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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
RESIDENTIAL CAPITAL, LLC, et al.,	Case No. 12-12020 (MG)
Debtors.	(Jointly Administered)
RESIDENTIAL CAPITAL, LLC, et al.,	
Plaintiffs.	
v.	Adv. Case No. 13-01262 (MG)
ALLSTATE INSURANCE COMPANY, et al.,	
Defendants.	

OBJECTION OF THE AD HOC GROUP OF JUNIOR SECURED NOTEHOLDERS TO THE MOTION OF AIG ASSET MANAGEMENT (U.S.), LLC, THE ALLSTATE ENTITIES, MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, AND THE PRUDENTIAL ENTITIES FOR SUMMARY JUDGMENT AND PARTIAL JOINDER TO THE DEBTORS' MOTION FOR SUMMARY JUDGMENT

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TO THE HONORABLE MARTIN GLENN,
UNITED STATES BANKRUPTCY JUDGE:

The Ad Hoc Group of Junior Secured Noteholders (the "Ad Hoc Group"),[1] by and through its undersigned counsel, hereby files this (i) objection to the Summary Judgment Motion[2] of the Securities Fraud Claimants[3] seeking summary judgment dismissing all counts asserted against them by the above-captioned debtors and debtors-in-possession (the "Debtors") in their Complaint filed on February 19, 2013 (the "Complaint") in the above-captioned adversary proceeding (the "Adversary Proceeding") and (ii) joinder to the Debtors' motion seeking summary judgment on Counts I and III of their Complaint in this Adversary Proceeding. In support of its objection and joinder, the Ad Hoc Group respectfully states as follows:

PRELIMINARY STATEMENT

On February 19, 2013, the Ad Hoc Group filed an objection to the motion of certain Securities Fraud Claimants under Bankruptcy Rule 3013 seeking a determination of their plan classification with respect to their alleged claims against certain Debtors (the "Misrepresentation Claims"). The parties and Court subsequently consolidated that Rule 3013 Motion with the

[1] The Ad Hoc Group is comprised of certain entities that hold or manage holders of 9.625% Junior Secured Guaranteed Notes due 2015 issued under that certain Indenture dated as of June 6, 2008. The Junior Secured Noteholders' claim is now equal to 115.5% of the face amount of the bonds and is currently increasing by virtue of the accrual of post-petition interest at the rate of approximately $250 million per year.

[2] Motion of AIG Asset Management (U.S.), LLC, the Allstate Entities, Massachusetts Mutual Life Insurance Company, and the Prudential Entities for Summary Judgment, [Case No. 13-01262, Docket No. 27] (April 2, 2013) (the "Summary Judgment Motion"). The Ad Hoc Group also objects to Motion of Lead Plaintiff, for Itself and on Behalf of the Certified Class, for Summary Judgment [Case No. 13-01262, Docket No. 29], Motion of Cambridge Place Investment Management Inc. for Summary Judgment [Case No. 13-01262, Docket No. 31], Motion of Union Central Life Insurance Company, Ameritas Life Insurance Corp., and Acacia Life Insurance Company for Summary Judgment [Case No. 13-01262, Docket No. 33] and Motion of the National Credit Union Administration Board as Liquidating Agent for Western Corp. Federal Credit Union and U.S. Central Federal Credit Union for Summary Judgment [Case No. 13-01262, Docket No. 34]. Each of these motions joins in and adopts the reasoning set forth in the Summary Judgment Motion, without raising additional arguments.

[3] The "Securities Fraud Claimants" are those holders of RMBS Certificates that filed the Summary Judgment Motion: AIG Asset Management (U.S.), LLC and affiliated entities, Allstate Insurance Company and affiliated entities, Massachusetts Mutual Life Insurance Company and Prudential Insurance Company of America and affiliated entities.

Adversary Proceeding and the named parties thereto have filed motions for summary judgment under Bankruptcy Rule 7056.

