Docket #0054 Date Filed: 7/5/2012

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 Adv. Case No. 12-ap-01671 (MG)
RESIDENTIAL CAPTIAL, LLC., *et al.*, Plaintiffs, -against- ALLSTATE INSURANCE CO., *et al.*, Defendants.	

MEMORANDUM OF LAW IN SUPPORT OF THE MOTION OF THE FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER FOR CITIZENS NATIONAL BANK AND AS RECEIVER FOR STRATEGIC CAPITAL BANK, TO DISMISS THE COMPLAINT FOR LACK OF JURISDICTION

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Through this adversary proceeding, the Debtors ask the Court to stay or enjoin the Federal Deposit Insurance Corporation from exercising its statutory powers as Receiver for Citizens National Bank and for Strategic Capital Bank. Acting within the authority that Congress granted it in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), the FDIC filed suit for violation of the Securities Act of 1933 against 17 issuers and underwriters (and certain of their control persons) of mortgage-backed securities that these banks purchased before they failed. One of those 17 defendants is Ally Securities LLC, which the FDIC sued as underwriter of certificates issued in three securitizations by Residential Accredit Loans, Inc. (RALI). Ally Securities is not a Debtor, but is a distant affiliate of Residential Capital LLC (ResCap), the principal Debtor, and of RALI, another Debtor.

This action should be dismissed because it violates the anti-injunction provision in FIRREA, which provides that "[n]o court may take any action, except at the request of the Board of Directors [of the FDIC] by regulation or order, to restrain or affect the exercise of powers or functions of the Corporation as a conservator or a receiver." 12 U.S.C. § 1821(j). As long as the FDIC is acting within the authority granted to it as a receiver or conservator under FIRREA, the Court lacks jurisdiction to take any action that would restrain or affect the FDIC's exercise of those statutory powers. Because the FDIC is acting well within its statutory authority as Receiver for these two failed banks in filing suit against Ally Securities for violation of the federal securities laws, and because the relief that the Debtors seek would "restrain or affect" the FDIC's exercise of those powers, this adversary proceeding seeks relief that the Court lacks authority to

grant. Thus, the FDIC should be dismissed with prejudice from this adversary proceeding and the proposed injunction against the FDIC should be denied.[1]

STATEMENT OF FACTS

I. The FDIC's Complaint

Citizens National Bank and Strategic Capital Bank both were closed on May 22, 2009, and the FDIC was appointed Receiver for each institution. Pursuant to its authority under 12 U.S.C. § 1821(d), on May 18, 2012, the FDIC as Receiver for these banks brought an action in the United States District Court for the Southern District of New York against 17 defendants for violations of Sections 11 and 15 of the Securities Act of 1933 in connection with the purchase by the failed banks of certificates in 12 securitizations of residential mortgage loans.[2] *See FDIC v. Bear Stearns Asset Backed Securities I LLC*, No. 1:12-cv-0400-LTS (S.D.N.Y. filed May 18, 2012). The defendants were sued in their capacities as issuers or underwriters of those certificates or as control persons of those defendants. (FDIC Compl. ¶ 3; Ex. A to Declaration of Kathryn E. Matthews, dated June 28, 2012.) None of the defendants in that action is a Debtor, nor is any defendant an officer, director, or control person of any Debtor. The only affiliate of a Debtor that the FDIC sued is Ally Securities, which it sued as an underwriter of three

[1] The FDIC joins in and adopts the similar argument made by the Federal Housing Finance Agency (FHFA) at pages 15-19 of its Memorandum of Law in Support of its Motion to Dismiss the Complaint and in Opposition to the Debtors' Motion to Extend the Automatic Stay and Enjoin Litigation Against Non-Debtors. As the FHFA explains in its brief, the anti-injunction provision in FIRREA is virtually identical to a provision in the Housing and Economic Recovery Act of 2008 (HERA), 12 U.S.C. § 4617(f), that likewise precludes courts from taking action that would restrain or effect the exercise of powers or functions of the FHFA as a conservator or receiver. (*See* FHFA Br. at 15-19.) Courts have interpreted both provisions broadly to bar the type of relief that the Debtors seek here. (*Id.)*

[2] The defendants are Bear Stearns Asset Backed Securities I LLC; The Bear Stearns Companies LLC; J.P. Morgan Securities LLC; Citicorp Mortgage Securities, Inc.; CitiMortgage, Inc.; Citigroup Global Markets Inc.; Credit Suisse First Boston Mortgage Securities Corp.; Credit Suisse Management LLC; Credit Suisse Securities (USA) LLC; Merrill Lynch Mortgage Investors, Inc.; Merrill Lynch Mortgage Capital Inc.; Merrill Lynch, Pierce, Fenner & Smith Inc.; Ally Securities, LLC; Deutsche Bank Securities Inc.; HSBC Securities (USA) Inc.; RBS Securities Inc.; and UBS Securities LLC.

securitizations issued by RALI.[3] (FDIC Compl. Scheds. 1, 2, 4.) The FDIC's complaint alleges that the offering documents related to these certificates contained material untrue and misleading statements. The action seeks damages of at least $66 million, the recovery of which would go to the receiverships of these failed banks.

