Docket #0057 Date Filed: 7/6/2012

MORRISON & FOERSTER LLP
1290 Avenue of the Americas
New York, New York 10104
Telephone: (212) 468-8000
Facsimile: (212) 468-7900
Larren M. Nashelsky
Gary S. Lee
Joel C. Haims
Proposed Counsel to the Debtors and Debtors in Possession With Respect to All Defendants Except Federal Home Loan Bank of Boston and Federal Home Loan Bank of Chicago

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Case No. 12-12020 (MG)
RESIDENTIAL CAPITAL, LLC, et al.,	Chapter 11
Debtors.	Jointly Administered

RESIDENTIAL CAPITAL, LLC, et al.,	Case No. 12-ap-01671 (MG)
Plaintiffs,	Bankruptcy Case No. 12-12020 (MG)
v.	Jointly Administered
ALLSTATE INS. CO., THE OTHER PARTIES LISTED ON EXHIBIT A TO THE COMPLAINT, JOHN DOES 1-1000,	
Defendants.	

DEBTORS' OMNIBUS REPLY IN FURTHER SUPPORT OF THEIR MOTION TO EXTEND THE AUTOMATIC STAY OR, IN THE ALTERNATIVE, FOR INJUNCTIVE RELIEF ENJOINING PROSECUTION OF CERTAIN LITIGATION AGAINST DEBTORS' DIRECTORS AND OFFICERS AND NON-DEBTOR CORPORATE AFFILIATES

1212020120706000000000011

TABLE OF CONTENTS

INTRODUCTION 1

ARGUMENT 2

I. Continuation of the Opposing Defendants' Lawsuits Will Expose the Debtors to the Risk of Collateral Estoppel, Stare Decisis, or Evidentiary Prejudice. 2

a. The Opposing Defendants' Claims Against the Non-Debtor Affiliates Are Not Independent of Their Claims Against the Debtors. 3

b. The Risks of Collateral Estoppel, Stare Decisis, and Evidentiary Prejudice Warrant a Stay 5

II. The Costs and Burdens of Discovery in the MBS Actions Justify an Extension of the Automatic Stay. 7

a. The Discovery Costs and Burdens Would Be Substantial. 7

b. Discovery Would Distract Debtor Employees Key to the Restructuring. 9

c. The Opposing Defendants Cannot Avoid the Automatic Stay of Discovery from the Debtors. 11

III. The Debtors' Indemnification Obligations to Non-Debtor Affiliates Will Adversely Affect the Bankruptcy Estate 12

a. The MBS Actions Give Rise to Indemnity Obligations from Debtors to Non-Debtor Corporate Affiliates 12

b. The Fact that the Opposing Defendants Assert Violations of Securities Laws Does Bar Indemnification of the Non-Debtor Affiliates. 13

c. The Indemnity Obligations are Not Contingent or Speculative 15

IV. Continuation Of The Opposing Defendants' Lawsuits Will Deplete Insurance Policies And Proceeds That Are An Asset Of The Estate. 15

a. The E&O Policies Cover the MBS Actions. 16

b. The Shared Insurance Policies and Proceeds Are an Asset of the Estate. 17

V. The Continued Prosecution of the MBS Actions Against the Non-Debtor Affiliates Should Also Be Enjoined Under Section 105. 18

TABLE OF AUTHORITIES

Page(s)

CASES

Adalman v. Baker, Watts & Co.,
599 F. Supp. 752 (D. Md. 1984) 13

Globus, Inc. v. Law Research Service, Inc.,
418 F.2d 1276 (2d Cir. 1969) 14

Globus v. Law Research Service, Inc.,
318 F. Supp. 955 (S.D.N.Y. 1970) 14

Hawaii Structural Ironworkers Penson Trust Fund v. Calpine Corp., Inc.,
2006 WL 3755175 (S.D.N.Y. Dec. 20, 2006) ..... passim

In re Calpine Corp.,
354 B.R. 45 (Bankr. S.D.N.Y. 2006) 2

In re Calpine Corp,
365 B.R. 401 (S.D.N.Y. 2007) 2, 6, 20

In re CitiSource, Inc. Sec. Litig.,
694 F. Supp. 1069 (S.D.N.Y. 1988) 13

In re Ionosphere Clubs, Inc.,
111 B.R. 423 (Bankr. S.D.N.Y. 1990) 2

In re Johns-Manville,
26 B.R. 420 (Bankr. S.D.N.Y. 1983) 4,5, 9

In re Lyondell Chem. Co.,
402 B.R. 571 (Bankr. S.D.N.Y. 2009) 19

In re OMC, Inc.,
2010 WL 4026097 (Bankr. S.D.N.Y. Oct. 13, 2010) 20

In re Quigley Co., Inc.,
676 F.3d 45 (2d Cir. 2012) 17

Margolin v. N.Y. Life Ins. Co.,
32 N.Y.2d 149 (N.Y. 1973) 14

McHale v. Alvarez (In re 1031 Tax Grp., LLC),
397 B.R. 670 (Bankr. S.D.N.Y. 2008) ..... passim

