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Hearing Date: February 7, 2013 at 10:00 a.m. (ET)
Objection Deadline: February 6, 2013 at 4:00 p.m. (ET)

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

In re:)	Case No. 12-12020 (MG)
)	
RESIDENTIAL CAPITAL, LLC, <u>et al.</u> ,)	Chapter 11
)	
Debtors.)	Jointly Administered
<hr/>		
RESIDENTIAL CAPITAL, LLC, <u>et al.</u> ,)	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 AMENDED)	
COMPLAINT, JOHN DOES 1-1000,)	
)	
Defendants.)	

**DEBTORS' MOTION TO EXTEND THE STAY AND
ENJOIN PROSECUTION OF THE WESTERN & SOUTHERN
ACTION AGAINST DEBTORS' NON-DEBTOR AFFILIATES**



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The Debtors file this motion seeking to further stay the continued prosecution of a lawsuit against the Debtors' non-debtor affiliates. That lawsuit, brought in Ohio state court by the Western & Southern Life Insurance Company, Western-Southern Life Assurance Co., Columbus Life Insurance Co., Integrity Life Insurance Co., National Integrity Life Insurance Co., and Fort Washington Investment Advisors (collectively "Western & Southern"), is based in part on the Debtors' issuance or sale of mortgage-backed securities. The Debtors are seeking a further three month extension—until April 30, 2013—of the stay already in place to ensure that the protections of the automatic stay are not nullified and that the Debtors' restructuring efforts may continue during this critical period with as few distractions as possible. This motion expressly incorporates and builds upon the motion filed by the Debtors on May 25, 2012, described below, and all of the related declarations and filings.

PRELIMINARY STATEMENT

1. Once again, the Debtors have successfully reached consensual stipulations with nearly two dozen parties staying the prosecution of their cases against the Debtors' non-debtor affiliates, with one single exception: Western & Southern. Western & Southern alone has refused a consensual stay and forced the Debtors to file and litigate this motion. The Debtors' request to extend the stay is reasonable and well-founded in the law, as previously recognized by this Court. (Order Granting Debtors' Motion to Extend The Automatic Stay, or In The Alternative, for Injunctive Relief ("W&S Order"), July 18, 2012, ECF No. 77; July 10, 2012 Hearing Transcript ("July 10, 2012 Tr." or "Stay Extension Decision"), ECF No. 75.)

2. On May 25, 2012, the Debtors filed a Motion to Extend the Automatic Stay or, in the Alternative, for Injunctive Relief Enjoining Prosecution of Certain Pending Litigation Against Debtors' Directors and Officers and Non-Debtor Corporate Affiliates (the "Original Stay Motion," ECF No. 4.) The Original Stay Motion sought relief with respect to

twenty-seven lawsuits arising from the Debtors' issuance or sale of mortgage-backed securities (the "MBS Actions").¹ The plaintiffs in twenty-three of the MBS Actions agreed to a stay until October 31, 2012 pursuant to so ordered stipulations.² (ECF Nos. 78–79, 84.) One other case, brought by Western & Southern (the "W&S Action"), was stayed though the same date pursuant to an order of this Court following a contested hearing. (W&S Order, ECF No. 77.)

3. Prior to October 31, 2012, parties to twenty-three of those same twenty-four stayed MBS Actions, including Western & Southern, and to one additional MBS Action³ not subject to the original stay, consented to a further extension of the stay until January 31, 2013, so ordered by this Court. (ECF Nos. 85–87.)⁴

4. Given the significant restructuring activities currently facing the Debtors, and the fact that a plan mediation process ("Plan Mediation") has just begun that may resolve the claims made in many of the MBS Actions against the Non-Debtor Affiliates, including the W&S

¹ These MBS Actions name as defendants four of the Debtors' non-debtor corporate affiliates: Ally Financial Inc. ("Ally Financial"), Ally Bank, GMAC Mortgage Group LLC ("GMACM Group"), and Ally Securities LLC ("Ally Securities") (together, the "Non-Debtor Corporate Affiliates"). Several of these lawsuits also name certain of the Debtors' former directors and officers (the "D&Os"). The Non-Debtor Corporate Affiliates and D&Os are referred to herein as the "Non-Debtor Affiliates." The Non-Debtor Affiliates named in the W&S Action are Ally Securities LLC and D&Os Bruce J. Paradis, Davee L. Olson, David C. Walker, Kenneth M. Duncan, Ralph T. Flees, James G. Jones, and David M. Bricker.

² Two additional MBS Actions in the Original Stay Motion were resolved and voluntarily dismissed from the Adversary Complaint. (Notice of Voluntary Dismissal, June 22, 2012, ECF No. 30.) In addition, the District Court withdrew the reference to the Bankruptcy Court of the Original Stay Motion as to the Federal Housing Finance Administration, and denied the Debtors' request. (*See Residential Capital, LLC, et al. v. Fed. Hous. Fin. Agency*, No. 12 Civ. 5116 (DLC) (S.D.N.Y. July 9, 2012), ECF No. 12.) The District Court's decision in that case is on appeal to the Second Circuit.

³ The additional MBS Action is captioned *John Hancock Life Ins. Co. (U.S.A.) v. Ally Fin. Inc.*, No. 12-CV-01841 (D. Minn. July 27, 2012), and is subject to a stipulation extending the automatic stay in the main bankruptcy case. (Stipulation and Order, *In re: Residential Capital, LLC*, No. 12-12020 (Bankr. S.D.N.Y. Oct. 23, 2012), ECF Nos. 1925, 2748.)

