Docket #0069 Date Filed: 7/9/2012

**UNITED STATES BANKRUPTCY COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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| In re:<br><br>RESIDENTIAL CAPITAL, LLC, *et al.*,<br><br>Debtors. | Case No. 12-12020 (MG)<br>Chapter 11<br>Jointly Administered<br><br>Adv. Case No. 12-01671 (MG) |
| RESIDENTIAL CAPTIAL, LLC., *et al.*,<br><br>Plaintiffs,<br><br>-against-<br><br>ALLSTATE INSURANCE CO., *et al.*,<br><br>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 WITHDRAW THE REFERENCE OF THIS ADVERSARY PROCEEDING TO THE BANKRUPTCY COURT**

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The Federal Deposit Insurance Corporation, as Receiver for Citizens National Bank and for Strategic Capital Bank and acting within its congressionally granted authority under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), filed suit in the Southern District of New York on May 18, 2012, alleging violations of the Securities Act of 1933 by certain issuers and underwriters of mortgage-backed securities (MBS) that the banks purchased before they failed. The FDIC sued one of those defendants, Ally Securities, as underwriter of certificates issued in three securitizations by Residential Accredit Loans, Inc. (RALI). Several distant affiliates of Ally Securities, including Residential Capital LLC (ResCap) and RALI, filed for Chapter 11 bankruptcy protection just days before the FDIC filed its suit. The FDIC did not name any of those Debtors as defendants, and it made no allegations against them in its complaint.

On June 4, 2012, the Debtors in the consolidated ResCap bankruptcy case commenced an Adversary Proceeding against the FDIC (along with the plaintiffs in several other MBS actions), seeking a court order (1) extending the automatic stay under section 362(a) of the Bankruptcy Code to claims against non-debtor affiliates of the Debtors (including the FDIC's claims against Ally Securities) until the effective date of a plan, or (2) enjoining the FDIC from pursuing its claims against solvent non-debtor Ally Securities until the date of a plan pursuant to section 105(a) of the Bankruptcy Code. The FDIC filed an objection to the Debtors' motion and moved to dismiss the complaint in the Adversary Proceeding on the ground that it is barred by the anti-injunction provision of 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). A court order granting the Debtors the relief they seek in the Adversary Proceeding

would violate the plain language and purpose of FIRREA by restraining the FDIC's power as Receiver for these failed banks to pursue claims against solvent non-debtor Ally Securities.

The FDIC now moves to withdraw the reference to the bankruptcy court. Under 28 U.S.C § 157(d), the district court shall withdraw a proceeding if it determines that "resolution of the proceeding requires consideration of both title 11 and other laws of the United States." Because the Adversary Proceeding against the FDIC requires substantial consideration of the anti-injunction provision of FIRREA and the resolution of a conflict between that provision and the relief that the Debtors seek under Bankruptcy Code, the Court should withdraw the reference as required by section 157(d). Alternatively, even if withdrawal were not mandatory here, the Court should withdraw the reference under the permissive withdrawal clause in section 157(d). *See* 28 U.S.C. § 157(d) (stating that district court may withdraw, in whole or in part, a proceeding on its own motion or the motion of any party "for cause shown"). Because the district court overseeing the FDIC's underlying action against Ally Securities and numerous other underwriters and issuers is best positioned to rule on the Debtors' motion to stay or enjoin and the consequences that such relief would have on the litigation pending before it, the Court should exercise its discretion and withdraw the reference under section 157(d).

Indeed, on July 9, 2012, Judge Cote granted a motion by defendant Federal Housing Finance Agency (FHFA), as Conservator for Freddie Mac, to withdraw the reference as to the FHFA on precisely this basis. (*See* Order, *Residential Capital, LLC v. Federal Housing Finance Agency*, No. 12 Civ. 5116 (DLC) (S.D.N.Y. July 9, 2012) (Ex. A to Declaration of Kathryn E. Matthews, dated July 9, 2012.)) Although she did not decide whether withdrawal of the reference was mandatory in light of the FHFA's invocation of a nearly identical anti-injunction provision in the Housing and Economic Recovery Act of 2008 (HERA), 12 U.S.C. § 4617(f), Judge Cote

concluded that "[t]his Court is best positioned to rule on debtors' motion to stay or enjoin litigation by FHFA in light of the potential consequences of such an order for the sixteen related actions pending before the Court." *Id.* She therefore granted the FHFA's motion under the permissive withdrawal clause in section 157(d).