II. **The Debtors' Complaint and Motion to Stay or Enjoin Actions Against Non-Debtors**

On May 25, 2012, the Debtors commenced this Adversary Proceeding by filing the Complaint and a Motion to Extend the 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 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 certain non-debtor affiliates of the Debtors, including the FDIC's claims against Ally Securities. 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, the FDIC's pursuit of its claims against Ally Securities.[4]

ARGUMENT

I. **The Complaint Against the FDIC Should Be Dismissed With Prejudice Because the Court Lacks Jurisdiction to Restrain the FDIC from Pursuing Its Claims Against Ally Securities.**

For the reasons explained in the FHFA's memorandum of law, as supplemented briefly below, the Complaint should be dismissed because FIRREA's anti-injunction provision deprives

[3] The failed banks bought their certificates in these trusts in the secondary market from dealers other than Ally Securities. (*Id.*)

[4] The Debtors' motion seeks the same relief sought in the Complaint. The FDIC filed its objection to the Debtors' motion on June 28, 2012.

this Court of jurisdiction to take any action that would restrain or affect the exercise of the FDIC's powers or functions as Receiver for the failed banks.

A. The FDIC Is Acting Within Its Authority as Receiver for Citizens National Bank and Strategic Capital Bank.

It is beyond dispute that the FDIC is acting within the scope of its powers as a receiver under FIRREA in pursuing claims against Ally Securities to recover damages for its violations of the federal securities laws on behalf of these failed banks.

Under 12 U.S.C. § 1821(d)(2)(A), the FDIC, as conservator or receiver for a failed bank, succeeds "by operation of law" to "(i) all rights, titles, powers, and privileges of the insured depository institution . . . with respect to the institution and the assets of the institution . . . ." Congress has given the FDIC broad authority to, among other things, "take over the assets . . . and conduct all business of the institution;" "collect all obligations and money due the institution;" "perform all functions of the institution in the name of the institution which are consistent with the appointment as conservator or receiver;" and "preserve and conserve the assets and property of such institution." *Id.* at § 1821(d)(2)(B)(i)-(iv). As receiver, the FDIC also has the power to "place the insured depository institution in liquidation and proceed to realize upon the assets of the institution . . . ." *Id.* §1821(d)(2)E; *see also id.* §1821(d)(2)(J) ("The Corporation may, as conservator or receiver – (i) exercise all powers and authorities specifically granted to conservators or receivers, respectively, under this chapter and such incidental powers as shall be necessary to carry out such powers . . . ."). This broad grant of authority easily encompasses the power to pursue claims against third parties to recover damages on behalf of the failed institution, as the FDIC is doing here.

B. Section 1821(j) Deprives the Court of Jurisdiction to Grant the Relief Requested by the Debtors.

FIRREA's anti-injunction provision prohibits any court from interfering with the exercise by the FDIC of its statutory powers as Receiver for these failed banks. Section 1821(j), titled "Limitation on court action," provides that, "[e]xcept as provided in this section, no court may take any action, except at the request of the Board of Directors by regulation or order, to restrain or affect the exercise of powers or functions of the Corporation as a conservator or a receiver." 12 U.S.C. § 1821(j). The Second Circuit has explained that section 1821(j) "is a direct manifestation of Congress's intent to prevent courts from interfering with the [Receiver] in the exercise of its statutory powers." *Volges v. Resolution Trust Corp*., 32 F.3d 50, 52 (2d Cir. 1994). The provision "has been interpreted broadly to bar judicial intervention whenever the FDIC is acting it its capacity as a receiver or conservator . . . ." *Bank of Amer., N.A. v. Colonial Bank*, 604 F.3d 1239,1243 (11th Cir. 2010) ; *see also Courtney v. Halleran*, 485 F.3d 942, 948 (7th Cir. 2007) (citing cases that have "recognized the breadth of § 1821(j)'s prohibition").

Section 1821(j) has been applied to preclude not only injunctive relief, but also declaratory and other forms of equitable relief. *See, e.g., 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."); *Esther Sadowsky Testamentary Trust v. Syron*, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009) (noting that section 1821(j) "has been found by several courts to constitute 'a sweeping ouster of courts' power to grant equitable remedies") (quoting *Courtney*, 485 F.2d at 948). Furthermore, it is clear that "FIRREA's anti-injunction provision . . . applies in the bankruptcy milieu." *Sunshine Devel., Inc. v. FDIC*, 33 F.3d 106, 113 (1st Cir. 1994).

Although there are exceptions to the jurisdictional bar in section 1821(j), they are "extremely limited." *RPM Investments, Inc. v. Resolution Trust Corp*., 75 F.3d 618, 620 n.2 (11th Cir. 1996). First, the bar does not apply where the FDIC clearly is acting outside the scope of its statutory powers as receiver or conservator, which is not the case here. Second, some courts have allowed action restraining the FDIC where that relief is imposed automatically by operation of law, without the need for action by any court. *See, e.g., In re Colonial Realty Co.*, 980 F.2d 125, 136-37 (2d Cir. 1992); *Sunshine Devel.,* 33 F.3d at 113. Thus, in *Colonial*, the court held that Section 1821(j) was not violated by operation of the automatic stay because the automatic stay is "imposed by Congressional mandate and not by court order." *Id.* at 137. "By its very terms," the court explained, "*no action by any court is necessary for the stay to take effect*." *Id.* (emphasis added).

This exception also does not apply here, because court action is required to effect the relief sought by the Debtors. *See Sunshine Devel.,* 33 F.3d at 114 (concluding that, when the automatic stay is not in place as to the FDIC, any action by the bankruptcy court to restrain the FDIC from proceeding in the exercise of its lawful powers is barred by section 1821(j)). For the reasons explained by the FHFA, the relief that the Debtors' seek here – extending the stay to non-debtors and enjoining third-party claims – clearly requires court action, and therefore would run afoul of the anti-injunction provisions in both FIRREA and HERA. (*See* FHFA Br. at 17-19.)

CONCLUSION

For all of the foregoing reasons, the Court should dismiss the Debtors' complaint against the FDIC with prejudice.

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