⁴ The only party that consented to the stay through October 31, 2012 but did not consent to an extension through January 31, 2013 was the Federal Deposit Insurance Corporation. The adversary proceeding against the FDIC was withdrawn to the District Court, where a motion to dismiss remains *sub judice*. (*See Order on Motion to Withdraw the Reference, Residential Capital, LLC v. Allstate Insurance Co.*, No. 12 Civ. 5360 (LTS) (S.D.N.Y. Sept. 26, 2012), ECF No. 10.)

Action, the Debtors sought a further extension of the stay in the MBS Actions pending against the Non-Debtor Affiliates on terms similar to those previously agreed to. All of parties contacted by the Debtors agreed to the extension of the stay—except Western & Southern. (ECF Nos. 89–90.)

5. The terms of the stipulations agreed to by the other plaintiffs in the MBS Actions allow certain aspects of those cases to move forward notwithstanding the stay, meaning the stay that the Debtors seek here is not only temporally limited but is also not a “complete” stay of the underlying cases. To wit, discovery against the Non-Debtor Affiliates that does not require the involvement of the Debtors is permitted, and motions to dismiss, motions for class certification, and motions to strike affirmative defenses may go forward, as may appeals of those motions. Western & Southern was offered—and refused—the same terms.

6. The Debtors have filed this motion in order to extend the stay in the W&S Action against the Non-Debtor Affiliates through April 30, 2013. This motion is based on the same fundamental arguments, facts, and law as the Original Stay Motion.⁵

7. The Debtors continue to work diligently on their restructuring efforts—presently focusing on closing the asset sales, moving Plan Mediation forward, continuing to cooperate with the Examiner’s investigation, preparing for and participating in the hearing on the proposed \$8.7 billion RMBS settlement agreement scheduled for mid-March 2013, and undertaking the massive claims process, among other tasks. (Declaration of Tammy Hamzehpour (“Hamzehpour Decl.”) at ¶ 5.) The Debtors and their advisors need to be singularly

⁵ For brevity, this motion focuses on new facts and developments since the Original Stay Motion, and does not include each and every argument and fact from the Original Stay Motion. However, the Debtors expressly incorporate the Original Stay Motion as well as all related declarations and filings. The primary documents that the Debtors incorporate are listed in Exhibit A hereto.

focused on executing those critical tasks—not responding to discovery requests or otherwise participating in ongoing litigation against the Non-Debtor Affiliates.

8. For the reasons set forth below, in the Original Stay Motion, and in the Stay Extension Decision, the Debtors respectfully request that this Court further extend the stay and enjoin the continued prosecution of the W&S Action against the Non-Debtor Affiliates through April 30, 2013.

STATEMENT OF FACTS

9. The Debtors incorporate the facts as stated in the Original Stay Motion and add the following additional facts which are relevant to this Renewed Stay Motion.

I. THE MBS ACTIONS

10. The Debtors' Non-Debtor Affiliates have been named in dozens of lawsuits based on the Debtors' mortgage-backed securities, including the W&S Action. (*See* Declaration of Jeffrey A. Lipps ("Lipps Decl.") at ¶ 8, May 25, 2012, ECF No. 6.)

11. In many of the MBS Actions, including the W&S Action, private investors seek damages for alleged violations of federal and state securities laws, fraud, and misrepresentations and omissions in connection with their purchases of the Debtors' private-label securities (the "PLS Investor Cases"). (*See id.* at ¶¶ 9–10.)

12. The W&S Action, like the other PLS Investor Cases, asserts claims against the Non-Debtor Affiliates that are based almost entirely on the alleged conduct of the Debtors. (*See id.* at ¶¶ 9–19.)

A. The W&S Action

13. The W&S Action is pending in Ohio state court. The plaintiffs in the W&S Action are five insurance companies and a registered investment advisor that bring claims "aris[ing] out of the sale of certain residential mortgage-backed securities [] to Western &

Southern.” (Ex. 15 to the Declaration of Joel C. Haims, May 25, 2012, ECF No. 5-15 (Amended Complaint at ¶ 1, *Western & Southern Life Ins. Co. v. Residential Funding Co, LLC*, No. A 1105042 (Ohio Ct. of Comm. P., Hamilton Cnty. Sept. 9, 2011)) (“W&S Amend. Compl.”).)

14. The Western & Southern claims arise from their investment of roughly \$102.8 million in seven mortgage-backed securities sponsored and issued by Debtors, and roughly \$112.6 million in three mortgage-backed securities sponsored and issued by entities unaffiliated with the Debtors. (*See id.* at ¶ 68.) Western & Southern alleges that all RMBS certificates they purchased “were sold pursuant to public filings and offering materials . . . that contained untrue statements and omissions of material facts,” (*id.* at ¶ 1), and they bring claims for violations of the Ohio Securities Act, negligent misrepresentation, civil conspiracy, and common-law fraud. (*Id.* at ¶¶ 231–77.)