Pacor, Inc. v. Higgins, 743 F.2d 984 (3d Cir. 1984) 6

Steel Workers Pension Trust v. Citigroup, Inc.,
295 B.R. 747 (E.D. Pa. 2003) 15

United Orient Bank v. Green (In re Green),
207 B.R. 762 (S.D.N.Y. 1997).....13

STATUTES

11 U.S.C. § 105.....2

11 U.S.C. § 362.....17

15 U.S.C. § 77o.....3

Debtors respectfully submit this Omnibus Reply in Further Support of Their Motion to Extend the Automatic Stay, or in the Alternative, for Injunctive Relief Enjoining Prosecution of Certain Litigation Against Debtors' Directors and Officers and Non-Debtor Corporate Affiliates (the "Stay Motion"). This Omnibus Reply is made with respect to the oppositions filed by the New Jersey Carpenters Health Fund ("NJ Carpenters") (Doc. 38), Union Central Life Insurance Co., Ameritas Life Insurance Co., and Acacia Life Insurance Co. (together, "Union Central") (Doc. 42), Cambridge Place Investment Management Co. ("Cambridge Place") (Doc. 41), the Federal Deposit Insurance Company ("FDIC") (Doc. 37), and The Western and Southern Life Insurance Co., Western-Southern Life Assurance Co., Columbus Life Insurance Co., National Integrity Life Insurance Co., and Fort Washington Investment Advisors, Inc. (together, "W&S") (Doc. 49) (all collectively, the "Opposing Defendants").[1]

INTRODUCTION

The Stay Motion sought to stay litigation against the Non-Debtor Affiliates in twenty-seven different lawsuits.[2] The Debtors voluntarily dismissed their request for a stay of two of those lawsuits. (*See* Notice of Voluntary Dismissal, June 22, 2012, Doc. 30.) Of the remaining twenty-five lawsuits, the parties in eighteen agreed to stay the prosecution of those lawsuits until October 31, 2012.[3]

Rather than agree to the Debtors' proposed temporary stay, the Opposing Defendants instead seek to avoid a stay altogether by seizing on a variety of issues that they claim refute the

[1] This Omnibus Reply does not address the opposition filed by the Federal Housing Finance Administration which raised arguments in conjunction with a motion to withdraw the reference. A reply addressing FHFA's opposition is being filed separately.

[2] Capitalized terms not defined herein refer to the defined terms from the Stay Motion.

[3] The Debtors attempted to reach a stipulation with W&S—and even agreed to W&S' request that the Non-Debtor Corporate Affiliates provide an answer and written discovery responses along with a toll of claims against them. But contrary to their suggestions in their opposition, W&S refused to agree to a consensual stay.

basis for a stay. None of their proffered arguments, however, undermine the basic facts. Indeed, the Opposing Defendants seem to argue nothing more than their belief that prosecution of their MBS Actions against the Non-Debtor Affiliates without any delay is far more important than the Debtors' ability to complete a successful restructuring. That is simply incorrect, and the Debtors have more than satisfied the standards for a temporary stay of the MBS Actions against the Non-Debtor Affiliates.

ARGUMENT

In an effort to avoid a stay of their lawsuits, the Opposing Defendants put forward five overarching arguments: (1) continuation of the lawsuits will not result in any collateral estoppel, *stare decisis*, or evidentiary prejudice against the Debtors to warrant a stay; (2) continuation of the lawsuits will not impose burdensome discovery obligations on the Debtors that would distract from the restructuring efforts; (3) continuation of the lawsuits "will not result in immediate, absolute indemnification obligations for the Debtors,"; (4) continuation of the lawsuits will not deplete property of the Debtors' estate because the insurance policies either are not property of the estate or do not cover the claims in the lawsuits; and (5) there is no basis for an injunction under § 105. Each of these arguments fails, and the Debtors Stay Motion should be granted.

I. Continuation of the Opposing Defendants' Lawsuits Will Expose the Debtors to the Risk of Collateral Estoppel, Stare Decisis, or Evidentiary Prejudice.

Where, as here, debtors and non-debtors share an identity of interest and the claims against them are inextricably interwoven, a stay of the claims against non-debtors is warranted to avoid the risk of res judicata, *stare decisis*, law of the case, and evidentiary prejudice to the debtors. *In re Calpine Corp.*, 354 B.R. 45, 50 (Bankr. S.D.N.Y. 2006), *aff'd*, 365 B.R. 401 (S.D.N.Y. 2007); *In re Ionosphere Clubs, Inc.*, 111 B.R. 423, 434 (Bankr. S.D.N.Y. 1990).

a. The Opposing Defendants' Claims Against the Non-Debtor Affiliates Are Not Independent of Their Claims Against the Debtors.

NJ Carpenters and the FDIC argue that there is no identity of interest between the Debtors and Non-Debtor Affiliates because their claims against the latter—brought under sections 11 and 12 of the Securities Act of 1933—impose direct liability and are "not based upon or derivative of the Debtors' own liability." (NJ Carpenters Opp'n at 11; *accord* FDIC Opp'n at 4–6.) This argument misses the mark.

First, NJ Carpenters brings a claim against the Non-Debtor Affiliates that, on its face, is based on a theory of derivative liability. The Third Cause of Action in their MBS Action alleges that the Non-Debtor Affiliates violated § 15 of the Securities Act which imposes liability on "controlling persons." 15 U.S.C. § 77o. (NJ Carpenters Compl. ¶¶ 249–57, attached as Ex. 10 to the Declaration of Joel C. Haims, May 24, 2012, Doc. 5 (the "Haims Decl.").) Indeed, NJ Carpenters alleges that the "Individual Defendants" and the "Underwriter Defendants"—Ally Securities and the D&Os—were "controlling persons" and "had the power to influence, and exercised that power and influence, to cause [the Debtors] to engage in violations of the Securities Act." (*See* NJ Carpenters Compl. ¶¶ 251–52.) That claim is unquestionably "derivative of the Debtors' own liability." (NJ Carpenters Opp'n at 11.); *See Lindsay v. Morgan Stanley* (*In re Morgan Stanley Info. Fund Sec. Litig.*), 592 F.3d 347, 358 (2d Cir. 2010) ("[T]he success of a claim under section 15 relies, in part, on a plaintiff's ability to demonstrate primary liability under sections 11 and 12.")

