Docket #0047 Date Filed: 6/28/2012

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: RESIDENTIAL CAPITAL, LLC, *et al*., Debtors.	Case No. 12-12020 (MG) Chapter 11 Jointly Administered
RESIDENTIAL CAPITAL, LLC, *et al*., Plaintiffs, v. ALLSTATE INS. CO., THE OTHER PARTIES LISTED ON EXHIBIT A TO THE COMPLAINT, JOHN DOES 1-1000, Defendants.	Adv. Case No. 12-01671 (MG)

DEFENDANT FEDERAL HOUSING FINANCE AGENCY'S MEMORANDUM OF LAW (I) IN SUPPORT OF FHFA'S MOTION TO DISMISS THE COMPLAINT FOR LACK OF JURISDICTION AND (II) IN OPPOSITION TO DEBTORS' MOTION TO EXTEND AUTOMATIC STAY AND TO ENJOIN LITIGATION AGAINST NON-DEBTORS

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Defendant Federal Housing Finance Agency ("FHFA" or "Conservator"), as Conservator for the Federal Home Loan Mortgage Corporation ("Freddie Mac"), by and through its counsel, respectfully submits this memorandum of law (1) in support of dismissal of the complaint in the Adversary Proceeding (the "Complaint") and (2) in opposition to the *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 "Debtor's Motion") filed by the above-captioned debtors (the "Debtors"), as plaintiffs in this adversary proceeding (the "Adversary Proceeding") commenced in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court").[1][2]

PRELIMINARY STATEMENT[3]

Through this action, the Debtors seek to enjoin third-party claims against their solvent affiliates including Ally Financial, the Debtors' indirect parent, and then to discharge them through a plan of liquidation. The Motion should be denied – and this case should be dismissed -- because the Debtors cannot obtain this relief against FHFA as a matter of law.

Congress enacted the Housing and Economic Recovery Act of 2008 ("HERA"), which established FHFA and gave the agency extensive authority over the government-sponsored entities ("GSEs"), Freddie Mac and Fannie Mae. FHFA has the responsibility to ensure the safety and soundness of the GSEs to protect the U.S. housing market. Congress accorded FHFA broad powers to fulfill its statutory mandate by permitting the Director to appoint FHFA as

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1 The FHFA files herewith the declaration of *Kanchana Wangkeo Leung* (the "Leung Declaration"), which is cited herein as "Leung Decl."

2 Nothing herein shall constitute a waiver of FHFA's right to contest the jurisdiction of this Court to grant the relief requested in the Motion against FHFA.

3 Capitalized terms not defined in the Preliminary Statement have the meanings ascribed to them *infra*.

Conservator of the GSEs with the authority to conserve and preserve assets, including by commencing lawsuits on behalf of Freddie Mac and Fannie Mae. Importantly, to ensure that the Conservator can exercise its powers free from interference, HERA (identical to a provision in FIRREA governing the FDIC) precludes any court from enjoining the actions of FHFA that would impede FHFA from fulfilling its statutory mandate as conservator. *See* 12 U.S.C. § 4617(f). Courts consistently have interpreted this provision (and the FIRREA analog) as requiring courts to reject attempts to enjoin FHFA and the FDIC.

FHFA has commenced litigation now pending in the Southern District of New York against the Affiliate Defendants to recover substantial sums to Freddie Mac and Fannie Mae. This Adversary Proceeding -- by requesting an injunction against the FHFA Case and a declaratory judgment extending the automatic stay to the Affiliate Defendants -- seeks relief that this Court lacks authority to grant. Because the proposed injunction to stay the FHFA Case – along with the Debtors' proposed plan injunction -- violates Section 4617(f) of HERA, it cannot be granted against FHFA.

For this reason alone, FHFA should be dismissed with prejudice from this adversary proceeding and the proposed injunction against FHFA should be denied.

* * * *

Even assuming *arguendo* that the proposed injunction would not violate HERA, it should still be denied. The Debtors list a parade of horribles that will unfold if the Court does not grant the requested injunction. Viewed in proper context and stripped of the Debtors' hyperbole, none of these concerns withstands scrutiny.

The Debtors claim that they will be subject to res judicata and collateral estoppel if FHFA's litigation proceeds. But these doctrines only apply where, unlike here, the litigation at

issue will result in an adverse judgment during the period covering the injunction. The schedule ordered by Judge Denise L. Cote in FHFA's pending litigation -- discussed in two court conferences attended by counsel to the Debtors and the Affiliate Defendants -- makes clear that no adverse judgment could possibly be rendered against any defendant prior to 2014 at the earliest. Because the Debtors have advised this Court that they will exit Chapter 11 in 2012, there is no risk of any adverse judgment.

Even if the Court approves the proposed third-party releases in favor of the Affiliate Defendants, the Debtors and the affiliates still will be subject to discovery. The Debtors and the Affiliate Defendants cannot discharge their obligations to produce documents and witnesses through a plan, and they have critical documents and percipient witnesses needed for FHFA's claims against other parties. Thus, the purported "harm" that the Debtors seek to avoid – mere participation in discovery – will be "suffered" in any event (and thus is hardly irreparable). Under Judge Cote's schedule, no depositions will be conducted until 2013. Accordingly, there is no risk that the Debtors' key management will be distracted by depositions in the FHFA Case. The balance of the equities weighs decidedly in favor of FHFA. The discovery must be completed in any event, and FHFA would be severely prejudiced if it cannot comply with the schedule ordered by Judge Cote. Public policy overwhelmingly weighs in favor of allowing FHFA to carry out its crucial statutory duties, especially because doing so will not disrupt the Debtors' reorganization efforts.

The Debtors also cite the risk of depletion of their insurance policies and potential indemnification risk as justifications for the stay. Not only have the Debtors failed to prove that their insurance coverage even applies to the FHFA Case, but even if it did, the policy identified by the Debtors includes a $25 million retention for each loss. The Debtors have produced no

proof that the Affiliate Defendants have incurred this amount or that they will during the period covered by the proposed stay. The Debtors claim that they will have to indemnify the Affiliate Defendants for the FHFA Case, but there is no risk of any judgment during 2012, so there will be no judgment to indemnify.

For the foregoing reasons and those set forth below, the Court should deny Debtors' Motion and dismiss the Complaint as to FHFA.

FACTUAL BACKGROUND

A. The FHFA Amended Complaint.

On September 2, 2011, FHFA, in its capacity as conservator for Freddie Mac, commenced the action styled *Federal Housing Finance Agency, as Conservator for the Federal Home Loan Mortgage Corporation v. Ally Financial Inc. f/k/a GMAC, LLC et al.* in the Supreme Court of the State of New York, County of New York. The action was then removed to the United States District Court for the Southern District of New York (the "District Court") where it is pending before Judge Cote as Case No. 11- Civ. 7010 (the "FHFA Case"). (Leung Decl. ¶ 14.)

FHFA's amended complaint[4] in the FHFA Case (the "FHFA Amended Complaint") filed on June 13, 2012, names ten defendants (collectively, the "FHFA Litigation Defendants"), consisting of: (1) Ally Financial, Inc. f/k/a GMAC, LLC ("AFI"), GMAC Mortgage Group, Inc. ("GMACM") and Ally Securities, LLC f/k/a Residential Funding Securities, LLC d/b/a GMAC RFC Securities ("Ally Securities" and collectively with AFI and GMG, the "Affiliate Defendants") and (2) seven underwriters that are neither Debtors nor affiliates of the Debtors

[4] A copy of the FHFA Amended Complaint (without exhibits) is annexed to Leung Declaration as Exhibit A.

(collectively, the "Non-Affiliate Defendants"). The Debtors are not named in the FHFA Amended Complaint. (Leung Decl. ¶ 15.)