The Ad Hoc Group now files this objection and joinder to address two legal arguments that the Securities Fraud Claimants raise in their Summary Judgment Motion and its Joinders -- first, that the residential mortgage backed securities ("RMBS Certificates") at issue do not meet the statutory definition of a "security of [a] debtor" for purposes of section 510(b) of the Bankruptcy Code and second, if each RMBS certificate is in fact found to be a "security of [a] debtor," then their Misrepresentation Claims should be treated as full recourse secured claims against each of the responsible Debtors. The Court should reject both arguments and grant summary judgment against the Securities Fraud Claimants on Counts I and III of the Complaint.

This first issue presents a straightforward issue of statutory interpretation of section 510(b), and the critical facts relating to the dispute are undisputed on the record herein. The Securities Fraud Claimants readily admit that it was the Debtors who constructed, marketed, and sold the RMBS Certificates held by them. See, e.g., Local Rule 7056-1 Statement of Stipulated Undisputed Facts and Agreed-To Exhibits [Docket No. 23] at ¶ 1 ("[O]ne or more of the Debtors served as depositors, sponsors, or servicers in connection with residential mortgage-backed securities . . ."); ¶ 2 ("[T]he Debtors that served as sponsors pooled non-conforming mortgage loans and assigned the mortgage loans to the Debtors that served as depositors, who then sold each pool to a newly formed RMBS securitization trust . . . in exchange for Certificates . . ."); ¶ 20 ("Debtors were involved in preparing the Prospectus, ProSupp, and other offering documents for each of their securitizations."); ¶¶ 43-50 (describing the Debtors' marketing of the RMBS securitizations).

Indeed, the Securities Fraud Claimants admit that they purchased the RMBS Certificates based on "information jointly prepared, vetted, authorized, and distributed by, among others, [certain Debtors]."[4] Notwithstanding that such Debtors were the proximate cause of the issuance of the RMBS Certificates and the sole source of the information underlying the alleged Misrepresentation Claims, the Securities Fraud Claimants now contend that the RMBS Certificates are not "securities of [a] debtor." Ostensibly, their argument is that the RMBS Certificates do not constitute legal obligations of any Debtor, but rather legal obligations of the RMBS trusts, and thus they are not Debtor securities. See Summary Judgment Motion pp. 11-12. But, as set forth herein, section 510(b) does not restrict itself to securities which represent a direct legal obligation of a debtor. Rather, section 510(b) pertains to securities as to which a debtor would be deemed "issuer," and not securities which constitute a direct legal obligations of a debtor. That definition is the only one consistent with existing case law, the specific legislative purposes of section 510(b) and the general principles of reorganization under the Bankruptcy Code.

The Securities Fraud Claimants' second argument -- that, to the extent each RMBS certificate is in fact deemed to be a "security of [a] debtor" for purposes of section 510(b), then the Court should declare that the Securities Fraud Claimants hold secured claims against the Debtors on account of their RMBS Certificates – is both procedurally and substantively defective. The pleadings in this Adversary Proceeding do not seek declaratory relief as to the status of Securities Fraud Claimants as secured creditors. Instead, the operative pleadings seek only a determination as to whether the Misrepresentation Claims should be subordinated under

[4] Motion of AIG Asset Management (U.S.), LLC, The Allstate Entities, Massachusetts Mutual Life Insurance Company, and the Prudential Entities for an Order under Bankruptcy Rule 3013 (i) Classifying RMBS Fraud Claims in the Same Class as the Securitizations Trusts' Claims for Purposes of Any Chapter 11 Plan for the Debtors and (ii) Directing that Misrepresentation Claims Cannot be Placed in a Plan Class That Will Be Subordinated Under Bankruptcy Code Section 510(b) [Docket No. 2284] ("Rule 3013 Motion") at p. 7.

section 510(b) to ***general unsecured claims*** of certain Debtors. Indeed, the Securities Fraud Claimants do not even allege that they are secured creditors at all, nor have they filed proofs of claim asserting their status as secured creditors of any Debtor. In any event, as a substantive matter, the Securities Fraud Claimants persist in their misapprehension of section 510(b) that a security must represent a "direct legal obligation" of a debtor to be deemed a "security of" that debtor. They are wrong as a matter of statutory interpretation. Moreover, there is no dispute – and the Securities Fraud Claimants in fact admit – that they purchased the securities with full knowledge that the RMBS Certificates were not, are not, and will not be direct legal obligations of any Debtor. In short, the Securities Fraud Claimants have not presented the Court with admissible evidence to support a legal claim that they are secured creditors, and the Court should deny judgment in their favor.

