor litigation in In re 1031 Tax Group, LLC, 397 B.R. 670 (Bankr. S.D.N.Y. 2008) ("1031 Tax"). The Debtors also appear to rely on 1031 Tax as supporting the grant of a preliminary injunction enjoining the MBS Litigation pending confirmation of a Chapter 11 plan. However, the facts and circumstances that led this Court to grant the relief in 1031 Tax are markedly different than the facts and circumstances before the Court with respect to this Motion.

First, the Trustee in 1031 Tax sought a preliminary injunction because the subject non-debtor litigation ". . . threaten[s] to undermine two settlement agreements the Trustee has negotiated with certain of the Debtors' former employees and also with several of its errors and omissions insurers." Id. at 673–74. The Court also pointed out that "the Trustee asserts that he is currently seeking to reach other similar settlement agreements and those efforts will also be adversely affected by the Colorado cases [the cases that were the subject of the stay]." Id. at

674. Therefore, in 1031 Tax, the Trustee and the plaintiffs in the Coloardo cases had competing claims against common defendants. No such circumstances exist here. The extraordinary injunctive relief sought by the Debtors does not involve any potential impact on claims asserted by the Debtors against third parties or litigation with any insurance carrier with respect to such claims which would lead to recoveries to the Debtors' estates through insurance payments or otherwise. The only Bankruptcy Rule 9019 settlement on the horizon in the Bankruptcy Cases involves the representation and warranty claims against the Debtors, and that settlement specifically carves out claims based upon violations of federal or state securities laws.

Second, one of the issues that formed the basis for the issuance of a preliminary injunction in 1031 Tax was the Trustee's claim that some or all of the causes of action asserted by the plaintiffs in the Colorado cases were derivative claims that belonged to the estate which implicated section 362(a)(3) of the Bankruptcy Code. Id. at 681–82. The Court in fact determined that certain of the causes of action were property of the estate. Id. at 682. No such issue exists here and the Debtors are not even maintaining that any of the claims asserted in the Class Action are property of the estate.

Third, the Court's granting of a 90-day section 105 injunction in 1031 Tax was premised on the Court's determination that the settlements and potential settlements negotiated and to be negotiated by the Trustee for the benefit of all creditors should be considered pursuant to Bankruptcy Rule 9019 without interference from the Colorado cases in the short term. The Court further determined that the Colorado cases could impair its jurisdiction. Id. at 684. None of those considerations exist here.

Fourth, the insurance issues confronting the Court in 1031 Tax involved the Trustee's affirmative claims against former insiders, which were to be satisfied, at least in part, by the

payment of insurance proceeds to the estate as a claimant, not an insured. That payment, the Court reasoned, could be diminished by the continued prosecution of the Colorado cases. The Court also referenced the insurers' motion to lift the stay to rescind the subject policies and the risk that allowing the Colorado cases to continue could aid the insurers' rescission claim. Id. at 685. Again, no such circumstances are present here.

Fifth, in 1031 Tax, the Trustee conceded that collateral estoppel and res judicata did not present a risk to the Debtors because the Debtors were not parties to the Colorado cases. Id. at 685. The Debtors here nevertheless press that argument, with no basis. The Court in 1031 Tax did reference the risk of respondent superior liability, id., but no such claim is or was made in the Class Action.

While the Court did consider the risk of liability for indemnification claims as a factor in granting the section 105 injunction in 1031 Tax, Lead Plaintiff submits that a risk of indemnification alone is insufficient to support such extraordinary relief. See Reliance Acceptance Group, 235 B.R. at 558. In addition, there is little, if any, risk of indemnification claims under the facts of the Bankruptcy Cases in any event. See supra, pp. 19–23. Therefore, 1031 Tax is of no help to the Debtors given the stark factual distinctions as discussed above.

3. A Third-Party Stay Would Cause Far Greater Harm to the Lead Plaintiff and the Putative Class Than the Debtors Would Suffer Without a Third-Party Stay.