Second, the claims that seek to impose "direct, not derivative" liability on the Non-Debtor Affiliates pursuant to sections 11 and 12 of the Securities Act may be direct claims but they are plainly inextricably interwoven with the Debtors' conduct. (*Id.* at 12.) Those claims are indisputably premised on the Debtors' underlying conduct. (*See* Declaration of Jeffrey A. Lipps,

May 24, 2012, Doc. 6 (the "Lipps Decl.") ¶¶ 13–14, 24, 49.) Indeed, those claims are all based on securities filings and securitizations issued by Debtor entities. (*See* FDIC Opp'n at 1 ("FDIC sued [Ally Securities] as underwriter of certificates issued in three securitizations by Residential Accredit Loans, Inc. (RALI)."); NJ Carpenters Compl. ¶ 1 (stating that lawsuit is based on "two separate Registration Statements and accompanying Prospectuses filed with the Securities and Exchange Comission by Residential Accredited Loans, Inc.").) As NJ Carpenters concedes, "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." (NJ Carpenters Opp'n at 11.)

Thus, the only way for the Opposing Defendants to prove liability against the Non-Debtor Affiliates is to make a prima facie case that the Debtors violated securities laws too. Any decisions and evidence generated in those lawsuits would thus be later used against the Debtors—whether in the underlying lawsuits or in claims the Opposing Defendants make against the Debtors' estate in these chapter 11 proceedings. *See McHale v. Alvarez (In re 1031 Tax Grp., LLC)*, 397 B.R. 670, 685 (Bankr. S.D.N.Y. 2008) (Glenn, J.) (staying lawsuits against debtors' former employees that could lead to *respondeat superior* liability for debtors during reorganization); *In re Johns-Manville*, 26 B.R. 420, 426 (Bankr. S.D.N.Y. 1983) (staying securities claims against debtor's directors and officers where claims were "in reality derivative of identical claims" that were or could be brought against the debtors). Given that identity of interest, the collateral estoppel, *stare decisis*, and evidentiary prejudice that the Debtors would face warrants a stay of the Opposing Defendants' claims against the Non-Debtor Affiliates.

The cases the Opposing Defendants cite are not to the contrary. The FDIC, for example, asserts that in *Hawaii Structural Ironworkers Penson Trust Fund v. Calpine Corp., Inc.*, "the debtor asked the court to enjoin the prosecution of an action under 1933 Act against . . . the underwriters of its securities" but the court refused to do so. (FDIC Opp'n at 6 (citing 2006 WL 3755175 (S.D.N.Y. Dec. 20, 2006)).) The FDIC is incorrect. In *Calpine*, the debtors did not seek a stay of claims against the underwriters. As that decision makes clear, the debtors sought a stay of only those claims "against individual defendants who were directors of the debtor." 2006 WL 3755175, at *1. It is unsurprising, then, that the Court's decision "did not reach" the underwriter defendants, since that issue was not before it. (FDIC Opp'n at 6.)

b. The Risks of Collateral Estoppel, Stare Decisis, and Evidentiary Prejudice Warrant a Stay.

NJ Carpenters and FDIC separately contend that, even if there is an identity of interest between the Debtors and the Non-Debtor Affiliates, "[t]here is no risk of collateral estoppel, *stare decisis*, or evidentiary prejudice against the Debtors" to warrant a stay. (NJ Carpenters Opp'n at 13; *see also* FDIC Opp'n at 11.) That argument is based on an overly restrictive view of collateral estoppel and a refusal to acknowledge that, practically speaking, the Debtors will have little or no chance to un-ring the bell following a decision that could be used against them.

First, NJ Carpenters blithely asserts that the "Debtors will not be bound by any decision against the Non-Debtor Defendants." And that the Debtors will be able to relitigate from scratch any ruling against them." (NJ Carpenters Opp'n at 15.)

There is no doubt that, as a practical matter, the Opposing Defendants will attempt to use any decisions or rulings against the Debtors. Whether by application of collateral estoppel, res judicata, or law of the case, the Debtors may have to live with any decision in a case that was resolved as to the Non-Debtor Affiliates. *See, e.g.*, *Johns-Manville*, 26 B.R. at 429 ("Even if

'[the debtor] is not so bound [by collateral estoppel], [it] may be disadvantaged in subsequent suits."). That is precisely why courts extend the automatic stay in these circumstances: otherwise, the Debtors will be faced with the choice of sitting on the sidelines and being stuck with rulings on issues they did not litigate, or be forced to litigate—the very thing the automatic stay is supposed to prevent. *Hawaii Structural*, 2006 WL 3755175, at *5 ("[A] prudent debtor would devote managerial and financial resources to assisting in the defense [of its affiliates] because of the potential impact upon a claim or suit against the debtor."); *In re Calpine Corp*, 365 B.R. 401, 412 (S.D.N.Y. 2007) ("This is especially so in situations where the debtor's liability has not yet been established and where the [nondebtor affiliate] has the ability to assert all of the debtor's factual and legal defenses to liability.").[4]

The cases the Opposing Defendants cite are not to the contrary. NJ Carpenters cites to *Pacor, Inc. v. Higgins*, but that decision is not relevant to the issue at hand. (NJ Carpenters Opp'n at 14.) The question in *Pacor* concerned the scope of the bankruptcy court's "related to" jurisdiction—not a motion to stay litigation. 743 F.2d 984, 994 (3d Cir. 1984). The FDIC's citation to *Queenie* is similarly misplaced. (FDIC Opp'n at 11.) That decision does not prohibit the stay of litigation based on the collateral estoppel risk to the Debtors, particularly where that risk is in addition to other potential harm to the Debtors such as the discovery burden, the indemnification obligations, and the depletion of estate property at issue here.