15. Western & Southern originally named as defendants Debtors Residential Funding Company, LLC; GMAC Mortgage, LLC; Residential Accredit Loans, Inc. (“RALI”); Residential Asset Mortgage Products, Inc. (“RAMP”); and Residential Funding Mortgage Securities I, Inc. (“RFMSI”). (*Id.* at ¶¶ 17–22.) They also named Ally Securities LLC (then known as Residential Funding Securities, LLC) as a defendant, as well as former directors and officers of the Debtors Bruce J. Paradis, Davee L. Olson, David C. Walker, Kenneth M. Duncan, Ralph T. Flees, James G. Jones, and David M. Bricker. (*Id.* at ¶¶ 28–34.) Finally, Western & Southern named as defendants seven entities not affiliated with the Debtors. (*Id.* at ¶¶ 23–27, 35–36.)

16. Pursuant to a Decision and Order dated June 6, 2012, the Hamilton County Court of Common Pleas granted, in part, two motions to dismiss the W&S Action. (*See* Ex. 2 to the Declaration of Steven S. Fitzgerald, June 28, 2012, ECF No. 49-1 (Decision and Order,

Western & Southern Life Ins. Co. v. Residential Funding Co., LLC, No. A 1105042 (Ohio Ct. of Comm. P., Hamilton Cnty. June 6, 2012)); *see also* Supplemental Declaration of Jeffrey A. Lipps (“Suppl. Lipps. Decl.”) at ¶ 34(b), July 6, 2012, ECF No. 59.) The court dismissed all claims against the D&Os for lack of personal jurisdiction,⁶ and it dismissed certain claims against all defendants that were barred by a statute of repose. As a result, Western & Southern’s claims as to Ally Securities arising from only one securitization—a securitization that involved over 23,000 mortgages—remain. (Suppl. Lipps Decl. at ¶ 34(b).)

17. Following those dismissals, some discovery has begun. (Declaration of Sarah P. Herlihy (“Herlihy Decl.”) at ¶ 5.) Western & Southern has served discovery on Ally Securities, but Ally Securities has not yet begun document production. (*Id.* at 6.) The plaintiffs in the W&S Action have only produced a small number of documents to date. (*Id.* at 7.)

18. The parties in the W&S Action recently filed a joint motion seeking to extend the fact discovery deadline until November 2013 which the Court has approved. (*Id.* at ¶ 8.) A trial date has been set for March of 2015. (*Id.* at ¶ 9.)

19. While all of Western & Southern’s claims against the Debtors have been automatically stayed since the filing of Debtors’ Chapter 11 petitions, Western & Southern’s remaining claims against Ally Securities will continue absent a stay, even though those claims are based on the same nucleus of facts as their claims against the Debtors. For example, all of Western & Southern’s claims are premised on the allegation that Debtors made false representations in their offering materials (*see, e.g.*, W&S Amend. Compl., ECF No. 5-15 at ¶¶

⁶ Several of the D&Os entered into tolling agreements with Western & Southern pursuant to the W&S Order which also prevented W&S from filing suits against the Non-Debtor Affiliates during the stay period. As set forth in the proposed order attached as Exhibit B hereto, the Debtors seek the same relief as to all of the Non-Debtor Affiliates: the W&S Action currently pending should be stayed and Western & Southern should be stayed from filing any additional actions against the Non-Debtor Affiliates..

232, 237, 242, 266, 273) and that Debtors engaged in “systematic” “abandonment of their underwriting guidelines and improper loan documentation.” (*Id.* at ¶ 97.) Western & Southern even brings a claim against Non-Debtor Affiliates for civil conspiracy, alleging that they “all agreed” with Debtors “to take the steps necessary to cause [Debtors’ RMBS trusts] to issue Certificates pursuant to materially misleading Offering Materials fraud [sic] in order to profit from the sale of the Certificates and/or profit from the servicing of the loans underlying the Certificates.” (*Id.* at ¶ 266.)

II. PROGRESS IN THESE CHAPTER 11 CASES AND TASKS AHEAD

20. The Debtors have made substantial progress in these unprecedented Chapter 11 cases. Prior to the Petition Date, the Debtors obtained support for an ambitious restructuring plan from Ally Financial, Inc., the Junior Secured Bondholders, and certain of the investors in RMBS. Since the Petition Date, the Debtors have secured and obtained court approval of over \$1.5 billion of DIP financing which stabilized the Debtors’ operations and gave the Debtors the opportunity to successfully sell its mortgage loan origination and servicing business and whole loan portfolio. The Debtors held successful auctions for those assets in late 2012, and are in the process of closing those sales.

21. The work on those significant tasks is not the entirety of the work the Debtors have been doing and continue to do. For example, the Debtors have also been cooperating with the Examiner’s investigation of certain transactions between the Debtors and AFI. The Examiner originally estimated his report would take six months to complete, but on October 10, 2012 the Examiner’s counsel advised the Court that the investigation and report may take even longer. (Memorandum Opinion & Order Denying the Motions of the FHFA and Underwriter Defendants to Compel Document Discovery from the Debtors (“FHFA Order”) at 28, *In re: Residential Capital, LLC*, No. 12-12020 (Bankr. S.D.N.Y. Oct. 12, 2012), ECF No.

1813.) The current estimate is that the Examiner will issue his report in April of this year.

(Second Supplemental Work Plan of Arthur J. Gonzalez, Examiner, *In re: Residential Capital, LLC*, No. 12-12020 (Bankr. S.D.N.Y. Nov. 26, 2012), ECF No. 2264-1.)

22. All the while, the Debtors have been undertaking a variety of other significant tasks, including operating their business and beginning the claims process, both of which are time consuming and labor intensive.