The FHFA Amended Complaint contains seven claims against the FHFA Litigation Defendants arising from false and misleading statements and omissions in the registration statements, prospectuses and other offering materials relating to $6 billion of residential mortgage-backed securities ("RMBS" or "Certificates") purchased by Freddie Mac from twenty-one securitization trusts between September 23, 2005 and May 30, 2007. The FHFA Amended Complaint alleges, among other things, that the documents related to the Certificates misrepresented that the underlying mortgage loans complied with certain underwriting guidelines and standards and presented a false picture of the characteristics and riskiness of those loans. The specific claims in the FHFA Amended Complaint are as follows:

	Named Defendants	Claim
First Claim For Relief	**Affiliate Defendants**: Ally Securities **Non-Affiliate Defendants**: JPMSI, Credit Suisse, RBS, Citi, Barclays, UBS and Goldman Sachs	Violation of section 11 of the Securities Act of 1933[5]
Second Claim For Relief	**Affiliate Defendants**: Ally Securities **Non-Affiliate Defendants**: JPMSI, Credit Suisse, RBS, Citi, Barclays, UBS and Goldman Sachs	Violation of section 12(a)(2) of the Securities Act of 1933[6]
Third Claim For Relief	**Affiliate Defendants**: GMACM, Ally Financial	Violation of section 15 of the Securities Act of 1933[7]

[5] Section 11 applies to statutorily defined parties if a person acquired a security which "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77(k).

[6] Section 12(a)(2) liability will apply to "any person who 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 light of the circumstances under which they were made, not misleading . . . ." 15 U.S.C. § 77(l).

Fourth Claim For Relief	**Affiliate Defendants**: Ally Securities **Non-Affiliate Defendants**: JPMSI, Credit Suisse, RBS, Citi, Barclays, UBS and Goldman Sachs	Primary Violations of Virginia Securities Act[8]
Fifth Claim For Relief	**Affiliate Defendants**: GMACM, Ally Financial	Controlling Person Liability Under Virginia Securities Act
Sixth Claim For Relief	**Affiliate Defendants**: Ally Securities **Non-Affiliate Defendants**: JPMSI, Credit Suisse, RBS, Citi, Barclays, UBS and Goldman Sachs	Common Law Fraud
Seventh Cause of Action	**Affiliate Defendants**: Ally Financial, GMACM	Aiding and Abetting Fraud

(Leung Decl. ¶ 16.)

The FHFA Amended Complaint seeks as against all FHFA Litigation Defendants, jointly and severally, an award of (1) rescission and recovery of the consideration paid for the RMBS Certificates, with interest, (2) Freddie Mac's monetary losses, (3) punitive damages, (4) attorney's fees and costs and (5) prejudgment interest. (Leung Decl. ¶ 17.)

Ally Securities is an SEC-registered broker-dealer that acted as an underwriter for eleven of the securitizations underlying the FHFA Amended Complaint; for five securitizations it was also the co-lead and selling underwriter. The FHFA Amended Complaint asserts five claims against Ally Securities for two violations of section 11 and section 12(a)(2) of the Securities Act

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[7] Section 15 liability, commonly referred to as control person liability, will apply to "every person who, by or through stock ownership, agency, or otherwise, or who pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under Section 11 of 12." 15 U.S.C. § 77(o).

[8] For the purposes of this opposition, Virginia Code Section 13.1-522(A)(ii) is equivalent to Section 11 and 12 liability while Section 13/1-522(C) is the equivalent of Section 15, control person liability.

of 1933, violations of the Virginia Securities Act, and common law fraud (collectively the "A/S Claims"). (Leung Decl. ¶ 18.)

The A/S Claims are asserted against Ally Securities because of its independent role as an underwriter for the Certificates. (Leung Decl. ¶ 19; s*ee e.g.* FHFA Amended Compl. ¶ 280 (First Claim For Relief) ("The Underwriter Defendants[9] acted as underwriters in connection with the sale of the Certificates for each of the 21 Securitizations . . ."); ¶ 290 (Second Claim for Relief) ("The Underwriter Defendants offered, promoted, and/or sold the Certificates publicly, including selling to Freddie Mac their Certificates . . ."); ¶ 317 (Fourth Claim For Relief) ("The Underwriter Defendants offered the Certificates publicly, including selling to Freddie Mac the Certificates . . ."); ¶ 344 (Sixth Claim For Relief) ("[T]he Fraud Defendants'[10] representations falsely and misleadingly misrepresented and omitted material statements of fact.").)

Debtor ResCap is wholly-owned by Non-Debtor GMACM, which in turn is wholly-owned by Non-Debtor Ally Financial. The FHFA Amended Complaint contains three claims against GMACM and Ally Financial.

Two claims allege control person liability against GMACM and Ally Financial under section 15 of the Securities Act of 1933 and the Virginia Securities Act (the "Control Person Causes of Action"). As to GMACM, those claims allege control person liability for the culpable conduct of the Debtors. As to Ally Financial, however, the control person claims also allege secondary liability for the culpable conduct of non-debtor Ally Securities. *See* FHFA Amended

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[9] The FHFA Amended Complaint provides that "Defendants Barclays, Citi, Credit Suisse, Goldman, JPMSI, RBS, and UBS are referred to together herein as the 'Non-Ally Defendants,' and together with Ally Securities as the 'Underwriter Defendants.'" (¶ 28.)

[10] The FHFA Amended Complaint defines "Fraud Defendants" as "Ally Securities, JPMSI and Goldman." (¶ 178.)

Compl. ¶¶ 309, 337. The third claim against GMACM and Ally Financial is for aiding and abetting fraud committed by Ally Securities, JPMSI and Goldman Sachs. (Leung Decl. ¶ 20.)

B. The District Court Proceedings.

The FHFA Case is one of sixteen similar securities actions brought by FHFA. All of these cases have been assigned to Judge Cote. In November 2011, to help coordinate the various cases and avoid unnecessary duplication, Judge Cote issued an Order staying discovery in all cases, but permitted the defendants in one focus case, *FHFA v. UBS Americas, Inc.*, to move for dismissal. Judge Cote indicated that once the UBS motion to dismiss was decided, the Court would lift the stay of discovery in all cases. However, Judge Cote permitted the defendants to make applications to the Court to maintain the stay in their particular cases. On May 4, 2012, Judge Cote granted in part and denied in part the motion to dismiss, leaving intact most of the claims against the UBS defendants. (Leung Decl. ¶ 21.)

Judge Cote held a scheduling a conference on May 14, 2012, at which the Court discussed coordinating litigation schedules for all of the cases. (*Id.*) The Debtors filed their Chapter 11 petition on the same day (the "Petition Date").During the May 14, 2012 conference, Judge Cote addressed the Debtors' bankruptcy filing, stating as follows:

> unless I hear a good reason otherwise, that obviously the automatic bankruptcy stay affects [the FHFA Case] insofar as it affects the parties *who have filed* for bankruptcy court protection, but that *the remainder of the case go forward*, including against the underwriter defendants.

(Leung Decl. Ex. B (Excerpt of Transcript of May 14, 2012 Hearing) at 14 (emphasis added).) Nobody in attendance – including counsel to the Debtors and Ally Financial -- objected or voiced any concerns with this approach.

On May 15, 2012, Judge Cote entered a scheduling order applicable to all sixteen actions specifically providing that the FHFA Case was stayed as to "any defendant that is subject to the 'automatic stay' codified in section 362 of the Bankruptcy Code, 11 U.S.C. § 362(a)." (Leung Decl. ¶ 22, Ex. C at 4.) The scheduling order further provided the following timeline for discovery in all actions, including the FHFA Case:

- Document discovery to be substantially completed by September 30, 2012;
- Depositions to begin in January 2013;
- Depositions to be coordinated so that each deponent is deposed once;

(*Id.* at 5.)

In a Pretrial Scheduling Order dated June 14, 2012, which was entered following a conference held on June 13, 2012, Judge Cote further specified the following dates and deadlines:

- Motions to dismiss the FHFA Case due by July 13, 2012, with oppositions due October 5, 2012 and replies due October 26, 2012;
- Document discovery to be substantially completed by September 30, 2012;
- Depositions to begin January 2, 2013;
- All fact and expert discovery to be completed by December 6, 2013;
- Summary judgment motions in the FHFA Case due by January 24, 2014, with oppositions due March 21, 2014 and replies due April 11, 2014;
- Trial in the FHFA Case would not begin before January 2015.

(Leung Decl. ¶ 23, Ex. D.)

C. <u>The Debtors' Proposed Plan Of Liquidation And Settlement.</u>

On the Petition Date, the Debtors disclosed that, subject to Court approval, they had negotiated and entered into three agreements. (*See* Affidavit of James Whitlinger [Ch. 11 Case

Docket No. 6] ¶ 7.) First, the Debtors entered into a stalking horse agreement with Nationstar Mortgage LLC for the sale of their mortgage loan origination and servicing businesses (the "Platform Sale APA"). Second, the Debtors had entered into a stalking horse agreement with Ally Financial for the sale of the Debtors' "legacy" portfolio consisting mainly of mortgage loans and other residual financial assets (the "Ally Legacy Sale APA"). Third, the Debtors had entered into a plan support agreement with Ally Financial and certain creditors (the "Plan Support Agreement").