[4] W&S's assurance—in a brief—that it will "not to assert res judicata or collateral estoppel against the Debtors in respect of any ruling it obtains" against the Non-Debtor Affiliates is, as this Court found, "cold comfort for the estates" and does not warrant a denial of the Stay Motion. *See McHale v. Alvarez (In re 1031 Tax Grp., LLC)*, 397 B.R. at 685. (W&S Opp'n at 6.)

II. The Costs and Burdens of Discovery in the MBS Actions Justify an Extension of the Automatic Stay.

The Opposing Defendants assert that the discovery burden the Debtors face is "exaggerated," "hyperbolic," "overstated," or "imagined." (W&S Opp'n at 6; NJ Carpenters Opp'n at 3, 16, 34; FDIC Opp'n at 7.) But the facts that the Debtors put forth are undisputed, and the Opposing Defendants offer no facts—only speculation and conclusory assertions—in response. The Debtors put forward evidence, in Mr. Lipps' declaration, setting forth in specific detail the overwhelming cost and burden of discovery in these lawsuits. (Lipps Decl. ¶¶ 70-78.) The Opposing Defendants have never challenged the statements in Mr. Lipps' declaration—either in deposition or in their oppositions. Instead, the Opposing Defendants offer nothing more than pure conjecture that discovery in their cases will not be burdensome.

a. The Discovery Costs and Burdens Would Be Substantial.

The discovery burdens in the MBS actions have been and will continue to be substantial. For example, *MBIA Insurance Corp. v. Residential Funding Company, LLC* involved only five securitizations sponsored by Debtor RFC from a single securitization shelf, of a single loan type, during a one year span. Nevertheless, the plaintiffs took eighty days worth of depositions from the Debtors' current and former employees. (*See* Lipps Decl. ¶¶ 28–29.) In another case involving only three securitizations, Debtor GMACM produced more than 1,000,000 pages of documents plus voluminous additional electronic records. (*Id.* ¶ 30.) The Opposing Defendants present no reason—much less any evidence—to suggest that the discovery burdens in their cases will not be similarly substantial. Indeed, the documents at issue in their lawsuits— the mortgage "loan files and underwriting guidelines," as FDIC recognizes (FDIC Opp'n at 9)—are in the Debtors' possession, custody, and control, and the burden of responding to discovery requests

would fall squarely on the Debtors. (Supplemental Declaration of Jeffrey A. Lipps (the "Supp. Lipps Decl.") ¶¶ 6–9.)

Rather than acknowledge these substantial discovery burdens, the FDIC asserts—incorrectly and in entirely conclusory fashion—that the discovery in its case "will easily be manageable." (FDIC Opp'n at 7.) That is so, the FDIC contends, because its lawsuit "involves only three trusts" and less than 4,000 mortgage loan files originated by a Debtor entity. (*Id.* at 7–8.) The FDIC is wrong. Indeed, MBIA's lawsuit against Debtor GMACM also involved only three securitization trusts, but the Debtors produced more than 1,000,000 pages of documents and substantial electronic records. (*See* Lipps Decl. ¶ 30.)

The FDIC's bald assertion that documents relevant to its case "have already been collected and produced in other actions" is similarly false. (FDIC Opp'n at 10.) The FDIC notably offers no proof whatsoever for that statement, other than its "anticipat[ion]" that it must so. (*Id.*) Wishing does not make it so. As set forth in Mr. Lipps' Supplemental Declaration, no securitizations at issue in the FDIC's lawsuit overlap with any securitizations for which the Debtors have previously collected and produced loan files. (*See* Supp. Lipps Decl. ¶¶ 12, 23, 30.) Similarly, the FDIC's lawsuit involves a different mix of custodians from those whose data was previously restored and collected for other lawsuits. (*Id.* ¶ 27.) And even if some documents produced in other lawsuits are also relevant to the FDIC's claims, that does not eliminate the cost and burden of producing those materials to the FDIC. Indeed, merely identifying those documents would require substantial time and expense—all to be borne by the Debtors. (*Id.* ¶¶ 14–20.)

For its part, NJ Carpenters' asserts that broad "[m]erits discovery is not likely to take place at all in the Class Action during the pendency of the Bankruptcy Cases." (NJ Carpenters

Opp'n at 17.) As an initial matter, if that is so, then NJ Carpenters is not harmed by a stay of its claims against the Non-Debtor Affiliates. Moreover, the fact that merits discovery is currently stayed pending a ruling on class certification does not mean that such discovery will be stayed throughout these bankruptcy proceedings. Indeed, NJ Carpenters admits that "discovery in the Class Action [will] continue[] at some point in the future." (*Id.*) If discovery were to resume during the pendency of these bankruptcy proceedings, perhaps because the court handling the underlying lawsuit lifts the stay or certifies a class, the resulting discovery burden on the Debtors would be significant. (*See* Supp. Lipps Decl. ¶ 22, 35.) Staying the lawsuit removes that threat.

b. Discovery Would Distract Debtor Employees Key to the Restructuring.

The Opposing Defendants also argue that discovery in their cases will not sufficiently burden the Debtors' employees to justify a stay. They are wrong on the law and the facts.

