Hearing Date and Time: May 23, 2013 at 2:00 p.m. (prevailing Eastern Time)

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Case No. 12-12020 (MG)
RESIDENTIAL CAPITAL, LLC, et al.,	Chapter 11
Debtors.	Jointly Administered
RESIDENTIAL CAPITAL, LLC, et al.,	Adv. Case No. 13-01262 (MG)
Plaintiffs,	
v.	**REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF DEBTORS' MOTION FOR SUMMARY JUDGMENT**
ALLSTATE INSURANCE COMPANY, et al.,	
Defendants.	

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PRELIMINARY STATEMENT

Equity and the plain meaning of the Bankruptcy Code[1] require subordination of the Investor Claims to prevent the Investors from getting two bites at the apple. The Investors already stand in line to recover through the Trust Claims on par with all other general unsecured creditors. Now they seek to recover *again* for the *same losses*, without meaningfully justifying this double recovery, which will disadvantage all other general unsecured creditors, including other Certificateholders to which the Investors agreed to be subordinated. Section 510 prohibits exactly this sort of gamesmanship.

There are four key questions before the Court. An affirmative answer to any of them compels subordination of the Investor Claims.

- ***First,*** are Certificates issued by the Debtors "securities of the Debtors"? If so, Section 510(b) compels subordination. The Investors acknowledge that the plain (or "colloquial") meaning of the phrase "securities of the debtor" denotes securities issued by the debtor. Nonetheless, the Investors would read into Section 510(b) a limitation narrowing its breadth solely to securities representing an ownership interest in, or obligation of, the Debtors. Neither the statutory language nor the legislative purpose supports such a limitation. *See* Section I.A.

- ***Second,*** were the Trusts affiliates of the Debtors at the time the Investor Claims arose? If so, Section 510(b) compels subordination for this reason as well. The Investors argue that the Trusts cannot be affiliates because they are not "business trusts." But the Trusts were established to generate a profit through the management of mortgage loans—a business (and property) that was operated by the Debtors pursuant to the PSAs. As a result, they are "business trusts" and were affiliates of the Debtors at the time the claims arose. *See* Section I.B.

- ***Third,*** should the PSAs' allocation among Certificateholders of "Subsequent Recoveries" from the Debtors be honored? If so, Section 510(a) compels subordination. The Investors' sole argument to the contrary—that the contracts do not explicitly address fraud claims—is beside the point. Section 510(a) and state law preclude the Investors from undermining the contractually agreed recovery structure by asserting fraud claims. *See* Section II.

[1] Capitalized terms used by not defined herein have the meanings ascribed to them in the *Memorandum of Law in Support of Debtors' Motion for Summary Judgment*, filed on April 2, 2013 [Adv. Pro. Docket No. 26] (the "Debtor Mot.").

- ***Fourth***, is subordination of the Investor Claims necessary to achieve an equitable result on these facts? If so, the Court can and should equitably subordinate the claims under Section 510(c). The Investors argue that such subordination would be impermissibly "categorical." Not true. The inequity here is caused by the particular facts of the Investors' contractual agreements and their overlapping claims. *See* Section III.

ARGUMENT

I. THE CLAIMS SHOULD BE SUBORDINATED UNDER SECTION 510(B)

A. The Certificates Are Securities "of" the Debtors

The parties agree that the Debtors are "issuers" of the Certificates. The narrow question before the Court is whether securities "of the Debtors" under Section 510(b) include securities which the Debtors issued or whether the term "of" means only securities representing an ownership interest in, or obligation of, the Debtors. There is no basis to read "of" so narrowly. (*See Debtors' Mem. of Law in Opp'n to Mot. of AIG Asset Mgmt. (U.S.) LLC, the Allstate Entities, Mass. Mut. Life Ins. Co., and the Prudential Entities for Summ. J.*, filed Apr. 23, 2013 [Adv. Pro. Docket No. 42] at 4-6 (the "Debtor Opp'n").) The statute's purpose and plain meaning, the economic substance of the securitizations, and the Second Circuit's direction to interpret Section 510(b) broadly, all support a finding that the Certificates are securities "of the debtor."