The Plan Support Agreement outlines the anticipated terms for the Debtors' reorganization. (*Id.* Ex. 8.) It provides that (1) Ally Financial will contribute $750 million "to fund the settlement of pending and future claims and to secure the releases in favor of the Released Parties … including third party releases . . ." (*Id.* at § 2.1(a)) and (2) Ally Financial will serve as the stalking horse bidder pursuant to the Ally Legacy Sale APA (*id.* at § 2.1(b)).

In exchange, the Plan Support Agreement binds the Debtors to pursue a plan that contains terms dictated by Ally Financial. (*Id.* at § 3.1(b).) Among the onerous terms include a requirement that the Debtors seek confirmation of a plan that imposes sweeping non-consensual third-party releases on the Debtors' creditors (the "Proposed Third-Party Releases"). (*Id.* at § 3.1(d)(ii).) Those releases would run in favor of Ally Financial, "its [non-Debtor] direct and indirect subsidiaries and affiliates" (*id.* at preamble) and each of their "members, officers, directors, agents, financial advisors, attorneys, employees, partners, affiliates and representatives" (*id.* at § 1.2 (definition of "Released Parties").)

Notably, the Proposed Third-Party Releases do not carve-out fraud, willful misconduct or any other intentional torts. (*Id.* at 3.1(d)(ii).). To the contrary, the Proposed Third Party Releases expressly cover any and all claims "whether known or unknown, whether for tort,

fraud, contract, *violations of federal or state securities laws* . . . including those in any way related to residential mortgage backed securities issued and/or sold by the Debtors . . ." (*Id.*) (emphasis added.) The Third-Party Releases were obviously are designed specifically to relieve Ally Financial and other non-debtors from liability in the FHFA Case and other similar litigations.

The Plan Support Agreement contains certain milestone dates (the "Milestones") and provides that the Debtors' failure to comply with those dates terminate the Plan Support Agreement. (*See* Affidavit of James Whitlinger Ex. 8 at Ex. A.) Of particular relevance herein, the Milestones include: (1) "[o]n or before May 25, 2012, the Debtors shall have filed a motion, in form and substance satisfactory to AFI, to extend the automatic stay of section 362(a) of the Bankruptcy Code to AFI and certain of its affiliates," (2) "[o]n or before October 31, 2012, the Bankruptcy Court shall have entered the Confirmation Order, which such order will grant final approval of the Plan . . . in form and substance satisfactory to AFI," and (3) "*[o]n or before December 15, 2012, the effective date of the Plan shall have occurred*." (*Id.*) (emphasis added) Accordingly, the Debtors have committed to an expedited bankruptcy process with an emergence during 2012.

D. The Stay Motion.

On May 25, 2012 – as required by the Plan Support Agreement – the Debtors initiated this Adversary Proceeding by filing the Complaint and the Motion. The Complaint seeks two forms of relief. First, it asks the Court to issue a declaratory judgment extending the automatic stay in Sections 362(a)(1) and (a)(3) of the Bankruptcy Code, until the effective date of a plan, to litigations against the Affiliate Defendants, including FHFA's claims against Ally Financial, GMACM and Ally Securities in the FHFA Case. Second, the Complaint asks the Court to issue

an injunction pursuant to Section 105(a) of the Bankruptcy Code enjoining, until the effective date of a plan, FHFA's continuation of the FHFA Case as against the Ally Financial, GMACM and Ally Securities. The Motion requests the same forms of relief sought in the Complaint (i.e., an extension of the stay and a Section 105 injunction) through the effective date of a plan.

ARGUMENT

I.
THE COMPLAINT AGAINST FHFA SHOULD BE DISMISSED WITH PREJUDICE

A. The Applicable Standards Of Review.

In deciding a motion to dismiss, courts will accept as true only well-pleaded factual allegations. *See Official Comm. of the Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand, LLP*, 322 F.3d 147, 158 (2d Cir. 2003) (quoting Cooper v. Parsky, 140 F.3d 433, 440 (2d Cir. 1998) (internal citation omitted)). A complaint that "consists of conclusory allegations unsupported by factual assertions" does not provide the defendants with proper notice of the claims against them. *Dubai Islamic Bank v. Citibank, N.A.*, 256 F. Supp. 2d 158, 162 (S.D.N.Y. 2003) (*quoting DeJesus v. Sears, Roebuck & Co.*, 87 F.3d 65, 70 (2d Cir. 1996)). Consequently, courts will not accept "conclusions of law or unwarranted deductions of fact" as true. *Dubai*, 256 F. Supp. 2d at 163 (quoting *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 771 (2d Cir. 1994)). If an affirmative defense negating plaintiff's claims appears on the face of the complaint, the claims should be dismissed under Rule 12(b)(6). *See Color Tile*, 322 F.3d at 158 (quoting *Pani v. Empire Blue Cross Blue Shield*, 152 F.3d 67, 74 (2d Cir. 1998) (citations omitted)).

In addition, on a Rule 12(b)(6) motion, a claim will be dismissed if it is not plausible on its face. *Ashcroft v. Iqbal*, 556 U.S. 662, 677 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555-56 (2007); *LH 1440 LLC v. Lehman Commercial Paper, Inc.*, (*In re Lehman Bros. Holdings*

Inc.), No. 09-1138, 2010 Bankr. LEXIS 2373, at *1-*2 (Bankr. S.D.N.Y. July 21, 2010) (Peck, J.) (applying *Iqbal*; granting motion to dismiss). When determining plausibility, courts "are not bound to accept as true a legal conclusion couched as a factual allegation." *Iqbal*, 556 U.S. at 679. Accordingly, "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.* at 1949; *Twombly*, 550 U.S. at 555. Moreover, a reviewing court must "draw on its judicial experience and common sense" to determine whether the alleged facts state a plausible claim. *Iqbal*, 556 U.S. at 679; *see also In re Lehman Bros. Holdings Inc*., 416 B.R. 392, 396 (Bankr. S.D.N.Y. 2009) ("[C]onsideration of the Motion [to Dismiss] necessarily leads to a review of the complaint within the commercial context" of the transaction in question.).

In the Complaint, the Debtors request (1) an injunction under Section 105 of the Bankruptcy Code against the continued prosecution of the FHFA Case against the Affiliate Defendants until the effective date of a plan or further order of this Court and (2) a declaratory judgment extending the stay under Sections 362(a)(1) and 362(a)(3) of the Bankruptcy Code to the continued prosecution of the FHFA Case against the Affiliate Defendants.

As discussed in detail below, both counts of the Complaint should be dismissed as to FHFA for failure to state a claim upon which relief can be granted because: (1) the Debtors are not entitled to the injunctive or declaratory relief sought in the Complaint because the Court lacks the jurisdiction and Congressional authority to issue any order or judgment against FHFA that prevents it from exercising its powers and duties as conservator for Freddie Mac under 4617(f) (*see* § I, *infra*) and (2) under no plausible set of facts or circumstances would (a) the Debtors suffer irreparable injury from continuation of the FHFA Case (*see* § II.B, C, D and E, *infra*), (b) the balance of the harms to the Debtors versus FHFA weigh in favor of granting an

injunction (*see* § I.A.2, *infra*) or (c) public policy weighs against enjoining FHFA's continuation of the FHFA Case (*see* § II.A.3, *infra*).

B. HERA Precludes The Court From Enjoining FHFA's Litigation Against The Affiliate Defendants.

1. The Housing and Economic Recovery Act of 2008.

On July 30, 2008, in the midst of what is known as the "Great Recession," Congress enacted the Housing and Economic Recovery Act of 2008 ("HERA"). HERA created FHFA as an "independent agency of the Federal Government." 12 U.S.C. § 4511(a). On September 6, 2008, pursuant to the authority granted under HERA, and after determining Fannie Mae and Freddie Mac could not "continue to operate safely and soundly and fulfill their critical public mission," the Director of FHFA placed Fannie Mae and Freddie Mac under the conservatorship of FHFA.[11] As conservator, FHFA, "immediately succeeded to all rights, titles, powers, and privileges of the regulated entity." 12 U.S.C. § 4617(b)(2)(A) and was empowered to "conserve and preserve the assets" of the GSEs, "collect all obligations and money due the regulated entity" and to "take such action as may be . . . necessary to put the regulated entity in a sound and solvent condition." 12 U.S.C. § 4617(b)(2)(B)(ii), (b)(2)(D)(i). Such actions include issuing subpoenas, § 4617(b)(2)(I), administering claims against the GSEs, § 4617(b)(3), commencing litigation within the new time periods established for lawsuits by the FHFA, § 4617(b)(12), (13) and recovering fraudulent transfers made by the GSEs, § 4617(b)(15).