First, NJ Carpenters erroneously suggests that courts extend the automatic stay only where "a debtor's critical restructuring personnel will be distracted by ongoing litigation in which they are named as defendants." (NJ Carpenters Opp'n at 18.) That simply is not the law. *See, e.g.*, *Hawaii Structural*, 2006 WL 3755175, at *5 (affirming extension of stay to securities claims against debtor's former directors and underwriters); *McHale v. Alvarez (In re 1031 Tax Grp., LLC)*, 397 B.R. at 684 (enjoining litigation against debtor's former employees). Indeed, the very case on which NJ Carpenters relies, *In re Johns-Manville*, itself approvingly cites and discusses cases staying securities litigation against a debtor's former officers and directors. 26 B.R. at 426 (citing *Wickes v. Groebner, et al.,* Adv. Proceeding No. LA-82-6107 filed on Aug. 14, 1982) (enjoining class actions against former officers and directors).

The rationale adopted in *Johns-Manville* and *Hawaii Structural* applies here: the discovery in those cases primarily sought internal company documents and information from the debtors and their current employees. So too here. *Compare Hawaii Structural*, 2006 WL

3755175, *5 (recognizing burden to employees "heavily involved in" restructuring, regardless of whether defendants were "no longer affiliated with the debtor") *with* Supp. Lipps Declaration ¶¶ 31–33 (outlining impact of continued litigation to Debtors' key employees). "[I]n this regard, it matters little that some of the individual defendants are no longer affiliated with the debtor," because the ultimate discovery burden falls on current employees who are critical to restructuring. *Hawaii Structural*, 2006 WL 3755175, at *5–6.

Second, the FDIC contends that discovery in its lawsuit will not burden any key employees because the "Debtors do not refer to any people involved in the reorganization with knowledge of the origination activities of Debtor GMAC Mortgage," the originator of loans in the MBS at issue in its lawsuit. (FDIC Opp'n at 10.) The Debtors' opening motion—and the supporting declarations—provided only examples of key employees who would be distracted with ongoing discovery burdens. In any event, there are myriad employees of Debtor GMAC Mortgage who are key to the Debtors' restructuring and who would be saddled with significant discovery obligations if these lawsuits were to continue, including Nora Pio, Michele Hreshko, Laura Reichel, Frank Madden, Sue Young, Darsi Meyer, and Paul Williams, just to name a few. (*See* Supp. Lipps Decl. ¶ 32.) Not only that, but the FDIC is simply incorrect that the employees listed in Mr. Lipps' initial declaration are irrelevant to their suit. For example, Heather Anderson would likely be a primary company witness in the FDIC litigation because of her knowledge of the deals at issue. (Lipps Decl. ¶ 74(a).)

Finally, the FDIC asserts that "the task of locating and producing loan files and accompanying servicing records can be done by clerical or technical personnel." (FDIC Opp'n at 10.) The FDIC offers no basis for its claim. For good reason: that simply is not the case. As set forth in the declarations supporting the Debtors' motion and in Mr. Lipps' Supplemental

Declaration, the documents and materials in these lawsuits cannot be obtained and produced by clerical or technical personnel; persons with knowledge of the underlying loan files and materials are critical to understanding and producing the documents. (*See* Supp. Lipps. ¶¶ 11–14.)

c. The Opposing Defendants Cannot Avoid the Automatic Stay of Discovery from the Debtors.

W&S asserts that "discovery may still be sought [from the Debtors] sought regardless of a stay." (W&S Opp'n at 6.) W&S is incorrect. *See In re Johns-Manville*, 40 B.R. 219, 223-226 (S.D.N.Y. 1984) (recognizing that, while the automatic stay might not automatically ban *all* third-party discovery requests to debtors, "such requests should be upheld *only* when such discovery will not interfere significantly with the Debtor's reorganization efforts," and affirming bankruptcy court's denial of third-party discovery); *see also In re Penn-Dixie Industries, Inc.*, 6 B.R. 832, 836 (Bankr. S.D.N.Y. 1980) (refusing to lift stay to allow plaintiff to pursue discovery from debtors because "[i]nterference by creditors in the administration of the estate, no matter how small, through the continuance of a preliminary skirmish in a suit outside the Bankruptcy Court is prohibited").

The cases that W&S cites are of no help. (W&S Opp'n at 6.) The decision that it cites from this circuit, *Signature Bank v. Ahava Food*, 2008 WL 4126248 (S.D.N.Y. Aug. 19, 2008), is devoid of any analysis and that decision does nothing to overrule *Johns-Manville* or *Penn Dixie*. W&S's reliance on *In re Miller*, 262 B.R. 499 (9th Cir. B.A.P. 2001), is similarly misplaced. That decision permitted discovery of information that would not affect the debtor or property of the debtor. Where, however, "the information sought" from the debtors could "affect the property of the Debtors' estates"—like the discovery sought here—the discovery is barred by the automatic stay. *In re Phila. Newspapers, LLC*, 423 B.R. 98, 105 (E.D. Pa. 2010).