For these reasons, and as explained in detail below, the FDIC therefore respectfully requests that the Court withdraw the reference of the Adversary Proceeding as to the FDIC.

## 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 banks' purchase of certificates in 12 securitizations of residential mortgage loans.[1] *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; Matthews Decl. Ex. B.) 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 securitizations issued by RALI. (FDIC Compl. Scheds.1, 2, 4.) The

[1] 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.

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 an Adversary Proceeding by filing a 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 ("Stay Motion"). Their Complaint and Stay Motion seek two forms of relief. First, they ask the Bankruptcy 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, they ask the Bankruptcy 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. On June 28, 2012, the FDIC filed an objection to the Stay Motion, and on July 5, it moved to dismiss the Complaint for lack of jurisdiction. An evidentiary hearing on the Stay Motion is scheduled for July 10, 2012.

## ARGUMENT

**I. Withdrawal of the Reference is Mandatory under the Circumstances of this Case.**

**A. Governing Legal Standard**

District courts have original jurisdiction over cases "arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b). They may, however, refer cases or proceedings that fall within that grant of jurisdiction to the bankruptcy court pursuant to 28 U.S.C. § 157(a). In this district, a standing order automatically refers such matters to the

Bankruptcy Court in the first instance. *See* Amended Standing Order of Reference, M-431, dated Jan. 31, 2012 (Preska, C.J.). District courts may, and in some cases must, withdraw the reference from the bankruptcy court under 28 U.S.C. § 157(d), which provides:

> The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court *shall*, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(emphasis added). Under both the language of section 157(d) and Federal Rule of Bankruptcy Procedure 5011(a), it is the district court rather than the bankruptcy court that determines whether to withdraw the reference. For the reasons explained herein, the reference of the Adversary Proceeding must be withdrawn under the mandatory withdrawal clause of section 157(d).

Withdrawal under section 157(d) is required for "cases or issues that would otherwise require a bankruptcy court judge to engage in significant interpretation, as opposed to simple application, of federal laws apart from the bankruptcy statutes." *City of New York v. Exxon Corp.*, 932 F.2d 1020, 1026 (2d Cir. 1991). Although the "standard for withdrawal of the reference is more easily satisfied when the non-bankruptcy law under consideration . . . raises a sharp conflict with competing provisions of the Bankruptcy Code," *Oneida Ltd. v. Pension Ben. Guar. Corp.*, 372 B.R. 107, 110 (S.D.N.Y. 2007) (internal quotations omitted), "section 157(d)'s 'substantial and material' standard is satisfied even where a non-bankruptcy federal statute only 'arguably conflicts' with the Bankruptcy Code." *In re Dana Corp.*, 379 B.R. 459, 460 (S.D.N.Y. 2007) (quoting *In re Cablevision S.A.*, 315 B.R. 818, 821 (S.D.N.Y. 2004)).

Mandatory withdrawal is not limited to matters of first impression. *See Enron Power Mktg., Inc. v. Cal. Power Exch. Corp.*, No. 04 Civ. 8177 (RCC), 2004 WL 2711101, at *2

(S.D.N.Y. Nov. 23, 2004) ("To satisfy [section 157(d)], the issues of non-bankruptcy law raised by the proceeding need not be unsettled or involve matters of 'first impression.') (citing *McCrory Corp. v. 99¢ Only Stores (In re McCrory Corp.)*, 160 B.R. 502, 505 (S.D.N.Y. 1993)). However, where "matters of first impression are concerned, the burden of establishing a right to mandatory withdrawal is more easily met." *Chemtura Corp. v. United States*, No. 10 Civ. 503, 2010 WL 1379752, at *1 (S.D.N.Y. Mar. 26, 2010) (quoting *In re Manhattan Invest. Fund Ltd.*, 343 B.R. 63, 67 (S.D.N.Y. 2006)) (citations omitted). "[I]n determining whether withdrawal of the reference is mandatory, this Court need not evaluate the merits of the parties' claims; rather it is sufficient for the Court to determine that the proceeding will involve consideration of federal non-bankruptcy law." *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC*, 454 B.R. 307, 312 (S.D.N.Y. 2011) (internal citations omitted).