ARGUMENT

In the Complaint, the Debtors assert three counts against the Securities Fraud Claimants, including two counts seeking to subordinate the Misrepresentation Claims pursuant to section 510(b) and 510(c) of the Bankruptcy Code. Complaint ¶¶ 91-98 (Count I); Id. ¶¶ 103 – 107. The Debtors thereafter moved for summary judgment on each of the three counts. As set forth herein, the Court should grant summary judgment in favor of the Debtors on Counts I and III[5] of the Complaint under Bankruptcy Rule 7056 because, on the undisputed facts, the Debtors are

[5] Count III of the Debtors' complaint seeks to equitable subordinate the Misrepresentation Claims pursuant to section 510(c) of the Bankruptcy Code. The Ad Hoc Group agrees that "no-fault" equitable subordination of the Misrepresentations Claims would be appropriate in the event the Court declines to subordinate those claims pursuant to section 510(b). Should the Court conclude that the RMBS Certificates are not "of the debtor" for purposes of section 510(b), then the Misrepresentation Claims could potentially evade the scope of this provision solely because of the form used by the Debtors during their pre-petition securitization process. This elevation of form over substance potentially results in an outcome – the enhancement of economic recoveries by the Securities Fraud Claimants, to the detriment of other general unsecured creditors – that would be inherently inequitable. The Court should, if necessary, exercise its discretion to equitably subordinate the Misrepresentation Claims pursuant to section 510(c) of the Bankruptcy Code to avoid any such inequitable outcome.

entitled to judgment as a matter of law, and should correspondingly deny summary judgment to the Securities Fraud Claimants.[6]

I. The Court Should Deny the Securities Fraud Claimants' Summary Judgment Motion Because the RMBS Certificates Are Securities "of the debtor" For Purposes of Section 510(b) of the Bankruptcy Code

As set forth in greater detail in the Ad Hoc Group's Rule 3013 Objection,[7] the RMBS Certificates are securities "of the debtor" because, under applicable law, the Debtors which acted as the depositor in the securitization transactions at issue (rather than the asset-backed trust itself) are the legal "issuer" of asset-backed securities. Ad Hoc Group Rule 3013 Objection pp. 6 – 10. This is the only interpretation of section 510(b) which harmonizes the Bankruptcy Code with the legal regulatory structure that the securities laws impose on those same securities. See 15 U.S.C. § 77b(2)(a)(4) ("[t]he term "issuer" means every person who issues or proposes to issue any security; except that with respect to . . . collateral-trust certificates, or with respect to certificates of interest . . . , the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued . . . ."); 15 U.S.C. § 78c(3)(a)(8) ("the term 'issuer' means the person or persons performing the acts and assuming the duties of depositor…"); SEC Rule 191, 17 C.F.R. § 230.191 (2005) ("The depositor for the asset-backed securities acting solely in its capacity as depositor to the issuing entity is the 'issuer' for purposes

[6] The Ad Hoc Group reserves all rights to argue that it is also the case that any claims asserted by the RMBS trusts against any of the Debtors must also be subordinated under section 510(b) of the Bankruptcy Code. See Objection of the Ad Hoc Group of Junior Secured Noteholders to Debtors' Motion Pursuant to Fed. R. Bankr. P. 9019 for Approval of the RMBS Trust Settlement Agreements [Docket No. 2824] ¶¶ 34-36. The Court need not address that issue at this time.

[7] See Objection of the Ad Hoc Group to the Rule 3013 Motion [Case No. 12-12020, Docket No. 2957] (Feb. 19, 2013) ("Ad Hoc Group's Rule 3013 Objection"). The Adversary Proceeding and the Rule 3013 Motion have been consolidated for administrative purposes. Letter Regarding Joint Status Report Regarding Potential Consolidation of Rule 3013 Motion and Advesrary Proceeding, Cross-Motions for Summary Judgment, Discovery, Stipulated Facts and Agreed-to Exhibits, and Timing, [Case No. 12-12020, Docket No. 3117]. The Ad Hoc Group expressly incorporates by reference herein its Rule 3013 Objection.