III. The Debtors' Indemnification Obligations to Non-Debtor Affiliates Will Adversely Affect the Bankruptcy Estate.

The Debtors have indemnification obligations both to their former Directors and Officers as well as the Non-Debtor Corporate Affiliates stemming from the Operating Agreement and the ResCap LLC Agreement. (Stay Motion at 3, 17–18; Declaration of James Whitlinger, May 25, 2012, Doc. 7 (the "Whitlinger Decl.") ¶¶ 22–24.) The Opposing Defendants contend that these indemnification obligations do not warrant a stay of their lawsuits for three reasons: first, the contracts at issue do not impose indemnification obligations on the Debtors; second, public policy bars indemnification of securities claims; finally, any such indemnification obligations would only create contingent, unsecured claims against the estate that are insufficient to stay litigation. The Opposing Defendants are mistaken.

a. The MBS Actions Give Rise to Indemnity Obligations from Debtors to Non-Debtor Corporate Affiliates

NJ Carpenters argues that the Debtors are not obligated to indemnify "AFI or Ally Securities . . . for direct liabilities incurred . . . in the course of their own business." (NJ Carpenters Opp'n at 21.) That argument mischaracterizes the Operating Agreement and wholly ignores the Debtors' indemnification obligations to the individual defendants.

First, the Operating Agreement requires the Debtors to indemnify the Non-Debtor Corporate Affiliates for "losses related to" the Debtors' "business and operations." (Whitlinger Decl. Exhibit B, at §§ 1, 3(c).) Because a fundamental part of the Debtors' business strategy consists of securitizing and selling mortgage loans that they purchase or originate, the Debtors thus are obligated to indemnify the Non-Debtor Corporate Affiliates for losses stemming from the Debtors' issuance or sale of mortgage-backed securities. That is the very essence of NJ Carpenters' claims: that Ally Securities is liable for the alleged misstatements or material

omissions in the registration statements and prospectuses that the Debtors filed in conjunction with their RMBS securities offerings. (*See* New Jersey Carpenters Compl. ¶¶ 171, 173, 175, 177, 179, 181, 185, 187, 191, 193; FDIC Compl. ¶¶ 86–92 (attached as Ex. 4 to Haims Decl.).)

Second, regardless of the scope of the Debtors' indemnification obligations to the Non-Debtor Corporate Affiliates, there is no doubt—and New Jersey Carpenters does not dispute—that the Debtors are obligated to indemnify the individual D&Os that NJ Carpenters have named as defendants. (Whitlinger Decl. ¶ 23, Ex. A, § 18.) Those indemnification obligations are sufficient to warrant a stay of NJ Carpenters' lawsuit on their own.

b. The Fact that the Opposing Defendants Assert Violations of Securities Laws Does Not Bar Indemnification of the Non-Debtor Affiliates.

The Opposing Defendants assert that the MBS Actions will not create any indemnification claims against the Debtors' estate because courts bar indemnification for violations of securities laws as a matter of public policy. (NJ Carpenters Opp'n at 20–21; FDIC Opp'n at 12–13.) That assertion does not withstand scrutiny.

First, while public policy bars indemnification for fraud, it is far from clear that the bar extends to securities law violations based on negligence or strict liability. *See In re CitiSource, Inc. Sec. Litig.*, 694 F. Supp. 1069, 1078 n.15 (S.D.N.Y. 1988) (noting "[t]here is some support" for the position that indemnification is permissible for negligent violators of the Securities Act); *Adalman v. Baker, Watts & Co.*, 599 F. Supp. 752, 754–55 (D. Md. 1984) (refusing to rule out the indemnification of a party not actively engaged in any wrongdoing under Section 12(a) or elsewhere where liability attaches as a matter of law). That makes sense: after all, indemnification is not typically unavailable for intentional torts, but that same prohibition does extend to acts of negligence. *Compare United Orient Bank v. Green (In re Green)*, 207 B.R. 762, 763 (S.D.N.Y. 1997) ("New York law prohibits indemnity for one's own intentional tort"),

with Margolin v. N.Y. Life Ins. Co., 32 N.Y.2d 149, 153 (N.Y. 1973) ("It has long been recognized that a party may protect itself from losses resulting from its liability for negligence by means of an agreement to indemnify."). Here, the Opposing Defendants bring claims premised on negligence or strict liability, and some specifically disclaim any allegations of fraud. (NJ Carpenters Compl. ¶ 3; FDIC Compl. ¶ 121.) There is therefore no reason to believe that the Debtors indemnification obligations will be barred as a matter of public policy.

Second, the Debtors have an ongoing obligation under the indemnity agreements to advance defense costs for D&Os and, in certain circumstances, for the Non-Debtor Corporate Affiliates. Thus, in the short term, the Debtors will be forced to incur substantial indemnification expenses—even if indemnification for an adverse judgment is ultimately barred as a matter of public policy. (*See* Whitlinger Decl. Ex. A, § 18(d)(i).)

Third, a public policy bar to the Debtors' indemnification obligations to the Non-Debtor Corporate Affiliates does not prohibit the Non-Debtor Affiliates from seeking contribution from the Debtors. Indeed, the case the FDIC cites points to for its assertion that public policy bars indemnification, *Globus, Inc. v. Law Research Service, Inc.*, 418 F.2d 1276 (2d Cir. 1969), confirms as much. There, the underwriter defendant, having paid plaintiffs the full amount of the judgment, brought a separate lawsuit seeking contribution from the other defendants. *See Globus v. Law Research Service, Inc.*, 318 F. Supp. 955 (S.D.N.Y. 1970). The district court granted the underwriter's motion and ordered the other parties to pay contribution. *Id.* at 958. Thus, even if the Non-Debtors Affiliates' indemnification claims were barred as a matter of public policy, they would nonetheless have claims against the Debtors for contribution.

c. The Indemnity Obligations are Not Contingent or Speculative

NJ Carpenters also argues that the "possibility of a contingent, unliquidated indemnity claim at some unspecified future time is not grounds for extension of the automatic stay." (NJ Carpenters Opp'n at 19.) NJ Carpenters misstates the law and the facts.