It is axiomatic that justice delayed is justice denied. Accordingly, a debtor seeking a stay of proceedings between third parties "bears the burden of justifying a delay tagged to another legal proceeding." Wedgeworth v. Fibreboard Corp., 706 F.2d 541, 542 (5th Cir. 1983). The Class Action has been ongoing for over three years and significant document production involving the Debtors has already taken place. All of the Former D&O Class Action Defendants have since left the Debtors' employ. To the extent that it becomes necessary to obtain further

document discovery from the Debtors, the likelihood of any burden such document discovery may arguably cause will diminish significantly once the Debtors conclude the sale of their businesses and wind-down their estate. On the other hand, as discussed above, the continuation of the Class Action against the Non-Debtor Defendants will cause no actual harm to the Debtors where merits discovery is not likely even to continue before the conclusion of the Bankruptcy Cases. Accordingly, the balance of harms weighs heavily against imposing a Third-Party Stay.

4. The Third-Party Stay Is Inimical to the Public Interest.

A debtor seeking to enjoin litigation against non-debtor entities must demonstrate that the requested injunction is not adverse to the public interest. In re Costa & Head Land Co., 68 B.R. 296, 303–04 (N.D. Ala. 1986). Facilitating a successful reorganization is one factor courts consider, but not, as the Debtors posit, the *sole* public interest at issue. Rather, determining whether an injunction serves the public interest requires balancing the public interest in a successful bankruptcy reorganization with other competing societal interests. In re Fowler Floor & Wall Covering Co., 93 B.R. 55, 58 (Bankr. M.D. Pa. 1988).

> The words "public interest" are defined in *Black's Law Dictionary* as "something in which the public, the community at large, has some pecuniary interest, or some interest by which *their legal rights or liabilities are affected*."

Costa & Head, 68 B.R. at 303 (emphasis in original).

Here, the public interest implicated by the Third-Party Stay is simple: the integrity of the capital markets and the public trust and investor confidence that result from maintaining that integrity. In the midst of an extended recession caused, many commentators claim, by the very activities underlying the Class Action, the issuance of a Third-Party Stay paving the road to broad permanent third-party releases and injunctions would risk violating the very fabric of market integrity, effectively nullifying the safeguards of federal and state securities regulations

for the exclusive benefit of the Debtors' parent, AFI. Extending the benefits of the Bankruptcy Code to parties who did not submit themselves to the procedural and substantive strictures appurtenant to being a chapter 11 debtor-in-possession "is simply to invite a wholesale restructuring of the expectations of those involved in commercial transactions without any indication from Congress that such a profound change was intended." Robbins v. The Chase Manhattan Bank, N.A., 1994 U.S. Dist. LEXIS 5100 at *19–*20 (W.D. Va. 1994), quoting In re Venture Properties, Inc., 37 B.R. 175, 177 (Bankr. D.N.H. 1984).

The Third-Party Stay sought by the Debtors in these Bankruptcy Cases is not designed to afford the Debtors a temporary reprieve from the burdens and distraction of litigation against related parties during the course of the Debtors' reorganization. Rather, the Third-Party Stay is intended only as a bridge, putting the Class Action on hold to enable the Debtors to propose a liquidating chapter 11 plan that forever absolves the Non-Debtor Defendants of liability in the Class Action (and presumably to give the Debtors additional leverage in soliciting acceptances of that plan). See AFI PSA at § 3.1(d)(ii). The proposed plan releases and injunctions, for which the Third-Party Stay is merely an intermediate step, are designed to shield AFI—not a Debtor—from its indemnification obligations to the Debtors' current and former directors and officers, and to shield AFI's affiliate, Ally Securities, from liability for its own actions as an underwriter. Compare AFI PSA at § 2.2(a) (reaffirming AFI's indemnity obligations to the Debtors' current and former directors and officers) with AFI PSA at §3.1(d)(ii) (seeking broad third-party releases and injunctions to protect, among others, the Debtors' officers and directors).