HERA also includes an anti-injunction provision prohibiting any court from interfering with FHFA's mandate. Specifically, 12 U.S.C. § 4617(f) provides,

[11] (*See* Leung Decl. Ex. I (Statement of FHFA Dir. James B. Lockhart) at 5 (Sept. 7, 2008).)

> Except as provided in this section or at the request of the Director, *no court may take any action to restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver*.

12 U.S.C. § 4617(f) (the "Anti-Injunction Provision") (emphasis added).

2. The Anti-Injunction Provision Is Fatal To Debtor's Claims Against FHFA In This Adversary Proceeding.

"HERA clearly and specifically limits the power of courts to review the actions of the FHFA when acting as a conservator." *Town of Babylon v. Fed. Hous. Fin. Agency*, 790 F. Supp. 2d 47, 54 (E.D.N.Y. 2011). Courts are prohibited from granting any relief that would restrain or affect the FHFA's authority as conservator. *See, e.g., NRDC, Inc. v. Fed. Hous. Fin. Agency*, 815 F. Supp. 2d 630, 642 (S.D.N.Y. 2011) (SAS) ("Under HERA, the FHFA has the authority to preserve and conserve the assets of the Enterprises, as well as take any action to put the Enterprises in a sound and solvent condition . . . Because the FHFA was acting within its authority under HERA when it issued the Letter, section 4617(f) applies and bars adjudication of this suit."); *Town of Babylon,* 790 F. Supp. 2d at 54 ("[T]here is no question that the acts sought to be nullified here were undertaken pursuant to FHFA's broad and important statutory charge as conservator of the GSE's. As such, this action is barred by 12 U.S.C. § 4617."); *Kuriakose v. Fed. Home Loan Mortg. Co.*, 674 F. Supp. 2d 483, 494 (S.D.N.Y. 2009) (JFK) ("By moving to declare unenforceable the non-participation clause in Freddie Mac severance agreements, in essence Plaintiffs are seeking an order which restrains the FHFA from enforcing this contractual provision in the future. The FHFA is well within its statutory authority to enforce the contracts of Freddie Mac and take any other action it determines to be in the best interest of Freddie Mac. HERA clearly provides that this Court does not have the jurisdiction to interfere with such authority."); *Esther Sadowsky Testamentary Trust v. Syron*, 639 F. Supp. 2d 347, 351 (S.D.N.Y. 2009) (BSJ) ("This ban is an essential part of HERA's comprehensive scheme for

conservatorships and receiverships. Here, the suit brought by the Trust would interfere with and potentially usurp precisely the powers granted to the FHFA by HERA. As such, maintenance of this suit would violate Section 4617(f) of HERA and cannot be permitted."). In sum, the "only relevant question" in conducting an analysis under Section 4617(f) "is whether the conservator or receiver is carrying out a statutory function or power." *Furgatch v. Resolution Trust Corp.*, No. 93-20304, 1993 WL 149084, *2 (N.D. Cal. April 30, 1993) (decided under parallel provisions in FIRREA (discussed *infra*)). HERA precludes the Court from granting equitable relief against FHFA as conservator -- including the injunctions and third party releases sought by the Debtors in the Adversary Proceeding -- as to the Affiliate Defendants.

Courts have barred other injunction actions under the nearly identical anti-injunction provision of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") against the Federal Deposit Insurance Corporation ("FDIC"). These precedents are particularly persuasive because Congress modeled the conservatorship provisions of HERA after FIRREA. *See* H.R. 110-142 ("The conservatorship and receivership provisions *were modeled after similar provisions in the Federal Deposit Insurance Act that apply to federally insured depository institutions*") (emphasis added); *Kuriakose*, 674 F. Supp. 2d at 493 ("In analyzing the limits of the Court's authority under § 4617(f) of [HERA], the Court may turn to precedent relating to the nearly identical anti-injunction statute under [FIRREA]"); *In re Fed. Home Loan Mortgage Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 795 (E.D. Va. 2009) ("[T]he Court is persuaded by decisions that have reached the same conclusion when interpreting [FIRREA], whose provisions regarding the powers of federal bank receivers and conservators are substantially identical to those of HERA."). As the Second Circuit has explained:

> FIRREA's anti-injunction provision is but part of a broader scheme enacted to allow the RTC expeditiously to wind up the affairs of defunct savings and loan institutions without judicial interference. Consistent with that purpose, the anti-injunction provision is a direct manifestation of Congress's intent to prevent courts from interfering with the RTC in the exercise of its statutory powers.

Volges v. Resolution Trust Corp., 32 F.3d 50, 52 (2d Cir. 1994); *see also Kuriakose*, 674 F. Supp. 2d at 493 (S.D.N.Y. 2009) ("[C]ourts generally have interpreted the anti-injunction provision broadly, holding that FIRREA bars all equitable relief relating to the statutorily provided powers of the receiver.") (*citing Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995) ("Not only does [FIRREA] bar injunctive relief, but in the circumstances of the present case where appellants seek a declaratory judgment that would effectively 'restrain' the FDIC from foreclosing on their property, [it] deprives the court of power to grant that remedy as well.")).

While courts have upheld the reach of the automatic stay under Section 362 of the Bankruptcy Code, any other injunctive relief -- including the Section 105(a) injunction sought here -- would violate Section 4617(f) of HERA. As explained by the First Circuit interpreting HERA's analog, FIRREA, "[t]he bankruptcy court is a creature of statute, and [the debtor] has not suggested that it is beyond Congress's lawful powers to limit the remedies available to that court or to remove selected matters from its jurisdiction. Here, Congress exercised that very power, limiting the authority of all courts -- the bankruptcy court included -- to enjoin the FDIC." *Sunshine Dev. v. FDIC*, 33 F.3d 106, 116 (1st Cir. 1994) (emphasis added). By contrast, the statutory prohibition is not violated when a court is merely recognizing the self-effectuating provisions of the automatic stay. *See id.* at 113-14 ("we are confident that the automatic stay does not violate FIRREA's anti-injunction provision because it arises directly from the operation

of a legislative enactment, not by court order.); *see also In re Colonial Realty Co.*, 980 F.2d 125, 137 (2d Cir. 1992) (holding that "the injunctive order issued in this case to implement the stay was in a sense superfluous" because "[t]he stay imposed by § 362(a) is automatically 'applicable to all entities' without any need for the intervention of any court or ruling.").

Here, the Debtors *do not* ask the Court to enforce the self-effectuating automatic stay provisions. FHFA recognizes and abides by that stay as to the Debtors. Rather, they seek affirmative action by the Court to enlarge the stay to solvent, non-debtor affiliates and order the following relief:

> *The automatic stay is hereby extended* to enjoin the continued prosecution of the MBS Actions against the Affiliate Defendants except as may otherwise be provided by order of this Court.
>
> The MBS Actions are hereby enjoined from prosecution against the Affiliate Defendants until the effective date of a plan of reorganization or as may otherwise be provided in orders of this Court.

(Proposed Order ¶¶ 2,3 [Adv. Pro. Docket No. 9] (emphasis added).)