NJ Carpenters cites *Steel Workers Pension Trust v. Citigroup, Inc.*, 295 B.R. 747 (E.D. Pa. 2003), but that case says nothing about extensions of the automatic stay; it only addressed whether a securities case was "related to" the bankruptcy of a non-party for purposes of a motion to remand. *Id.* at 748.

As for the facts, there is nothing "contingent" or "speculative" about the Debtors' indemnification obligations. The Operating Agreement on their face applies to the MBS Actions, including the Opposing Defendants' lawsuits. While indemnification for specific judgments might, at the moment, be contingent—because no MBS Actions have actually resulted in judgment—the Debtors are still obligated to pay defense costs for the indemnitees. (*See* Whitlinger Decl. Ex. A, § 18(d)(i).) And while it is true that such obligations would become unsecured claims in this bankruptcy, they nonetheless impact the Debtors' total liabilities and thus recovery of creditors.

IV. Continuation Of The Opposing Defendants' Lawsuits Will Deplete Insurance Policies And Proceeds That Are An Asset Of The Estate.

The Opposing Defendants put forward two arguments that the insurance policies providing coverage for the MBS Actions do not warrant a stay. *First*, NJ Carpenters and FDIC both contend that the E&O insurance policies do not provide coverage for their claims. (*Id.*; FDIC Opp'n at 13–14.). (NJ Carpenters Opp'n at 26–30.) *Second*, NJ Carpenters asserts that the shared insurance is not property of the Debtors' estates. The Opposing Defendants are wrong on both counts.

a. The E&O Policies Cover the MBS Actions.

The Opposing Defendants also question whether the shared E&O policies—and in particular, the policy attached as an exhibit to Mr. Whitlinger's declaration—cover their claims. To that end, NJ Carpenters attempts to cast aspersions on the Debtors' "tactical or strategic" reason for attaching only the one representative policy. (NJ Carpenters Opp. at 26–27.) That is unnecessary. As the Debtors explained in the Stay Motion, that specific policy is representative of additional similar policies, and the Debtors have since produced additional primary policies in their possession during discovery in this adversary proceeding.

The Opposing Defendants also argue that the E&O policy attached to Mr. Whitlinger's declaration does not cover their claims, either because their claims were filed during a different policy period or because the scope of the insurance does not cover the claims. (NJ Carpenters Opp'n at 26–30; FDIC Opp'n at 13–14.) Those arguments fail. The primary E&O insurer, Chubb, issued a letter setting forth its "preliminary coverage position" (the "Coverage Letter") that dispenses with both of these arguments. As to the policy period, Chubb's Coverage Letter makes clear that, "pursuant to Section 7(a) of the relevant policies, all Loss associated with the MBS actions 'shall be deemed one Loss' and such Loss shall be deemed to have originated during the 07–08 BPL Policy"—*i.e.*, the policy attached to Mr. Whitlinger's declaration. (*See* Coverage Letter (attached as Ex. 8 to the Supplemental Declaration of Joel C. Haims) at 10.)

Chubb's Coverage Letter also makes clear that the Opposing Defendants claims fall within the scope of the insurance policy. The Coverage Letter states: "the MBS Actions trigger coverage under the Broker-Dealer Services Liability Clause of the 07–08 BPL Policy, because they are civil proceedings 'brought by or on behalf of a Broker-Dealer Customer against an Insured for a Broker-Dealer Wrongful Act.'" (*See id.* at 13.) The Coverage Letter also notes

that the lawsuits filed by Cambridge Place, NJ Carpenters, and Union Central,[5] had been tendered and were included in the MBS Actions covered by the E&O policy. (*See id.* at 2, 5, 7.)[6]

In short, the Opposing Defendants' claims are covered by E&O policies that are a shared asset of the estate. Continuation of those lawsuits would risk depletion of that asset, and thus should be stayed pursuant to §362(a)(3).

b. The Shared Insurance Policies and Proceeds Are an Asset of the Estate.

NJ Carpenters questions whether the E&O policies and proceeds are an asset of the estate, as the Debtors submit, but it offers no evidence for its assertion. As set forth in the Stay Motion, the Second Circuit's recent decision in *In re Quigley Co., Inc.*, 676 F.3d 45 (2d Cir. 2012) confirms that shared insurance policies, like those at issue here, and their proceeds are assets of the estate. (*See* Stay Mot. at 35–37.) Despite spending several pages discussing multiple cases regarding insurance policies and proceeds, NJ Carpenters entirely ignores the Second Circuit's decision in *Quigley*, let alone attempts to distinguish it. For good reason: as in *Quigley*, the shared policies and proceeds are assets of the estate. (*See id.*)

This Court's decision in *McHale v. Alvarez (In re 1031 Tax Group)* is also instructive. In that case, much like this one, the debtor (through its trustee) reached a proposed settlement with non-debtor affiliates (former employees). The proposed settlement included the debtor's promise to seek relief staying litigation against the non-debtor affiliates and the release of claims the debtor may have had against its affiliates in exchange for funds to the estate, a release of

[5] The Western and Southern and FDIC MBS Actions would be covered under the insurance policies on the same bases, but they were not filed until after the Coverage Letter was issued, so they are not discussed therein. In fact, the FDIC case was not filed until after the bankruptcy filing.