The Bankruptcy Code was never intended to be used as a shield behind which officers and directors of a chapter 11 debtor or its non-debtor parent and affiliates could hide their violations of the federal securities laws. See In re Chateaugay Corp., 76 B.R. 945, 948-49

(S.D.N.Y. 1987). The prompt resolution of civil suits involving allegations of securities law violations directed toward directors and officers of companies involved in the issuance of securities is in the public interest, more today than ever, and even more so in the context of mortgage-backed securities.

The United States Supreme Court has long held that there is a public interest in the integrity of the securities markets. Basic Inc. v. Levinson, 485 U.S. 224, 230 (1988). The Second Circuit has acknowledged that class actions on behalf of investors of a debtor are "vigorously litigated" outside of the bankruptcy court. See Hirsch v. Arthur Andersen & Co., 72 F.3d 1085, 1093-95 (2d Cir. 1995) (holding that claims for fraud and negligence in connection with the purchase of securities can only be prosecuted by the investors, not by the bankruptcy trustee); see also Teledyne Indus., Inc. v. Eon Corp., 401 F. Supp. 729, 734–36 (S.D.N.Y. 1975), aff'd sub nom Teledyne Indus., Inc. v. Podell, 546 F.2d 495 (2d Cir. 1976). Thus, securities law actions on behalf of investors routinely proceed against non-debtors even where a related entity is a debtor in bankruptcy.

Multiple successful corporate reorganizations have coexisted with major securities class actions against the respective debtors' officers, directors, accountants, and underwriters without any stay or injunction of the ongoing private actions, and without undue inconvenience to, or burden on, the debtor. See, e.g., In re Equity Funding Corp. of Am. Sec. Lit., 438 F. Supp. 1303 (C.D. Cal. 1977) ($962 million recovery); In re King Resource Co. Sec. Lit., 420 F. Supp. 610 (D.C. Colo. 1976) ($13 million recovery); In re Penn Cent. Sec. Litig., 347 F. Supp. 1327 (E.D. Pa. 1972), aff'd, 494 F.2d 528 (3d Cir. 1974). In addition, in In re Am. Cont'l Corp./Lincoln Savings & Loan Sec. Lit., MDL 834 (D. Ariz.), which involved a liquidating chapter 11 plan, the lead plaintiffs received over $275 million in recoverables and $3 billion in verdicts.

Securities litigation involving the debtors in In re Enron Corporation, In re WorldCom, Inc., In re Delphi Corporation, In re Washington Mutual Inc., In re Lehman Brothers Holdings, Inc., and In re New Century TRS Holdings, Inc., some of the largest and most complicated chapter 11 bankruptcy proceedings in the history of American jurisprudence, continued despite the debtors' bankruptcy proceedings. The debtors in each of those cases filed and confirmed plans of reorganization or liquidation in the face of active securities litigation. Imposition of a Third-Party Stay would not only ignore these lessons of past experience, but would set a very unfortunate and dangerous precedent for the future. See In re WorldCom, Inc., 298 B.R. 308 (S.D.N.Y. 2003) (permitting securities litigation to continue against non-debtor defendants); see also In re Northwest Airlines Corp., Adv. No. 06-01219 (ALG) (Bankr. S.D.N.Y. Apr. 27, 2006) (order denying to extend automatic stay or enjoin securities and ERISA litigation against non-debtor defendants in complex airline bankruptcy).

Following the Debtors' reasoning in the Motion to its conclusion, *all* securities actions against non-debtor affiliates and former officers and directors of chapter 11 debtors should be automatically enjoined. See Northwest Tr. At 35:3–6. If such expansive protection for non-debtors was intended under the bankruptcy laws, Congress would have expressly provided such protection in the Code. However, chapter 11 affords no such protection to non-debtors. Such a blanket injunction risks further destroying the integrity of and investor confidence in the securities markets, particularly in connection with mortgage backed securities that lie at the core of the current economic crisis.

Quite simply, the Third-Party Stay is inimical to the public interest, and sound public policy requires that the Motion be denied.

CONCLUSION

WHEREFORE, the Lead Plaintiff respectfully requests that the Court deny the Motion and grant the Lead Plaintiff such other and further relief as the Court deems just and appropriate.

Dated: June 28, 2012
New York, New York

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