This relief can only be obtained through Section 105(a) of the Bankruptcy Code, which is not self-effectuating. *Adelphia Communs. Corp. v. Associated Elec. & Gas Ins. Servs., Ltd. (In re Adelphia Communs. Corp.)*, 302 B.R. 439, 442 (Bankr. S.D.N.Y. 2003) ("Because seeking relief under 105(a) would require commencing an adversary proceeding and then seeking an injunction (as compared and contrasted to requests for relief under section 362, which is self-effectuating, and requires neither), ACC and ABIZ have commenced the necessary adversary proceedings to do so, and have filed preliminary injunction motions."). Indeed, the Debtors concede that the automatic stay – on its face – does not apply to the Affiliate Defendants and that is why they ask the Court "to extend" the automatic stay beyond to non-debtors. (*See* Motion 2 ("The MBS Actions *against the Debtors* are now stayed pursuant to the automatic stay of

Section 362. This Court should *extend* the automatic stay pursuant to Sections 362 or 105 to stay or enjoin the continuation of the MBS Actions against the Affiliate Defendants . . .) (emphasis added)). Thus, unlike in *Colonial Realty*, the Debtors cannot rely on the self-effectuating statutory stay, but rather ask the Court to enjoin conduct that falls outside the automatic stay and which, as recognized in *Sunshine*, cannot be enjoined.

The continuation of the FHFA Case plainly is an "exercise of powers or functions of the [FHFA] as a conservator" for Freddie Mac. *See* 12 U.S.C. § 4617(f). In its lawsuit, FHFA seeks to redress wrongs that the FHFA Litigation Defendants committed against Freddie Mac and seeks to compensate Freddie Mac for the losses that the FHFA Litigation Defendants caused Freddie Mac to suffer. The FHFA Case squarely fits within FHFA's mandated duties and authorizations that include "collect[ing] all obligations and money due" to Freddie Mac and "tak[ing] such action as may be . . . necessary to put [Freddie Mac] in a sound and solvent condition." *See* 12 U.S.C. § 4617(b)(2)(B)(ii), (b)(2)(D)(i); *see also Town of Babylon*, 790 F. Supp. 2d at 50 ("The FHFA is charged by statute with the responsibility of, *inter alia*, identifying and minimizing further financial risk to [Freddie Mac] to ensure [its] future economic safety and viability.").

The Complaint and the Debtor's Motion -- by requesting that the Court extend the automatic stay and enjoin FHFA's prosecution of the FHFA Case -- asks for relief that violates HERA. Accordingly, the Complaint must be dismissed and the Motion must be denied on this basis alone.

II.
THE DEBTORS HAVE FAILED TO SHOW THAT THE FHFA CASE SHOULD BE STAYED AGAINST THE AFFILIATE DEFENDANTS

Assuming *arguendo* that the Court has the authority to extend the stay or to enjoin FHFA from continuing to prosecute the FHFA Case, it clearly should not do so here. There is no risk of any judgment or any adverse consequences to the Debtors by allowing the litigation to proceed. By contrast, the prejudice to FHFA would be overwhelming. The FHFA Case is part of a coordinated proceeding that covers sixteen actions commenced by FHFA, all pursuant to its Congressionally-mandated duties and powers as conservator for Freddie Mac. Judge Cote has put into effect a carefully orchestrated schedule that ensures that all these actions can be resolved efficiently. That schedule depends on document discovery being substantially completed in approximately three months, on September 30, 2012. It also mandates that witnesses will only be deposed once in all proceedings. Because the Non-Affiliate Defendants are also defendants in at least one other FHFA action, their witnesses will have to be deposed for the FHFA Case at the same time as the other coordinated action(s) in which they are named as defendants. If document or deposition discovery is delayed due to a bankruptcy stay covering the Debtors and Affiliate Defendants, there is a reasonable risk that FHFA will have to proceed with merits discovery on a significantly more limited record than in any other FHFA lawsuit. In short, an injunction would prejudice FHFA's ability to meet the Court-ordered schedule, develop its case, and recover funds for Freddie Mac and ultimately the U.S. taxpayers.

A. The Debtors Have Not Met Their Burden For An Injunction Under 11 U.S.C. § 105(a).

The Debtors bear the heavy burden of showing "extraordinary" circumstances required for a Section 105 injunction. *In re Third Eighty-Ninth Assocs*., 138 B.R. 144, 146

(S.D.N.Y. 1992). "While 11 U.S.C. § 105(a) does grant the bankruptcy court broad powers to issue any order necessary or appropriate to carry out the provision of this title, *it is an extraordinary exercise of discretion to use that power to stay a third party action not involving the debtor.*" *In re Brentano's Inc.*, 36 B.R. 90, 92 (S.D.N.Y. 1984) (emphasis added). Section 105 "does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity." *In re United Health Care Org.*, 210 B.R. 228, 231 (S.D.N.Y. 1997). Only when a suit against third-parties "threaten[s] to thwart or frustrate the debtor's reorganization efforts" may bankruptcy courts extend the automatic stay pursuant to 11 U.S.C. § 105(a). *In re Adelphia Commc'ns Corp.*, 298 B.R. 49, 54 (S.D.N.Y. 2003) (quotation omitted).

To obtain injunctive relief under Section 105(a), the Debtors must demonstrate all of the following: (1) a substantial threat of imminent, irreparable harm to the estates or the reorganization if an injunction is not granted; (2) a substantial likelihood that the movant will prevail on the merits, *i.e.*, successfully reorganize; (3) that the threatened injury to the Debtors and the estates outweighs the threatened harm to the parties to be enjoined; and (4) that the granting of the injunction will not disserve the public interest. *See In re United Health Care Org.*, 210 B.R. at 233; *see also In re Commonwealth Oil Refining Co.*, 805 F.2d 1175, 1188-89 (5th Cir. 1986). "[A]ll of the[se requirements] 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); *see also Sabratek Corp v. LaSalle Bank, N.A.,* 257 B.R. 732 (Bankr. D. Del. 2000) (declining to enjoin a state court that did not involve property of the estate because there was no showing of irreparable harm).

1. The Debtors Have Failed To Establish A Substantial Threat of Irreparable Injury Or That The Balance Of The Harms Weighs In Favor Of An Injunction.

Irreparable harm in the context of a reorganization is shown only where -- unlike here -- the failure to enjoin the actions would "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) (holding that the debtor must show that the action "would so consume the time, energy and resources of the debtor that it would substantially hinder the debtor's reorganization effort'"). The Debtors must present strict proof -- not conclusory allegations -- to sustain this burden. *Dore & Assocs. Contracting, Inc. v. Am. 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) (denying Section 105 injunction against action against debtors' auditor because purported risk of delay to the reorganization was "mere speculation [that did] not constitute the type of proof required to entitle the Debtors to an injunction"). Further, "the threat to the reorganization process must be *imminent, substantial and irreparable*." *In re Calpine Corp.*, 365 B.R. at 410 (emphasis added).

The Debtors make three flawed arguments to support an extension of the automatic stay. First, the Debtors contend that enjoining the litigation is "necessary to preserve the property of the Debtors' estate" because of the purported risks of expending insurance proceeds and incurring indemnification obligations. (Motion at 40.) As discussed below, continuing the FHFA Case against the Affiliate Defendants bears no real risk of either outcome. (*See* Argument §§ II.D and II.E, *infra.*) Second, the Debtors argue that "the risk of collateral estoppel, *stare decisis*, and evidentiary prejudice to the Debtors also warrant an injunction." (Motion at 41-42.)

However, as shown below, these factors simply do not apply to the continuation of the FHFA Case. (*See* Argument § II.B, *infra.*) Third, the Debtors argue that "they would face substantial discovery burdens that would irreparably harm their efforts to restructure." (Motion at 42-43.) In reality, as discussed below, this is no real concern with respect to the FHFA Case. (*See* Argument § II. C, *infra.*) As such, the Debtors have not established a substantial risk of irreparable harm.

2. Enjoining The FHFA Case Is Not In The Public Interest.

The public interest is best served by continuation of the FHFA Case, not an extension of the automatic stay. The Debtors address this prong of the injunction standard in dismissive fashion by contending that "'in the context of bankruptcy proceedings, the 'public interest' element means the promotion of a successful reorganization.'" (Motion at 45) (*quoting OMC, Inc. v. Local Union 28 of the Sheet Metal Workers' Int'l Union (In re OMC, Inc.)*, 2010 Bankr. LEXIS 3600 , at * 12(Bankr. S.D.N.Y. Oct. 13, 2010).)