23. In addition, Plan Mediation has recently commenced before the Honorable Judge Peck of this Court. The Plan Mediation will focus on, among other things, “AFI Related Issues,” including “third party claims against AFI,” which may include the claims against the Non-Debtor Affiliates in the Western & Southern Action. (Debtor’s Motion for Appointment of a Mediator, *In re: Residential Capital, LLC*, No. 12-12020 (Bankr. S.D.N.Y. Dec. 6, 2012), ECF No. 2357.)

24. At the September 11, 2012 hearing on the Federal Housing Finance Agency’s motion to lift the automatic stay,⁷ the Court noted the significance of the tasks the Debtors were then dealing with:

[O]ver the next sixty days in this case, there is an enormous amount of activity that’s at the very core of [these] Chapter 11 bankruptcy proceedings. There is an auction scheduled . . . for October 23rd. There are twenty some odd parties that have signed nondisclosure agreements that are engaged in due diligence . . . [there is] a contested hearing scheduled for November 5th for which expedited discovery is underway and arguments that the debtor hasn’t fully complied with its obligations to produce everything it was required to produce. So there’s expedited discovery ongoing for a very important hearing currently schedule for November 5th There’s an examiner’s investigation going on.

⁷ On October 12, 2012, this Court denied the Federal Housing Finance Agency and Underwriter Defendants’ motion to compel document discovery from the Debtors (the FHFA Order) for use in a lawsuit against the Non-Debtor Affiliates, which is pending in District Court. The FHFA Order has been appealed to Judge Cote and the appeal will be fully briefed on February 1, 2013.

(Sept. 11, 2012 Evidentiary Hearing Transcript (“Sept. 11, 2012 Tr.”) at 20, *In re: Residential Capital, LLC*, No. 12-12020 (Bankr. S.D.N.Y. Sept. 11, 2012), ECF No. 1428.) The Court reiterated in the FHFA Order the critical tasks facing the Debtors through January 31, 2013 and concluded the factor of timing “weighs heavily in favor of maintaining the stay to protect Debtors from FHFA’s and the Underwriter Defendants’ discovery requests until at least February 2013.” (FHFA Order at 27.) The Court further noted that “in addition to their day-to-day responsibilities,” Debtors must focus on the auction of their principal assets, preparing for the hearing on the approval of the proposed \$8.7 billion RMBS trust settlement, complying with the Examiner’s investigation, and continuing to litigate foreclosure cases and related litigation across the country. (*Id.* at 27–29.)

25. While the specific time period the Court was pointing to has passed and the auctions have been completed, many of the same obligations the Debtors faced then remain. For example, the Debtors are still focused on closing the sales, preparing for the contested hearing on the proposed \$8.7 billion RMBS trust settlement (rescheduled for mid-March 2013), and cooperating in the Examiner’s investigation. (Hamzehpour Decl. at ¶ 5.) And now Plan Mediation has commenced and the claims bar date has passed, meaning the Debtors must process thousands of claims totaling billions of dollars. (*Id.*) So the concerns highlighted by the Court during the September 11, 2012 hearing and in the October 12, 2012 FHFA Order largely remain.

26. In short, as the Court succinctly put it at an earlier point in this bankruptcy case: “With everything that’s going on in this case, the debtor has more than its hands full.” (Sept. 11, 2012 Tr. at 20.) In light of the Debtors’ full plate, the W&S Action against the Non-

Debtor Affiliates should continue to be stayed in order to minimize and avoid the burdens and distractions that it will bring.

ARGUMENT

27. The automatic stay of Section 362(a) is “one of the fundamental debtor protections provided by the bankruptcy laws.” *Midlantic Nat’l Bank v. N.J. Dep’t of Env’tl. Prot.*, 474 U.S. 494, 503 (1986) (internal quotation marks and citation omitted).

28. The automatic stay of Section 362(a)(1) should be extended to stay actions against non-debtors “where ‘there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant.’” *Queenie, Ltd. v. Nygard Int’l*, 321 F.3d 282, 288 (2d Cir. 2003) (quoting *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 999 (4th Cir. 1986)). And this is precisely what the Court already found with regards to the W&S Action. (July 10, 2012 Tr. at 132 (citing *A.H. Robins Co.*, 788 F.2d at 999).)

29. The Court has the power to extend the automatic stay to non-debtors pursuant to Section 105 of the Bankruptcy Code. (July 10, 2012 Tr. at 127.) *See also, e.g., Queenie*, 321 F.3d at 287–88; *Nev. Power Co. v. Calpine Corp. (In re Calpine Corp.)*, 365 B.R. 401, 410 (S.D.N.Y. 2007); *McHale v. Alvarez (In re The 1031 Tax Group, LLC)*, 397 B.R. 670, 686 (Bankr. S.D.N.Y. 2008) (Glenn, J.).

30. The Court addressed substantially the same issues raised here in the Stay Extension Decision when it extended the automatic stay to Non-Debtor Affiliates in the W&S Action, and the Debtors’ need for a temporary extension of the automatic stay remains. The Court should again stay the continuation of the W&S Action against the Non-Debtor Affiliates through April 30, 2013.