of the asset-backed securities of that issuing entity."); Item 1101 of Regulation AB, 17 C.F.R. § 229.1101(e) (2005) ("For asset-backed securities transactions where the person transferring or selling the pool assets is itself a trust, the depositor of the issuing entity is the depositor of that trust."); Talcott J. Franklin & Thomas F. Nealon III, Mortgage and Asset Backed Securities Litigation Handbook, Appendix A (2011) (stating that "the Depositor is considered the statutory issuer of CMBS, although technically CMBS are issued by the Trust"); see also Fed. Hous. Fin. Agency v. UBS Ams., Inc., 858 F. Supp. 2d 306, 334 (S.D.N.Y. 2012) (finding that SEC Rule 191 applies to residential mortgage-backed securities).

Far from being a "technical" interpretation, as the Securities Fraud Claimants argue, the identification of a depositor entity as the responsible party for RMBS Certificates is substantially consistent with the plain language and purpose of section 510(b) as well as the general rehabilitative purposes of chapter 11. Among other things, deeming securities issued by a depository entity to be "securities of" that entity for purposes of section 510(b):

- Permits investors in securities to assert direct claims for securities law violations against a debtor entity (rather than a special purpose trust) where appropriate. Indeed, the present dispute concerns the priority appropriate for such claims, and there is no dispute that such claims could be allowed, to the extent fixed and liquidated,

- Diminishes the likelihood of a double-recovery by a securities investor, by requiring that such investor recover on its subordinated misrepresentation claim only after similarly situated creditors have been paid in full,

- Harmonizes the plain language of section 510(b) with the securities law regulating the issuance of RMBS Certificates,

- Declines to condition the substantive recovery of a claim through the chapter 11 plan process on the form used by the debtor to structure the transaction, and

- Conforms with the general principles underlying section 510(b), namely preventing the dilution of recovery of a class of creditors that took no risk with respect to the performance of a type of security.

See Rule 3013 Objection pp.6-15.

To avoid subordination under section 510(b) and substantively improve their economic recovery on the RMBS Certificates, the Securities Fraud Claimants instead propose an alternate textual interpretation of section 510(b) that seeks to exploit the particular securitization process implemented by the Debtors before the Petition Date.[8] In their pleadings, the Securities Fraud Claimants repeatedly request that the Court interpret securities "of the debtor" to mean securities "representing a direct obligation or liability of the debtor." To that end, the Securities Fraud Claimants repeatedly emphasize that the prospectus and other related securitization documents only provided each RMBS certificate holder with recourse against its respective RMBS trust, and not against any Debtor. See Summary Judgment Motion at pp. 11-14. Indeed, as even the Securities Fraud Claimants admit, had any of the Debtors implemented a process for RMBS issuance that permitted RMBS certificate holders recourse against it or its affiliates, then section 510(b) would require the subordination of the Misrepresentation Claims. Adopting an interpretation requiring that the securities at issue must represent a direct legal obligation of a debtor would have the practical effect of rewarding the Securities Fraud Claimants with a double recovery – first on the actual RMBS Certificates (as a result of any recovery of their respective trust through the proposed RMBS settlement) and second on their unsubordinated contractual claims against the relevant Debtors. The proposed interpretation of section 510(b) would therefore improve the economics of claim recoveries for one particular group of creditors (to the

[8] The interpretation offered by the Securities Fraud Claimants lacks any meaningful case support. These claimants continue to bestow unwarranted significance to a decision issued by Judge Walrath in the Washington Mutual chapter 11 cases concluding that RMBS Certificates are not "of the debtor" for purposes of section 510(b) of the Bankruptcy Code. Summary Judgment Motion at pp.13 – 14. As set forth in the Ad Hoc Group's Rule 3013 Objection, Judge Walrath's decision was issued without the benefit of any briefing from the debtors in those chapter 11 cases on the securities laws' treatment of a depositor entity as the issuer of RMBS Certificates. Moreover, that Washington Mutual decision was the subject of a motion for reconsideration arguing that the "issuer" of asset-backed securities is the depositor entity. Ad Hoc Group Rule 3013 Objection p. 9. That motion was continued, but an order was never entered by the Court. Id. Indeed, far from the Washington Mutual court lacking "the occasion to consider [the securities law] argument," the court expressly declined to order the withdrawal of the reconsideration motion. Id.

detriment of other creditors) solely because of the form of the securitization vehicle used by the Debtors.