The Debtors are wrong. When considering the "public interest," courts do not consider the effect on the debtor's reorganization in isolation, but rather *balanced with competing societal interests*. Each of the three cases that the Debtors cite for this proposition -- including an opinion issued by this Court -- make this point abundantly clear. *See OMC, Inc.*, 2010 Bankr. LEXIS at *6-*7 ("courts look to several factors to assess whether a TRO should be granted. These considerations include . . . the public interest which requires a balancing of the public interest in successful reorganization *with competing societal interests.*") (emphasis added); *see also Nevada Power Co. v. Calpine Corp. (In re Calpine Corp.)*, 365 B.R. 401, 413 (S.D.N.Y. 2007) ("Evaluation of the public interest factor of the analysis requires a balancing of the public interest in successful bankruptcy reorganizations with other competing societal interests")

(internal citation quotation omitted); *Haw. Structural Ironworkers Pension Trust Fund v. Calpine Corp.*, 2006 U.S. Dist. LEXIS 92499, *13-*14 (S.D.N.Y. Dec. 20, 2006) ("the court must consider the public interest which requires a balancing of the public interest in successful bankruptcy reorganizations with other competing societal interests.") (internal citation quotation omitted).

Moreover, the threats to reorganization in *OMC* are simply not present here. There, this Court found that without the requested injunction, the debtor would continue to lose jobs and employees, and it was "unquestionable" that to reorganize, the Debtor needed to retain its employees, which it could not do if its unionized workforce left because of defendant Sheet Metal Workers' National Pension Fund's refusal to grant pension credit. *Id.* at *13. There are no similar circumstances extant here.

Pursuant to HERA, Freddie Mac issued senior preferred stock to the U.S. Treasury. (*See* Leung Decl. Ex. J (Excerpt of Nov. 15, 2011 U.S. Dept. of Treasury Agency Financial Report, Fiscal Year 2011) at 13.)) As of March 31, 2012, the U.S. Treasury's investment in Freddie Mac, as measured by the aggregate liquidation preference value of its senior preferred stock, exceeds $72 billion. (See Leung Decl. Ex. K. (Excerpt of Freddie Mac's Form 10-Q for the quarter ended March 31, 2012) at 8.) The public interest is best served by allowing the FHFA Case to proceed because any recoveries in that case would benefit Freddie Mac's stakeholders, including the U.S. Treasury and, therefore, the U.S. taxpayer.

Moreover, through HERA, Congress reaffirmed its longstanding view that the GSEs' shared mission of promoting home ownership in the United States is pivotal to the stability of the Nation's economy. *See Legislative proposals on GSE Reform: Hearing Before the H. Subcomm. on Capital Mkts. Ins. & Gov't Sponsored Enters. of the H. Comm. On Fin. Servs.*, 110th Cong. 1-

2 (2007) (statement of Rep. Paul E. Kanjorski, Chairman, S. Comm. On Capital Mkts. Ins. & Gov't Sponsored Enters.) ("Fannie Mae and Freddie Mac presently guarantee about $3 trillion in mortgage-backed securities . . . we need to have strong, independent, and world class GSE regulation to oversee these sizeable institutions. Such a regulatory system will promote confidence in the GSEs, protect a continued viability of our capital markets, ensure taxpayers against systemic risk, and expand housing opportunities."); *see also Legislative Proposals on Government-Sponsored Enterprise (GSE) Reform: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 88 (2007) (statement of Rep. Deborah Pryce) (". . . the GSEs have become some of the largest private debt issuers in the world. All together, Fannie, Freddie, and the Federal Home Loan Banks hold over $5.4 trillion in outstanding debt and Mortgage-Backed Securities, larger than the $4.9 trillion publicly held debt of the U.S. Clearly proper regulation of the GSEs is needed to maintain a healthy housing finance system, and the possible systemic risk posed by inaction is too great to sit on our hands.").

Therefore, the public interest would be best served by permitting FHFA to continue its action against Non-Debtors.

B. The Risk Of Collateral Estoppel Is A Practical Impossibility Given The Scheduling Of These Cases And The Underlying Litigation.

Judge Cote's scheduling order in the FHFA Case ensures that no judgment could be rendered against the Affiliate Defendants during these Chapter 11 proceedings. Collateral estoppel applies only where "(1) the issues in both proceedings are identical, (2) the issue in the prior proceeding was *actually litigated and actually decided*, (3) there was a *full and fair opportunity to litigate* in the prior proceeding, and (4) the issue previously litigated was *necessary* to support a *valid* and *final judgment* on the merits." *Carney v. Philippone*, 332 F.3d 163, 170 (2d Cir. 2003) (emphasis added). In the FHFA case, discovery will not conclude until

2013, long after the Debtors' proposed timeframe for the completion of these Chapter 11 cases. FHFA Case likely would not go to trial until January 2015. Thus, there is minimal risk that a final judgment could be entered during this timeframe.

Even assuming *arguendo* that collateral estoppel was a meaningful risk, that alone would not be a cognizable basis to extend the stay. Indeed, the Second Circuit's opinion in *Queenie Ltd. v. Nygard*, 321 F.3d 282 (2d Cir. 2003), refutes the Debtors' contention. (Motion at 23) (citing *Queenie*). There, in declining to extend the stay to non-debtor co-defendants, the Second Circuit stated:

> we have not located any decision applying the stay to a non-debtor solely because of an apprehended later use against the debtor of offensive collateral estoppel or the precedential effect of an adverse decision. If such apprehension could support application of the stay, there would be vast and unwarranted interference with creditors' enforcement of their rights against non-debtor co defendants.

Id. at 288; *see also Diaz v. Scores Holding Co*., 2008 U.S. Dist. LEXIS 38248, at *10 (S.D.N.Y. May 9, 2008) (refusing to extend the stay to certain non-debtor defendants based solely on potential collateral estoppel where the action with respect to those parties would have no immediate adverse economic consequence for the debtor's estate). If collateral estoppel is insufficient to warrant a stay, then certainly the Debtors' purported evidentiary prejudice argument similarly must fail. (Motion at 26.) Moreover, given that only document discovery will proceed in 2012, there is no risk of evidentiary prejudice in any event.

Accordingly, even if the risk of collateral estoppel, res judicata and evidentiary prejudice here were more than theoretical, that would still not justify an extension of the automatic stay.[12]

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[12] The other cases cited by the Debtors for extending the stay based on collateral estoppel do not support the Debtors' position or inapposite. For example, *In Adelphia Communs. Corp. v. Associated Elec. & Gas Ins. Servs., Ltd.* (*In re Adelphia Communs. Corp.*), 302 B.R. 439, 451 (Bankr. S.D.N.Y. 2003), the court was

C. The FHFA Case Against The Affiliate Defendants Will Not Distract Or Impede The Debtors' Restructuring Efforts.

The Debtors argue that the FHFA Case "should also be stayed because . . . the Debtors will face significant discovery burdens that will distract key personnel and frustrate the Debtors' restructuring efforts." (Motion at 26-27.) The crux of the Debtors' argument is that, even as non-participants in the litigation, the Debtors (including employees purportedly critical to the restructuring) would be required to expend time and resources participating in document discovery and appearing for depositions. (*Id.* at 26-32.) The record contradicts the Debtors' contentions.[13]

First, the Debtors and their affiliates cannot evade discovery obligations through the Chapter 11 process. Even if the Debtors succeed in obtaining the draconian third-party releases they have proposed, FHFA will be able to obtain the requested discovery. FHFA will still have claims against other parties, and the Debtors will have to produce documents and deponents as

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highly critical of the collateral estoppel arguments, explaining as follows: "As ACC and ABIZ are not defendants in the Declaratory Judgment Action (and, absent leave of this Court, will not be defendants in the Declaratory Judgment Action at least in the near future), this Court has some doubts as to whether collateral estoppel would apply; if the issue came up on this Court's watch, it would likely regard the absence of ABIZ and ACC in the action giving rise to the argued collateral estoppel to be fatal to such a contention." In *Eastern Air Lines v. Rolleston (In re Ionosphere)*, 111 B.R. 423, 434 (Bankr. S.D.N.Y. 1990), the lawsuit at issue involved "identical claims based upon identical facts" to claims against the debtors. Likewise, in *Calpine Corp. v. Nev. Power Co.* (*In re Calpine Corp.*), 354 B.R. 45, 50 (Bankr. S.D.N.Y. 2006), the court found that the defendant insurer's liability was entirely contingent on the debtor's liability to the plaintiff.