I. THE AUTOMATIC STAY SHOULD BE EXTENDED TO STAY THE W&S ACTION AS AGAINST THE NON-DEBTOR AFFILIATES.

31. Section 105(a) authorizes the Bankruptcy Court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [title 11],” and gives this Court broad powers to extend Section 362 and enjoin actions against non-debtors. (July 10, 2012 Tr. at 127 (“Courts find the power to extend the automatic stay to nondebtors in Section 105 of the Bankruptcy Code.”); *see also LTV Steel Co. v. Bd. of Educ. of the Cleveland City Sch. Dist. (In re Chateaugay Corp. Reomar, Inc.)*, 93 B.R. 26, 29 (S.D.N.Y. 1988) (“The Bankruptcy Court has authority under section 105 broader than the automatic stay provisions of section 362 and may use its equitable powers to assure the orderly conduct of the reorganization proceedings.”) (citation and internal quotation marks omitted); *Haw. Structural Ironworkers Pension Trust Fund v. Calpine Corp. Inc.*, No. 06 Civ. 5358 (PKC), 2006 WL 3755175, at *4 (S.D.N.Y. Dec. 20, 2006) (“Section 105 may support the issuance of an injunction to parties who do not fall within the scope of section 362(a).”); *In re The 1031 Tax Group*, 397 B.R. at 684 (“Section 105 authorizes a bankruptcy court to exercise power outside the bounds of the automatic stay.”).)

32. This Court has reasoned that “all a bankruptcy court must find to enjoin a claim against a nondebtor under Section 105(a) [i]s that the claim would threaten to thwart or frustrate the debtor’s reorganization efforts []and that the injunction is important for reorganization.” (July 10, 2012 Tr. at 128 (internal citations omitted).) As described below, that standard is easily met here.

33. In applying Section 105 in other contexts, courts in this district apply the “traditional preliminary injunction standard as modified to fit the bankruptcy context.” *In re Calpine*, 365 B.R. at 409. Even applying the “full” Section 105 test—which involves evaluating

four factors, none of which is determinative—makes clear that the relief sought by the Debtors is warranted. Under that test, courts will evaluate:

- i. whether there is an imminent irreparable harm to the debtor's estate or its ability to restructure;
- ii. whether there is a reasonable likelihood of a successful restructuring;
- iii. whether the balance of harms tips in favor of the debtor; and
- iv. whether the public interest weighs in favor of an injunction.

See id.; *In re United Health Care Org.*, 210 B.R. 228, 233 (S.D.N.Y. 1997); *Haw. Structural*, 2006 WL 3755175, at *4; *Lyondell Chem. Co. v. Centerpoint Energy Gas Servs., Inc. (In re Lyondell Chem. Co.)*, 402 B.R. 571, 588–89 (Bankr. S.D.N.Y. 2009). The Debtors satisfy all four of these factors.

34. As detailed below, the harm to Debtors from engaging in significant discovery, using insurance proceeds, facing indemnification claims, and having to live with adverse findings and decisions in a case it will not be participating in are real, and irreparable. In addition, the Debtors have made substantial strides towards restructuring, and it is more than reasonably likely that they will successfully restructure. The public interest is supported because in a bankruptcy case, protecting the estate is paramount, especially because here the Debtors' ultimate corporate parent is 74% owned by the federal government. All of those harms significantly outweigh any harms that could befall Western & Southern because the Debtors seek only an additional limited stay—a stay that provides several meaningful exceptions—and fact discovery in the W&S Action is not likely to close until the end of this year and the trial date is more than two years away. (Herlihy Decl. at ¶¶ 8–9.)

35. Using the powers granted pursuant Section 105 of the Bankruptcy Code, this Court should further extend the automatic stay to the Non-Debtor Affiliates in the W&S Action to prevent four primary harms to the Debtors.

- **First**, the Debtors and Non-Debtor Affiliates share an identity of interest such that judicial decisions or factual findings in the W&S Action against the Non-Debtor Affiliates will effectively amount to decisions against the Debtors pursuant to the doctrines of collateral estoppel and stare decisis.
- **Second**, the Debtors are obligated to indemnify the Non-Debtor Affiliates for any defense costs and losses incurred in the W&S Action.
- **Third**, the Debtors may face discovery burdens if the W&S Action proceeds against the Non-Debtor Affiliates. The discovery burdens that the Debtors face stem from the fact that the claims and allegations against the Non-Debtor Affiliates in the W&S Action are based on the Debtors' conduct, and proving those cases would likely require the Debtors' documents and employees. Although the FHFA Order provides a respite from third party discovery, Western & Southern has indicated that it intends to seek discovery from the Debtors notwithstanding the FHFA Order. It may also seek discovery of the Debtors through the Non-Debtor Affiliates in the W&S Action. In addition, the FHFA Order is on appeal, and by its own terms is not indefinite.
- **Finally**, if the W&S Action is allowed to continue, the Non-Debtor Affiliates may draw down insurance proceeds that the Debtors submit are property of the estate, thus the stay should be extended.

36. These four reasons, the fact that the Debtors are in the midst of key restructuring tasks, and the fact that Plan Mediation may go a long way in resolving Western & Southern's claims against the Non-Debtor Affiliates in any event, all counsel in favor of a temporary and limited extension of the automatic stay.