The Court should decline to interpret the provisions of the Bankruptcy Code, including section 510(b), in such a way that improperly elevates form over substance. See, e.g., In re Financial News Network, Inc., 980 F.2d 165, 169 (2d Cir. 1992) (observing that, "in bankruptcy proceedings substance should not give way to form"); In re Patriot Coal Corp., 482 B.R. 718, 744 (Bankr. S.D.N.Y. 2012) (transferring venue of bankruptcy case because allowing debtor's venue choice to stand would "elevate form over substance in a way that would be an affront…to the integrity of the bankruptcy system").

II. The Misrepresentation Claims Are Quintessential Securities Fraud Claims Subject to Mandatory Subordination under Section 510(b) of the Bankruptcy Code

In addition to the RMBS Certificates being "securities of" the Debtors, each of the other requirements for mandatory subordination of the Misrepresentation Claims pursuant to section 510(b) of the Bankruptcy Code is met here. First, there is no material dispute that the RMBS Certificates sold in connection with the Pooling and Servicing Agreements constitute "securities" as defined under section 101(49) of the Bankruptcy Code. The mortgage loans and the related RMBS Certificates deposited into each RMBS Trust constitute "securities" for purposes of section 510(b) of the Bankruptcy Code. The Bankruptcy Code broadly defines "security" to include notes, bonds and debentures as well as any "other claim or interest commonly referred to as a 'security.'" 11 U.S.C. § 101(49).

Second, there is no material dispute that the Misrepresentation Claims are on account of damages arising from the purchase or sale of those securities See 11 U.S.C. § 510(b). On their face, these claims seek to recover monetary damages from the Debtors on the ground that the relevant prospectuses and other offering materials inaccurately described the pertinent mortgages

in violation of the Securities Act. See, e.g., Summary Judgment Motion p. 6; Rule 3013 Motion p. 7. The prospectus representations that form the basis for the allegations underlying the Misrepresentation Claims relate to the prospectus' inaccurate description of the underwriting standards, owner-occupancy rates, loan-to-value ratio, borrower income and other indicators of the quality of the mortgages that relate to the likelihood that the mortgages would generate cash flow to pay amounts owed on the RMBS Certificates. See First Amended Complaint, filed on Apr. 15, 2011, *Allstate Ins. Co. v. GMAC Mortg., LLC*, No. 27-cv-11-3480 (Minn. Dist. Ct.)[9] at Ex. F (discussing Securities Fraud Claimants' securities fraud claims by reference to representations made in the exemplar RALI Series 2006-QO3[10] Prospectus Supplement ("ProSupp") and underlying prospectus at issuance of the RMBS Certificates). As such, the Misrepresentation Claims are the quintessential securities fraud claims subject to subordination under section 510(b). See e.g., Rombro v. Dufrayne (In re MedDiversified, Inc.), 461 F.3d 251, 256 ("In enacting section 510(b), Congress focused on the problem of claims alleging fraud or other violations of law in the issuance of the debtor's securities.").

III. The Securities Fraud Claimants Are Not Secured Creditors of Any of the Debtors

Perhaps as a rhetorical flourish, the Securities Fraud Claimants assert that, if in fact the RMBS Certificates constitute securities "of the Debtors" for purposes of section 510(b), then the RMBS Certificates "should naturally be deemed secured notes of the Debtors, backed by the mortgage loans once owned by the Debtors." Summary Judgment Motion p. 33. In advancing that argument, the Securities Fraud Claimants now seek to have the Court characterize the

[9] This complaint is attached as Exhibit 16 to Local Rule 7056-1 Statement of Stipulated Undisputed Facts and Agreed-To Exhibits [Docket No. 23].

[10] The parties to the Adversary Proceeding have agreed to use the RALI 2006-QO3 transaction for illustrative purposes. Local Rule 7056-1 Statement of Stipulated Undisputed Facts and Agreed-To Exhibits [Docket No. 23] at ¶ 8. The ProSupp and the underlying prospectus are attached as exhibits to the Statement of Stipulated Undisputed Facts and Agreed-To Exhibits.