[13] In addition, the cases cited to support the Debtors' position are not persuasive and easily distinguishable. For example, the Debtors cite *American Film Technologies, Inc. v. Taritero* (*In re American Film Techs., Inc.*), 175 B.R. 847 (Bankr. D. Del. 1994), which is inapplicable because it does not discuss any potential burden or hardship on the debtor by continuing litigation against the non-debtor party. Instead, the bankruptcy court stayed an action against a debtor's former and present directors because continued prosecution of the action would have exposed the debtor to the risk of vicarious liability and collateral estoppel. *Id.* at 850. Likewise, *Loewen Group* involved entirely different facts and legal concepts. *In re Loewen Group, Inc. Sec. Litig.*, 2001 U.S. Dist. LEXIS 6482 (E.D. Pa. May 16, 2001). There, the court, without discussing or relying on sections 105(a) or 362, *sua sponte* placed the pre-petition consolidation class actions in civil suspense. *Id.* at *4.

third-parties. These obligations cannot be discharged pursuant to a plan: the automatic stay does not shield the Debtors from discovery. *See In re Miller*, 262 B.R. 499, 504-05 (9th Cir. B.A.P. 2001) (holding that the automatic stay did not protect debtor from having to comply with discovery requests in multi-defendant case in which debtor was one of the defendants, so long as the discovery requests pertained only to creditors' claims against other, non-debtor defendants); *In re Mahurkar Double Lumen Hemodialysis Catheter Patent Litig.*, 140 B.R. 969, 977 (N.D. Ill. 1992) (Easterbrook, J., sitting by designation) (holding that the debtor and its employees were not protected by the automatic stay with respect to discovery relating to claims against non-debtor co-defendants and the debtor "has no ground to interfere with or disrupt discovery that is calculated to lead to evidence admissible against" his solvent co-defendant*); In re Hillsborough Holdings Corp.*, 130 B.R. 603, 605 (Bankr. M.D. Fla. 1991) (holding that the automatic stay did not prevent discovery aimed at debtor as long as the discovery pertained to claims and defenses of a non-debtor party). Courts have found this to be true even if the information discovered could later be used against the debtor. *See e.g., In re Richard B. Vance & Co.*, 289 B.R. 692, 697 (Bankr. C.D. Ill. 2003) (noting that the majority rule is that the automatic stay does not prohibit discovery pertaining to claims against a debtor's co-defendants, "even if the discovery requires a response from the debtor, and even if the information discovered could later be used against the debtor."); *In re Miller*, 262 B.R. at 504 ("Information is information, and we believe the discovery of it as part of the development of a case against non-debtor parties is permissible, even if that information could later be used against the party protected by the automatic stay.").

The Debtors aver that "discovery from the Debtors would be Herculean," that "[e]ach securitization shelf . . . involves documents, processes and personnel" and that "the

securitizations include more than 660,000 mortgage loans, each of which involves hundreds of pages of documents."[14] (Motion at 27). Specifically as to the FHFA Case, the Debtors state that:

> should discovery proceed to the logical next step, only the debtor entities have possession of the mortgage loan files, underwriting parameters, and other information necessary to evaluate any collection of loan files that may ultimately be at issue in the litigation.
>
> Thus, as with the other investor cases, the discovery process will prove to be excessively burdensome on the debtor entities should the litigation against the non-debtor entities be permitted to proceed.

(Motion, Ex. 6 (Declaration of Jeffrey A. Lipps) at ¶¶ 67-68).) The Debtors do not explain why such discovery would be "excessively burdensome." Apparently the Debtors would like the Court to apply a presumption that *voluminous* discovery means *burdensome* discovery. Of course, no such presumption does or should exist. *See, e.g., Everett v. MCI, Inc. (In re WorldCom, Inc.)*, 2008 Bankr. LEXIS 437, *14-*15 (Bankr. S.D.N.Y. Feb. 14, 2008) ("While response to [the discovery] requests may involve 'large volumes of documents' and 'impose significant costs and burdens' on Debtor, the mere fact that responding to discovery may involve large volumes of documents or may be burdensome does not, by itself, excuse compliance with discovery requests).

Indeed, the Debtors and Affiliate Defendants could produce the documents without much burden or expense. The Debtors and Affiliate Defendants collectively hold virtually all relevant documents in electronic format, organized by mortgage loan, which should be easily accessible to compile a production. (Motion at 27; Motion Ex. 6 (Lipps Decl. ¶ 15.).) The Debtors have already compiled some or all of the relevant documents in connection with the sales process, and

[14] The amount of mortgage loans referenced by the Debtors includes loans for all defendants in the Adversary Proceeding, not just FHFA.

third-parties such as potential bidders may already have had access to those documents. ((Excerpt of June 8, 2012 Deposition of James M. Whitlinger) at 68:5-11 ("And so they [Nationstar] had access to various information, financials for historical results. They had access to some internal business review materials. We gave them electronic tapes relating to the loan portfolios, the MSRs that were for sale."), 77:3-7 ("I believe we've already done a lot of the work as part of the Nationstar process, so we have a lot ready to go for any bidder to look at. There's a lot created and ready to go.").) Moreover, it appears that the Debtors may be required to provide many of these documents to the Committee (in response to its 2004 motion) and/or to the Examiner. If so, the Debtors cannot seriously contend that providing the documents in connection with the FHFA Case would be burdensome in that the costs and burdens (if any exist) would be incurred regardless of continuation of the FHFA Case.

The Debtors also fail to demonstrate any real risk that key personnel will be deposed in the FHFA Case during the pendency of the Bankruptcy Case. As discussed above, Judge Cote's scheduling order sets document discovery to continue through 2012, with depositions scheduled to begin in 2013. Given that the Debtors expect to emerge from bankruptcy in 2012, there is no realistic possibility that any representative of the Debtors will be deposed in the FHFA Case while the Debtors are in Chapter 11. Moreover, given Judge Cote's scheduling order, there is no realistic possibility that the Debtors' management will be subjected to deposition in the FHFA Case during the pendency of the bankruptcy.

Finally, the Debtors have not demonstrated why any discovery including depositions of their employees – should they occur before their emergence – would interfere with the Debtors' reorganization. The Debtors argue that "[i]n many instances, the Debtor employees who are critical to the discovery in the MBS Actions are also critical to the Debtors' efforts to preserve

value of the estate and successfully reorganize." (Motion at 29.) But the Debtors identify only two such employees: ResCap's Director of Treasury and a Senior Director of Investor Reporting. (Motion at 29-31.) The Debtors allege that those two key employees, if involved in the non-debtor litigations, could not carry out their tasks necessary for the reorganization. (*Id.*)

The Debtors' allegations, even true, are insufficient to meet their evidentiary burden. Courts will only extend the automatic stay when the debtor has proven that because of "unusual circumstances" the litigation against the non-debtors would have a "material effect upon . . . [the] reorganization effort." *CAE Indus. Ltd. v. Aerospace Holdings Co.*, 116 B.R. 31, 33-34 (S.D.N.Y. 1990). Here, even if the two employees identified are essential to both the litigations and to the restructuring efforts, and could not perform both functions, that does not mean – and the Debtors have not even argued – that reorganization cannot occur without them. The Debtors' vague and general allegations of potential distractions and restricted participation in the Debtors' reorganization do not represent the requisite "danger of imminent, irreparable harm to the estate or the debtor's ability to reorganize." *In re United Health Care Org*., 210 B.R. at 233.

Indeed here -- given (1) that the Debtors have retained numerous seasoned legal and financial advisors, (2) that the Debtors already have gathered, analyzed and produced many of the relevant documents to potential bidders, and (3) that the Debtors have already extensively negotiated sales agreements and a plan support agreement that frames their reorganization process – it seems doubtful that these two employees, essential as they may be, would derail the reorganization process of a multi-billion entity with more than 3,600 employees.

Accordingly, the Debtors have not, and cannot, show that continuation of the FHFA Case as against the Affiliate Defendants will distract or derail the Debtors' reorganization process.

D. The Debtors' Purported Indemnification Obligations Do Not Justify Extending The Automatic Stay Or Granting An Injunction.

The Debtors argue that the Court should extend the automatic stay because "[t]he continuation of the MBS Actions against the Affiliate Defendants will create indemnification claims against the estate." (Motion at 33.) The Debtors claim that pursuant to ResCap's Amended and Restated Operating Agreement dated November 27, 2006 (the "Operating Agreement"), "the Debtors are obligated to indemnify the Non-Debtor Corporate Affiliates for attorneys' fees/expenses and losses incurred in the MBS Action."[15] This argument fails based on undisputed facts and well-established law.