A. The Debtors Face Substantial and Critical Restructuring Tasks Over the Next Three Months That Justify Further Extending the Stay

37. As noted in the Original Stay Motion, one of the primary concerns of the Debtors is to minimize distractions and burdens during the critical phases of their restructuring. The Court echoed those concerns at the July 10, 2012 evidentiary hearing when it granted Debtors' Original Stay Motion with respect to the W&S Action. At that hearing, the Court

concluded, “The most significant factor favoring extending the stay in this case is the substantial discovery burden and expense the debtors would face if the Western & Southern action goes forward against Ally Securities.” (July 10, 2012 Tr. at 136–37.) The Court also recognized that “[a]ny prospective discovery will also burden current and former employees of the debtors.” (*Id.* at 137.) The same is true now.

38. At the time the Original Stay Motion was made, Debtors hoped that by October 31, 2012 they would be closer to plan confirmation. However, due to a variety of factors, including the Examiner’s investigation, the adjournment of the RMBS trust settlement hearing, and the commencement of Plan Mediation, the schedule has been extended, and the critical tasks necessary for a successful restructuring are still ongoing.

39. As described above, the next few months involve some of the most crucial and time consuming tasks of the bankruptcy. The docket is “very, very full” and “front-loaded [] between now and the end of this year. It may spill over into early next year.” (Sept. 11, 2012 Tr. at 45–46.) Those things that concerned the Court in September have indeed spilled over into 2013, and some remain months from resolution. Put best, the Court said “we are jam-packed with very time-intensive things that are going on” (*Id.*)

40. Although the Court was discussing a somewhat earlier period in the Debtors’ restructuring, many of the same issues still face the Debtors, and additional obligations are also occupying the Debtors’ time and resources. The Debtors believe the Court’s concerns enunciated in September, and memorialized in the FHFA Order a month later continue: the immense obligations they face in the near-term, obligations that are core to their restructuring and the administration of these Chapter 11 cases, are paramount. Anything interfering with the Debtors’ ability to meet these obligations, such as the distractions that allowing the W&S Action

to go forward would pose, should be avoided. As noted by the Court, the obligations facing the Debtors in these Chapter 11 cases are not indefinite, but they are substantial. That is precisely why the Debtors need an additional—and limited—extension of the Stay.

B. The W&S Action Should Be Stayed Because if It Goes Forward, a Variety of Harms to the Debtors Would Result.

41. As discussed in the Stay Extension Decision, the potential for adverse decisions and findings that may effectively bind the Debtors, the Debtors indemnification obligations to the Non-Debtor Affiliates, the burdensome discovery that will result, and the depletion of shared insurance policies with the Non-Debtor Affiliates all favor an extension of the stay.

1. Continuation of the W&S Action Would Result in Decisions That Amount to Decisions Against the Debtors.

42. As the Fourth Circuit held in *A.H. Robins*—a decision endorsed by the Second Circuit in *Queenie*—the automatic stay should be extended to non-debtors where “there is such identity between the debtor and the third-party defendant,” *Queenie*, 321 F.3d at 288, that a finding or “judgment against the third-party defendant will in effect be a judgment or finding against the debtor.” *A.H. Robins*, 788 F.2d at 999. This Court has confirmed that “a stay should be provided to codefendants when the claims against them and the claims against the debtor are inextricably interwoven, presenting common questions of law and fact, which can be resolved in one proceeding.” *Eastern Air Lines, Inc. v. Rolleston (In re Ionosphere Clubs, Inc.)*, 111 B.R. 423, 434 (Bankr. S.D.N.Y. 1990) (citations and internal quotation marks omitted).

43. In the Stay Extension Decision, the Court pointed to this very argument. In particular, the Court noted that Western & Southern’s “claims against Ally Securities are based on the same nucleus of facts as the claims against the debtors” and “[a]ny decisions and evidence generated would thus be later used against the debtors, whether in the underlying

lawsuits or in claims the [plaintiffs] make against the debtors' estate in these Chapter 11 cases.”
(July 10, 2012 Tr. at 133–34.)

2. Continuation of the W&S Action Would Create Indemnification Obligations for the Debtors' Estate.

44. The Court recognized at the July 10, 2012 evidentiary hearing that findings against the Non-Debtor Affiliates (and even merely defending the cases against them) could have direct effects on the Debtors because of the indemnity obligations the Debtors have to the Non-Debtor Affiliates for “‘losses related to’ the debtors’ ‘business and operations’.” (July 10, 2012 Tr. at 135–36.)

45. The Non-Debtor Affiliates are entitled to indemnification from the Debtors for certain claims pursuant to an Amended and Restated Operating Agreement between Debtor ResCap and Non-Debtor Ally Financial and the Amended and Restated Limited Liability Company Agreement of ResCap (“ResCap LLC Agreement”). (Hamzhepour Decl. at ¶ 8.)

46. The continuation of the W&S Action against the Non-Debtor Affiliates will create indemnification claims against the estate, and as a result, this Court should extend the automatic stay to stay the W&S Action against the Non-Debtor Affiliates. *See, e.g., W.R. Grace & Co. v. Chakarian (In re W.R. Grace)*, Nos. 01-1139 (JKF), ADV. A-01-771, 2004 WL 954772, at *2 (Bankr. D. Del. Apr. 29, 2004); *Queenie*, 321 F.3d at 287; *Calpine Corp. v. Nev. Power Co. (In re Calpine)*, 354 B.R. 45, 50 (Bankr. S.D.N.Y. 2006), *aff’d*, 365 B.R. 401 (S.D.N.Y. 2007); *North Star Contracting Corp. v. McSpedon (In re North Star Contracting)*, 125 B.R. 368, 370 (S.D.N.Y. 1991).