**B. The Adversary Proceeding Raises Issues Requiring Substantial Consideration of FIRREA and Bankruptcy Law.**

The Adversary Proceeding raises issues that will require substantial consideration of federal non-bankruptcy law – section 1821(j) of FIRREA – and the resolution of an apparent conflict between that statute and the Bankruptcy Code. In particular, the Court must consider whether FIRREA's anti-injunction provision precludes the Debtors from obtaining the relief that they seek in the Adversary Proceeding, *i.e.*, a court-ordered extension of the stay to protect Ally Securities, a non-debtor, or an injunction prohibiting the FDIC from pursuing its claims against Ally Securities.

**1. FIRREA's Anti-Injunction Provision Precludes a Court from Granting the Relief that the Debtors Seek in the Adversary Proceeding.**

To ensure that the FDIC may exercise the powers granted to it as receiver without unnecessary interference, Congress included the anti-injunction provision in FIRREA. Section 1821(j), titled "Limitation on court action," provides:

> Except 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").[2]

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

[2] It is beyond dispute that the FDIC is acting within its statutory powers as receiver in bringing suit to recover damages for violations of the securities laws by entities that issued and underwrote securities that the banks purchased before they failed. *See, e.g*., 12 U.S.C. § 1821(d)(2)(A) (providing that 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 . . . ."; *id.* § 1821(d)(2)(B)(i)-(iv) (granting 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.* §1821(d)(2)(E) (granting FDIC as receiver the power to "place the insured depository institution in liquidation and proceed to realize upon the assets of the institution . . . .").

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, courts have held that "FIRREA's anti-injunction provision . . . applies in the bankruptcy milieu." *Sunshine Devel., Inc. v. FDIC*, 33 F.3d 106, 113 (1st Cir. 1994); *see also id.* at 116 ("[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.").

**2. Because the Adversary Proceeding Requires Substantial Consideration of Section 1821(j) and Its Interplay with the Bankruptcy Code, the Court Should Withdraw the Reference.**

The threshold issue to be resolved on the Stay Motion is whether the Court may extend the bankruptcy stay to preclude the FDIC from pursuing its claims against Ally Securities, or temporarily enjoin those claims, without "restrain[ing] or affect[ing] the exercise of [the FDIC's] powers" in violation of section 1821(j). The FDIC maintains, for the reasons set forth in its Motion to Dismiss the Complaint, that section 1821(j) squarely applies and bars the relief that the Debtors seek, because such relief requires court action and it would interfere with the FDIC's exercise of its statutory powers as Receiver. *See Sunshine Devel.*, 33 F.3d at 114 (1st Cir. 1994) (concluding that when an automatic stay does not currently prevent the FDIC from prosecuting its claims, 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)).

The Debtors, however, have taken the position that the nearly identical anti-injunction provision in the Housing and Economic Recovery Act of 2008 (HERA) does not preclude the Bankruptcy Court from granting the same relief with respect to the FHFA. (See Debtors' Opp. to FHFA Mot. to Withdraw Reference.) The Debtors have asserted that (1) a temporary stay or injunction does not "restrain or effect" the exercise of a receiver or conservator's power, but merely delays it, and therefore does not implicate the anti-injunction provision, and (2) extension of the stay to cover the non-debtor affiliates is automatic, does not require court action (even though they have sought it), and therefore does not implicate section 1821(j). (*See* Debtors' Opp. to FHFA Mot. to Withdraw Reference, at 8-14.)