1. The Debtors Have Not Demonstrated A Risk That Indemnification Claims Will Arise.

The Debtors allege in conclusory fashion that "[t]he continuation of the MBS Actions against the Affiliate Defendants will create indemnification claims against the estate." (Motion at 33.) The Debtors do not explain how or when those claims will arise or the anticipated dollar amounts. The Debtors' omissions are telling.

As discussed herein, there is no risk of indemnification of any judgment during the period of the proposed stay. Because Judge Cote's scheduling order in the FHFA Case contemplates only document discovery during 2012, there is no likelihood of a judgment being rendered against the Affiliate Defendants during these Chapter 11 cases. Accordingly, the only claims that could even arguably give rise to indemnity during the Bankruptcy Cases are the Affiliate Defendants' litigation expenses for defending the FHFA Case. Those claims, even if indemnifiable, should be not be substantial given that (1) the FHFA Case will not proceed past

[15] None of the Debtors' employees, officers or directors are parties to the FHFA Case and, therefore, this opposition does not address the D&O indemnity, which is wholly inapplicable to FHFA.

document discovery during the Debtors' stay in bankruptcy and (2) the documents will have to be produced in any event.

Thus, the indemnity issues raised by the Debtors do not justify the extraordinary relief sought here.

2. The Indemnification Provisions Are Unenforceable With Respect To Claims Arising In The FHFA Case.

The Debtors cannot indemnify the Affiliate Defendants for the acts alleged in the FHFA Case. It is against public policy to indemnify for securities violations. Courts generally do not permit indemnity for violations of securities laws. *Credit Suisse First Boston, LLC v. Intershop Communs. AG*, 407 F. Supp. 2d 541, 546 (S.D.N.Y. 2006) (RJH). In *Globus v. Law Research Service, Inc.*, 418 F.2d 1276 (2d Cir. 1969), purchasers of securities sued the underwriter claiming that the offering circular was misleading, alleging violations of the Securities Act of 1933. A jury found the underwriter "had actual knowledge of the material misrepresentations" and was liable for violations of the Securities Act of 1933. The underwriter asserted indemnification claims against the issuer under the underwriting agreement, which the lower court denied. The Second Circuit affirmed the denial of the underwriter's indemnification claim. The court held if such indemnification were allowed "[u]nderwriters who knew they could be indemnified simply by showing that the issuer was 'more liable' than they (a process not too difficult when the issuer is inevitably closer to the facts) would have a tendency to be lax in their independent investigations." *Id.* at 1288.

Courts have expanded the reach of *Globus* to apply to claims based solely on negligence. *See Credit Suisse First Boston, LLC v. Intershop Communs. AG*, 407 F. Supp. 2d at 547 ("courts in this district and elsewhere readily extended *Globus's* reasoning to preclude indemnification in cases involving negligent misrepresentations."); *Odette v. Shearson, Hammill & Co.*, 394 F.

Supp. 946, 956 (S.D.N.Y. 1975) ("If Shearson were held liable under § 12(2) on a showing of mere negligence, Globus I might not necessarily preclude the court from awarding indemnification. The Second Circuit was careful to confine its holding barring indemnification to conduct involving 'more than ordinary negligence.' Nonetheless I believe that the court's statement of the public policy objections to indemnification of liabilities under the 1933 Act is broad enough to cover negligent misconduct in violation of § 12(2).") (internal citations omitted). Moreover, courts have routinely held that if liability on a claim is not indemnifiable, then any rights for reimbursement of attorney fees from defending such claims likewise are not indemnifiable. *See Barbagallo v. Marcum*, 2012 U.S. Dist. LEXIS 66550 at *14 (E.D.N.Y. May 9, 2012) ("the indemnitor's duty to defend its contractual indemnitee is no broader than its duty to indemnify.") (internal citations omitted).

The Affiliate Defendants' indemnification claims against the Debtors based on the FHFA Case, if any exist, are unenforceable as a matter of law and public policy. The FHFA Amended Complaint contains counts for (1) violations of section 11, 12 and 15 of the Securities Act of 1933, (2) violations of the Virginia Securities Act, (3) common law fraud, and (4) aiding and abetting fraud. Courts have held each of these types of claims to be non-indemnifiable. Likewise, the Affiliate Defendants' attorneys fees related to defense from such claims would not be subject to indemnification unless the Affiliate Defendants were held not liable after trial or on summary judgment.

3. Even if Indemnifiable Obligations Arise, The Debtors' Estates Would Not Be Depleted Or Harmed.

Finally, even if the FHFA Case creates indemnity obligations for the Affiliate Defendants while the Bankruptcy Cases are pending, and even assuming that the corresponding indemnification rights are deemed enforceable, the Debtors' estates still will not suffer because

the FHFA is entitled to a single recovery. *See Singer v. Olympia Brewing Co.*, 878 F.2d 597, 600 (2d Cir. 1989) (describing the "one satisfaction rule," which provides that a plaintiff is entitled to only one satisfaction for each injury). Either FHFA or the Affiliate Defendants (by way of indemnification) would assert one pre-petition claim against the Debtors.

Accordingly, the Debtors have not shown any reason that their purported indemnification obligations to the Affiliate Defendants justify extending the automatic stay to enjoin FHFA from continuing the FHFA Case.

E. The Errors and Omissions Insurance Policies Do Not Support The Relief Requested.

The Debtors argue that if the FHFA Case proceeds against the Affiliate Defendants, the Debtors' estates could be depleted because the Affiliate Defendants would use insurance proceeds otherwise available to the Debtors. (Motion at 34-35.) The Debtors provide scant factual support for this argument; what little they do provide does not support the relief sought.

First, as discussed above, the Debtors have not established any real possibility that the Affiliate Defendants will be subjected to an adverse judgment in the FHFA Case during pendency of the Bankruptcy Cases. The cost of producing documents is not likely to be substantial in the context of these cases, and it is an expense that inevitably will be incurred. Accordingly, even if the Debtors establish that the Affiliate Defendants' liabilities in the FHFA Case are covered by the relevant policies – and they certainly have not established that in the Motion – that point is purely hypothetical and does not support the relief sought.

Second, the Debtors have not established that the Affiliate Defendants' liabilities in the FHFA Case would fall within the timeframes covered by the E&O policy. The insurance policy included with the Motion is a "claims made" policy covering losses on account of claims "first made" "during the Policy Period." (Declaration of James Whitlinger [Adv. Pro. Docket No. 7]

Ex. C. at 38-39.)[16] The policy period is December 31, 2007 to December 31, 2008. Inasmuch as the FHFA Case and the claims made therein were not asserted until 2011, the policy documents provided by the Debtors do not establish the alleged coverage. The Debtors' vague statement that this "policy is *representative* of subsequent E&O policies, including the terms and conditions in those policies" proves nothing. (Motion at 17 (emphasis added).)

Third, even *if* the Affiliate Defendants do incur liabilities in the FHFA Case during the pendency of the Bankruptcy Cases and even *if* the timeframes of coverage in the applicable policies would cover such liabilities, the Debtors' estates still would not suffer any harm. The E&O policies contain $15 million in coverage *in excess* of a $25 million retention for each loss. (Declaration of James Whitlinger [Adv. Pro. Docket No. 7] Ex. C. at 2 (Items 2 & 4, p. 2).) This means that if the insured entities submit a claim for payment of defense costs or a judgment relating to a covered claim, the insured entities (and *not* the carrier) must pay the first $25 million owed on the submitted claim before the insurer starts paying. Here, there is no proof that this has occurred or will occur anytime soon with respect to the claims asserted in the FHFA Case. Accordingly, there is no reasonable likelihood that any policy proceeds will be accessed by the Affiliate Defendants on account of the FHFA Case.

* * *

The Debtors have failed to demonstrate that continuing the FHFA Case against the Affiliate Defendants creates a real risk of harm or prejudice to the Debtors, their estates or their restructuring efforts. That flaw is fatal to the requested injunction.

[16] To avoid confusion the policy page citations refer to the pages of the PDF document filed with the Court, as noted in the top margin thereof.

CONCLUSION

For the foregoing reasons, the Court should order (1) the dismissal of FHFA with prejudice from the Adversary Proceeding, (2) denying the Debtor's Motion, and (3) granting to FHFA such other and further relief deemed just and proper.

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