[6] New Jersey Carpenters also calls the Debtors' insurance coverage into question because, as the Debtors noted in the Stay Motion, Ally Financial, and not one of the Debtors, tendered the MBS Actions to the insurer for coverage. But who tenders the claim has no bearing on whether the policies cover the Debtors and whether proceeds are therefore assets of the estate. In this case, Ally Financial as the policy owner is the only party that can tender claims on behalf of itself and its subsidiaries.

claims against the estate, and an assignment of rights to the affiliates' E&O insurance policies. 397 B.R. at 676. (*Cf.* Settlement and Plan Support Agreement, *In re Residential Capital, LLC* (May 14, 2012), ECF No. 6-8 (the "AFI PSA").) The Court enjoined litigation against the debtor's affiliates in large part because—in addition to creating a risk that the debtor would have to indemnify its affiliates—continued litigation would draw down the E&O policies, thereby depleting estate assets. 397 B.R. at 685. The same is true here: the Non-Debtor Affiliates have "already claimed against the E&O Policies, policies whose proceeds are assets of the estate. If [cases against the Non-Debtor Affiliates] go forward, insurance proceeds recoverable by the estate from these wasting policies may be diminished by defense costs" of the Non-Debtor Affiliates. *See id.*

NJ Carpenters attempt to distinguish the present case from *In re 1031 Tax Group* fails. For example, it claims that the "basis for the issuance of a preliminary injunction" was the trustee's claim that "some or all of the causes of action" it sought to stay "were derivative claims that belonged to the estate." (NJ Carpenters Opp'n at 36.) That is incorrect. Although the Court requested briefing on whether any of the claims the trustee sought to stay were derivative of the estate's claims, that was an entirely separate issue from the Court's decision to stay the prosecution of claims that did not belong to the estate—in part, on the basis of shared insurance policies. 397 B.R. at 678, 685.

V. The Continued Prosecution of the MBS Actions Against the Non-Debtor Affiliates Should Also Be Enjoined Under Section 105.

Finally, as demonstrated in the Debtors' Stay Motion, the Debtors satisfy all four factors to obtain a section 105 preliminary injunction. *First*, continued prosecution of the MBS actions clearly poses an imminent and irreparable harm to the Debtors' estate and their ability to successfully restructure. The Opposing Defendants would lull the Court into believing that these

harms will only arise far in the future, or at least far enough into the future that the Court can put off the Stay Motion until some other day. That is untrue. The burdensome and distracting discovery would continue; the indemnification obligations will accrue; and the shared insurance will be depleted. Those harms are all imminent and justify an injunction.

Second, there is a reasonable likelihood that the Debtors' restructuring will succeed. "The Debtors have so far been successful in doing everything they've needed to do to date;" they "are proceeding on track, and there is no reason to believe or suspect that their reorganization will fail." *In re Lyondell Chem. Co.*, 402 B.R. 571, 590 (Bankr. S.D.N.Y. 2009). NJ Carpenters would have the Court believe that this factor does not favor an injunction. But in so arguing, it completely twists the law, focusing instead on whether a plan it claims is "envisioned in the AFI PSA" is confirmable. (NJ Carpenters Opp'n at 32.) That assertion, along with its continued suggestion that the Stay Motion is merely a "bridge" to broad and permanent third-party releases, is an unfounded distraction that does not weigh against granting the stay. *See McHale v. Alvarez (In re The 1031 Tax Group)*, 397 B.R. at 687 (noting that "settlements initially reached may be altered to overcome objections to approval"). The law focuses on whether the Debtors "are proceeding on track" to a successful restructuring—and as to that, there is no argument to the contrary.

Third, the balance of harms clearly favors granting the injunction. In contrast to the imminent harms to the Debtors' estates demonstrated in the Debtors' Stay Motion, the Opposing Defendants have offered little or no potential countervailing harm. NJ Carpenters presents a vague theory that a limited five-month stay of its securities class action against the Non-Debtor Affiliates will somehow "nullify[] the safeguards of federal and state securities regulations," and "violat[e] the very fabric of market integrity." (NJ Carpenters Opp'n at 38.) The FDIC, for its

part, fails to explain why a temporary stay of its lawsuit will result in any substantial harm when it already waited until May 18, 2012—years after the deals at issue—to file suit. Meanwhile, W&S concedes that discovery in its case does not close until April 2013 and that it has no trial date until 2014. The temporary stay that the Debtors request will have little effect, if any, on the Opposing Defendants—but as set forth above, failure to stay those lawsuits will have substantial harm on the Debtors and their estate.

Fourth and finally, the public interest is served by issuing an injunction. As this Court has recognized, "in the context of bankruptcy proceedings, the 'public interest' element means the promoti[on] of a successful reorganization." *In re OMC, Inc.*, No. 10-14864 (MG), 2010 WL 4026097, at *5 (Bankr. S.D.N.Y. Oct. 13, 2010) (quoting *In re Am. Film Techs.*, 175 B.R. 847, 849 (Bankr. D. Del. 1994)); *accord In re Calpine Corp*., 365 B.R. at 413; *Haw. Structural*, 2006 WL 3755175, at *6. Enjoining the Opposing Defendants claims against the Non-Debtor Affiliates to avoid irreparable harm to the Debtors and allow them to restructure successfully is a far greater public interest than allowing the plaintiffs to continue pursuing their private securities litigation claims.

Dated: July 6, 2012
New York, New York

/s/ Joel C. Haims
Larren M. Nashelsky
Gary S. Lee
Joel C. Haims

MORRISON & FOERSTER LLP
1290 Avenue of the Americas
New York, New York 10104
Telephone: (212) 468-8000
Facsimile: (212) 468-7900

Proposed Counsel to the Debtors and Debtors in Possession