The Debtors' arguments are refuted by the plain language of section 1821(j),[3] the applicable case law,[4] and their own papers in support of the Stay Motion.[5] The mere fact that the Debtors raise these arguments, however, establishes that withdrawal of the reference is mandatory, because their resolution requires substantial interpretation of the interplay between 12 U.S.C. § 1821(j) and section 362(a) of the Code.

[3] The statute states in plain terms that a court may not take "any action" that would restrain or affect the FDIC's exercise of its statutory authority. There is nothing in the language of the statute that would support the limitation that the Debtors propose, *i.e.*, that the injunction does not apply if the proposed restraint would be only a temporary one.

[4] The case law is clear that court action is required to "extend" the stay in the way that the Debtors request. *See, e.g.*, *Calpine Corp. v. Nevada Power Co. (In re Calpine Corp.)*, 354 B.R. 45, 49 (Bankr. S.D.N.Y. 2006) ("Because non-debtors do not fall within the protection of the automatic stay, at times section 105 must be invoked on their behalf to prevent creditors from frustrating an otherwise-viable reorganization effort by pursuing actions against them."); *In re Granite Partners, L.P.*, 194 B.R. 318, 337 (Bankr. S.D.N.Y. 1996) (holding that a bankruptcy court may enjoin a suit against a third-party who shares an insurance policy with the debtor because of the threat that the policy will be depleted, but stating "that the issue is not whether the automatic stay applies, but whether it should be extended under section 105(a) of the Bankruptcy Code.").

[5] *See, e.g.*, Stay Motion at 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 MBS Actions against the Non-Debtor Affiliates . . .") (emphasis added).

Indeed, the Second Circuit has expressly recognized that the type of conflict presented in this case warrants withdrawal of the reference. In *Colonial Realty*, the court considered whether the FDIC's pursuit of fraudulent conveyance claims as conservator under FIRREA violated the automatic stay that was in effect. Before answering the question in the affirmative, the court stated:

> Although the issue is moot at this juncture, *it would appear that the FDIC's motion [to withdraw the reference] should have been granted*, pursuant to § 157(d), in view of the FDIC's timely motion and the asserted conflict between provisions of the Bankruptcy Code and other federal statutes.

*In re Colonial Realty Co.*, 980 F.2d 125, 128 n.5 (2d Cir. 1992) (emphasis added). Thus, as the Second Circuit acknowledged, resolution of the conflict between the anti-injunction provision in FIRREA and section 362(a) of the Bankruptcy Code is precisely the sort of issue that mandates withdrawal of the reference. Other courts likewise have concluded that cases involving such direct conflicts are especially appropriate candidates for withdrawal. *In re Dana Corp.*, 379 B.R. at 460 ("Because CERCLA and the Bankruptcy Code arguably conflict in that the former seeks the full recovery of costs incurred or to be incurred in connection with the clean-up of environmental pollution while the latter seeks the prompt discharge of liability, I am further convinced that withdrawal is both mandated and appropriate."); *In re Cablevision S.A.*, 315 B.R. 818, 821 n.4 (S.D.N.Y. 2004) ("The very existence of a dispute as to whether . . . rights . . . under the [Trust Indenture Act] and Williams Act supersede Section 304 or whether the Bankruptcy Code overrides the TIA, regardless of the ultimate resolution of such dispute, mandates withdrawal.").

**II. Alternatively, the Court Should Exercise Its Discretion to Withdraw the Reference under Section 157(d).**

Even if the Court were to find that withdrawal of the reference is not mandatory under these circumstances, it still should grant the FDIC's motion under the permissive withdrawal clause in section 157(d). There is cause to do so here because Judge Swain, who is overseeing the FDIC's action against Ally Securities and the other underwriters and issuers of securities that the banks purchased before they failed, is best positioned to decide how a stay or injunction of the FDIC's claims against Ally Securities would affect the litigation pending before her. (*See* Matthews Decl. Ex. A.)

## CONCLUSION

For the foregoing reasons, the FDIC respectfully submits that the Court should enter an order withdrawing the reference of this action to the bankruptcy court.

Dated: New York, New York
July 9, 2012

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