3. Continuation of the W&S Action Would Lead to Burdensome Discovery From the Debtors.

47. The Court also correctly noted at the July 10, 2012 evidentiary hearing on the Original Stay Motion that the “most significant factor favoring extending the stay in this case

is the substantial discovery burden and expense the debtors would face” if the Western & Southern Action proceeded. (July 10, 2012 Tr. at 136–37.)

48. Further recognizing the extreme burden discovery that even a single action would pose on the Debtors, this Court denied the FHFA’s motion to compel production from the Debtors in the FHFA Action. (*See* FHFA Order at 34.) In doing do, the Court also recognized that the Debtors “have a very difficult few months ahead,” (*id.* at 27), and concluded that, “the Debtors simply cannot also undertake the very substantial burden of producing the Loan Files requested by the FHFA and the Underwriter Defendants.” (*Id.* at 29.)

49. Western & Southern has made clear that it intends to seek discovery directly from the Debtors—in particular the Loan Files and Loan Tapes that the Debtors have previously resisted producing because of the scope of the burden they impose.

50. In the near term, the Debtors are engaged in closing the asset sales, which requires significant work from the same employees who would be responsible for loan file and Loan Tape production. (Hamzehpour Decl. at ¶ 5–6; *see also* Declaration of John G. Mongelluzzo at ¶¶ 59–60(a), *In re: Residential Capital, LLC*, No. 12-12020 (Bankr. S.D.N.Y. Aug. 7, 2012), ECF No. 1023-2 (noting that Debtors’ Fulfillment Group, which responds to all loan-file requests, was tasked with researching loan files and clearing exceptions in connection with the sale of Debtors’ mortgage-servicing rights).) Participating in discovery now would unduly distract those employees from the Debtors’ number one task: completing the sales in order to recover money for distribution to the creditors. (Hamzehpour Decl. at ¶ 6.) These same employees are also engaged in the Examiner investigation and RMBS Trust Settlement. (*Id.*)

4. Continuation of the W&S Action May Deplete the Insurance Policies the Debtors Share With the Non-Debtor Affiliates.

51. At the July 10, 2012 evidentiary hearing on the Original Stay Motion, the Court noted that because the insurance policies shared by the Debtors and the Non-Debtor Affiliates would be used in defending the W&S Action, “every dollar spent of policy proceeds reduces the amount available for claims by the debtors.” (July 10, 2012 Tr. at 138.) The same concern remains. (Hamzhepour Decl. at ¶ 7.)

52. Indeed, Section 362(a)(3) protects the bankruptcy estate’s assets by automatically staying “any act to obtain possession . . . or to exercise control over property of the estate.” 11 U.S.C. § 362(a)(3). As this Court has recognized, Section 362(a)(3) “prohibits interference with the disposition of the assets that are under the Court’s wing—*whether or not the Debtor is named as a defendant as part of the effort.*” *Adelphia Commc’ns Corp. v. Am. Channel, LLC (In re Adelphia Commc’ns Corp.)*, 345 B.R. 69, 76 (Bankr. S.D.N.Y. 2006) (emphasis added).

C. Plan Mediation May Resolve the Claims Against the Non-Debtor Affiliates

53. In addition to the reasons the Court pointed to when it issued the W&S Order, Plan Mediation has recently commenced before the Honorable Judge Peck of this Court. Plan Mediation will focus on, among other things, “AFI Related Issues,” including “third party claims against AFI,” which may include the claims against the Non-Debtor Affiliates in the Western & Southern Action. (Debtor’s Motion for Appointment of a Mediator, at ¶¶ 6, 20–21, *In re: Residential Capital, LLC*, No-12-12020 (Bankr. S.D.N.Y. Dec. 6, 2012), ECF No. 2357.)

54. The Second Circuit has held that a bankruptcy court may under Section 105 enjoin a creditor from suing a third party altogether to facilitate settlement negotiations, provided the settlement is an important part of the debtor’s reorganization plan. *See In re*

Drexel Burnham Lambert Group, 960 F.2d 285, 293 (2d Cir. 1992) (affirming § 105 injunction to facilitate settlement that was essential to debtor's reorganization effort). The same logic suggests that here the Court may—and should—take the less drastic step of temporarily enjoining prosecution of the Western & Southern Action while critical settlement negotiations are ongoing.

55. The Debtors and their advisors are devoting time and resources to Plan Mediation that is critical to their restructuring—and that could have a material impact on the W&S Action. It makes practical sense for the W&S Action to remain stayed because the time, energy, and expense that litigation may impose on the Debtors could be for nothing depending on the outcome of Plan Mediation.

CONCLUSION

56. For the foregoing reasons and for the reasons stated in the Original Stay Motion, the Debtors respectfully request that this Court enter an order in substantially the form as the proposed order attached as Exhibit B hereto extending the automatic stay and enjoin the continued prosecution of the W&S Action as against the Non-Debtor Affiliates until April 30, 2013, and grant such other and further relief as this Court deems just and proper.