Misrepresentation Claims as secured claims against certain Debtors, subordinated only to those Debtors' other secured claims. Id.

As an initial matter, the Summary Judgment Motion fails to invoke the Court's jurisdiction to grant the relief requested. Indeed, the Summary Judgment Motion seeks no affirmative relief whatsoever – it simply requests the dismissal of the counts raised by the Debtors in their Complaint. Summary Judgment Motion p. 1. The only affirmative relief sought by the Securities Fraud Claimants is contained in their Rule 3013 Motion, which seeks only to ensure the classification and relative priority of the Misrepresentation Claims as ***general unsecured claims***. Rule 3013 Motion p. 11 ("Both the R&W Claims and the Misrepresentation Claims are, on their face, ***general unsecured claims*** that normally are placed in the same class") (emphasis added). Moreover, the proofs of claim filed by the Securities Fraud Claimants on account of the Misrepresentation Claims confirm their view that these contingent and unliquidated claims would, even if allowed and fixed, be general unsecured claims against any Debtor.[11] As a procedural matter, a party may not properly seek summary judgment on a claim that has not been interposed in an operative pleading. See, e.g., Rojo v. Deutsche Bank, 487 Fed. Appx. 586, 588 (2d. Cir. 2012) (refusing to address merits of claim raised for the first time at the summary judgment stage of the litigation); Greenidge v. Allstate Ins. Co., 446 F.3d 356, 361 (2d Cir. 2006); Syracuse Broad. Corp. v. Newhouse, 236 F.2d 522, 525 (2d Cir. 1956).

In any event, the RMBS Certificates undeniably represent legal obligations of the RMBS trusts – not the Debtors. See ProSupp at S-22 ("The certificates represent interests only in the

[11] See, e.g., Claim Nos. 4778, 5321, 5326, 5344, 5346 and 5347, asserted by AIG Securities Lending Corporation c/o AIG Asset Management (U.S.) LLC; Claim Nos. 5320, 5330, 5334 and 5339, asserted by American International Group Retirement Plan c/o AIG Asset Management (U.S.) LLC; Claim Nos. 5318, 5319, 5322, 5324, 5332 and 5352, asserted by American International Group, Inc. c/o AIG Asset Management (U.S.) LLC; Claim Nos. 4500, 4501, 4503, 4504, 4516, 4656, 4963 and 5078, asserted by Allstate Life Insurance Co.; Claim Nos. 4868, 4870 and 4871, asserted by Financial Guaranty Insurance Company; Claim Nos. 5846 – 5851, asserted by MBIA Insurance Corporation.

RALI Series 2006-QO3 Trust…investors will have no recourse to the depositor, the master servicer or any other entity, and will incur losses"). No Debtor possesses a property interest in the mortgage loans underlying the RMBS Certificates for purposes of section 541 of the Bankruptcy Code. As a result, the RMBS Certificates are not "secured by a lien on property in which the estate has an interest" sufficient to transform any of the Misrepresentation Claims into secured claims against any of the Debtors. See 11 U.S.C. § 506(a) ("An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim."). The Securities Fraud Claimants admit as much. Summary Judgment Motion p. 11 ("Moreover, the risk disclosures in the Offering Materials confirm that the Certificates are paid solely from the [trust] assets…and there is no recourse against any of the Debtors").

Ultimately, the Securities' Fraud Claimants' new counterfactual rests on a fundamental misconception – that deeming the seller and depositor entities to be the "issuers" of the RMBS Certificates would effectively collapse the securitization trust structure for all purposes. As noted above, the mere fact that a Debtor may bear issuer liability with respect to a particular security does not require the Court to find that it bears liability on the underlying security.

WHEREFORE, for the foregoing reasons, the Ad Hoc Group requests that the Court (a) deny the Securities Fraud Claimants' Summary Judgment Motion, (b) grant the Debtors' motion for summary judgment on Counts I and III of the Complaint, and (c) grant such other further relief as it deems just.

Dated: April 23, 2013
New York, New York

Respectfully submitted,

By: /s/ J. Christopher Shore
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