Dated: January 31, 2013
New York, New York

/s/ Joel C. Haims

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Joel C. Haims
Jonathan C. Rothberg

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Counsel to the Debtors and Debtors in Possession

Exhibit A

The following documents—and, unless otherwise noted, all attachments thereto—previously filed in this adversary proceeding, *Residential Capital, LLC, et al. v. Allstate Insurance Co., et al.*, 12-ap-01671 (MG), are expressly incorporated into Debtors’ Motion to Extend the Stay and Enjoin Prosecution of the Western & Southern Action Against Debtors’ Non-Debtor Affiliates:

1. Debtors’ Motion to Extend Automatic Stay or, in the Alternative, for Injunctive Relief Enjoining Prosecution of Certain Pending Litigation Against Debtors’ Directors and Officers and Non-Debtor Corporate Affiliates, May 25, 2012, ECF No. 4.
2. Declaration of Joel C. Haims and Exhibit 15 thereto, May 25, 2012, ECF Nos. 5 and 5-15.
3. Declaration of Jeffrey A. Lipps, May 25, 2012, ECF No. 6.
4. Declaration of James Whitlinger, May 25, 2012, ECF No. 7.
5. Declaration of Anne Janiczek, May 25, 2012, ECF No. 8.
6. 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, July 6, 2012, ECF No. 57.
7. Supplemental Declaration of Jeffrey A. Lipps, July 6, 2012, ECF No. 59.
8. Supplemental Declaration of Joel C. Haims and Exhibits 1 through 8 thereto, July 6, 2012, ECF Nos. 60 and 60-1–60-8.

Exhibit B

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

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

**ORDER GRANTING DEBTORS' MOTION TO EXTEND THE STAY AND
ENJOIN PROSECUTION OF THE WESTERN & SOUTHERN ACTION
AGAINST DEBTORS' NON-DEBTOR AFFILIATES**

Upon the motion (the "Motion") of the above-captioned debtors and debtors in possession (collectively, the "Debtors") for entry of an Order pursuant to 11 U.S.C. §§ 362(a)(1) and/or 362(a)(3) extending the automatic stay to the continued prosecution by The Western and Southern Life Insurance Company, Western-Southern Life Assurance Company, Columbus Life Insurance Company, Integrity Life Insurance Company, National Integrity Life Insurance Company, and Fort Washington Investment Advisors, Inc. (collectively, "Western & Southern" and, together with the Debtors, the "Parties") against the Non-Debtor Affiliates⁸ in *Western & Southern Life Insurance Co. v. Residential Funding Co., LLC*, No. A1105042 (Ohio Ct. of Comm. P., Hamilton Cnty.) (the "Western & Southern Action"); and/or for entry of an order

⁸ Capitalized terms used but not otherwise defined herein shall have the meanings set forth in the Motion.

pursuant to 11 U.S.C. § 105(a) enjoining and prohibiting the continued prosecution of the Western & Southern Action against Non-Debtor Affiliate Ally Securities, LLC (“Ally Securities”). The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334; venue of this proceeding and this Motion in this District is proper pursuant to 28 U.S.C. §§ 1408 and 1409; notice of this Motion and the opportunity for a hearing on this Motion was appropriate under the particular circumstances and no other or further notice need be given; the relief requested is in the best interest of the Debtors’ estates, their creditors and other parties in interest; and after due deliberation and sufficient cause appearing therefore, it is hereby

ORDERED, ADJUDGED, AND DECREED THAT:

1. The Motion is approved and Western & Southern is hereby enjoined from the continued prosecution against, and the pursuit of any discovery from, the Non-Debtor Affiliates in the Western & Southern Action until April 30, 2013 (the “Stay”), with all parties retaining all rights to seek to extend or terminate the Stay at that time, except as specifically provided in paragraphs 2 and 3 below.

2. Notwithstanding paragraph 1 above, Western & Southern may pursue document discovery in the Western & Southern Action against Ally Securities, but only as to documents in the possession of Ally Securities. Nothing in this paragraph or this Order shall require or permit the pursuit of discovery of documents in the possession of the Debtors.

3. The stay is effective as to the Non-Debtor Affiliates, including the Debtors’ former officers and directors, only upon their agreement to toll any statute or period of limitations, statutes of repose, or other time-based limitations or defenses which might be asserted as a time bar and/or limitation to any claim that could be asserted against them by Western & Southern during the Stay Period, and Western & Southern shall forbear bringing any lawsuits against the Non-Debtor Affiliates during the Stay Period.

4. The Debtors are authorized to take all actions necessary to effectuate the relief granted pursuant to this Order in accordance with the Motion.

5. Notwithstanding the possible applicability of Bankruptcy Rules 6004(h), 7062, 9014 or otherwise, the terms and conditions of this Order shall be immediately effective and enforceable upon its entry.

6. To the extent that this Order is inconsistent with any prior order or pleading with respect to the Motion in these cases, the terms of this Order shall govern.

7. The Court retains jurisdiction with respect to all matters arising from or related to the implementation of this Order.

8. Notwithstanding anything herein to the contrary, this Order shall not modify or affect the terms and provisions of, nor the rights and obligations under, (a) the Board of Governors of the Federal Reserve System Consent Order, dated April 13, 2011, by and among AFI, Ally Bank, ResCap, GMAC Mortgage, LLC, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation, (b) the consent judgment entered April 5, 2012 by the District Court for the District of Columbia, dated February 9, 2012, (c) the Order of Assessment of a Civil Money Penalty Issued Upon Consent Pursuant to the Federal Deposit Insurance Act, as amended, dated February 10, 2012, and (d) all related agreements with AFI and Ally Bank and their respective subsidiaries and affiliates.

New York, New York
Dated: _____, 2013

HONORABLE MARTIN GLENN
UNITED STATES BANKRUPTCY JUDGE