First, on its face, Section 510(b) precludes any inference that Congress intended to limit subordination to claims based on securities in a debtor's capital structure. Quite the opposite, Section 510(b) explicitly subordinates claims based on securities outside a debtor's capital structure by including securities that are "of affiliates" of a debtor.[2] Because Congress expressly determined that claims based on securities beyond a debtor's capital structure must be

[2] *See, e.g., O'Cheskey v. Templeton (In re Am. Hous. Found.)*, No. 10-02016, 2013 Bankr. LEXIS 1449, at *52-53 (Bankr. N.D. Tex. Mar. 30, 2013) (subordinating claims based on security interests in limited partnerships operated by the debtor); *Jenkins v. Tomlinson (In re Basin Res. Corp.)*, 190 B.R. 824, 826-27 (Bankr. N.D. Tex. 1996) (subordinating claims based on security interests in joint ventures operated by the debtor).

subordinated, there is no reason to read an implied "ownership" or "obligation" limitation into the term "securities of the debtor."

Second, the plain meaning of securities "of the Debtor" includes securities issued by the Debtor. For that reason, many courts have read Section 510(b) to refer to securities "issued by" the Debtor. (*See* Debtor Mot. at 9-12.)[3] The Investors respond that these cases simply "refer colloquially to a security of a company as a security that was issued by the company." (*Opp'n of AIG Asset Mgmt. (U.S.) LLC, the Allstate Entities, Mass. Mut. Life Ins. Co., and the Prudential Entities to Debtors' Mot. for Summ. J.*, filed Apr. 23, 2013 [Adv. Pro. Docket No. 43] at 4 ("Investor Opp'n").) *But that is precisely the point*. "Of the debtor" plainly (or "colloquially") means securities *issued by* a debtor.

And the Investors do not contest that the Certificates are issued by the Debtors as a matter of law.[4] Instead, the Investors respond that the securities law provision defining the Debtors as the issuers first references the issuer and then clarifies in an "except that" clause that the depositor is the issuer in the context of asset-backed securities. (Investor Opp'n at 5-6.) This argument proves the Debtors' point: the Investors' attempt to limit Section 510(b) to the securities representing an ownership interest in, or obligation of, the Debtors is contrary to the laws' recognition that ownership often corresponds with issuance, *except* in the context of asset-backed securities where "ownership" is not the relevant benchmark.

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[3] Citing *Allen v. Geneva Steel Co. (In re Geneva Steel Co.)*, 281 F.3d 1173, 1177 (10th Cir. 2002) (Section 510(b) subordinates claims for damages arising from the purchase or sale of securities "issued by the debtor") and *Brown v. Owens Corning Inv. Review Comm.*, 541 F. Supp. 2d 958, 970 (N.D. Ohio 2008), *aff'd*, 622 F.3d 564 (6th Cir. 2010) (same); *see also In re Rancher Energy Corp.*, No. 09-32943 MER, 2011 WL 2604763, at *3 (Bankr. D. Colo. June 30, 2011) (same); *Weissmann v. Pre–Press Graphics Co. (In re Pre–Press Graphics Co.)*, 307 B.R. 65, 71 (N.D. Ill. 2004) (same); *Maxwell v. Novell, Inc. (In re marchFirst, Inc.)*, 431 B.R. 436, 441 n.8 (Bankr. N.D. Ill. 2010) (same).

[4] The Investors' extensive discussion of the district court's opinion in *Alfa, S.A.B. de C.V. v. Enron Creditors Recovery Corp. (In re Enron Creditors Recovery Corp.)*, 422 B.R. 423 (S.D.N.Y. 2009) for the proposition that there are limits in relying upon the definition of a term for one statute when interpreting another (Investor Opp'n at 4-5), is a distraction. Nothing that the Investors cite refutes that, when interpreting issues surrounding securities, their issuance, and liability for securities law claims, the securities laws are a very relevant place to look.

Third, federal law defines the Debtors as issuers of the Certificates in recognition of the economic substance of the transactions. Congress made clear that "the depositor is the person responsible for the flotation of the issue" and the legal status of "issuer" should attach to "*the actual manager of the trust*." H.R. Rep. No. 73-85, at 12 (1933) (emphasis added). This is no "artificial construct." (Investor Opp'n at 6.) Quite the opposite, Congress looked beyond the legal construct of the trusts to focus on the business reality. (*See* Debtor Opp'n at 7-8 & n. 9.) For the same reason, the Court's reading of Section 510(b) should focus on the "person responsible" and the "actual manager," and not exclude securities so closely tied to the Debtors as the Certificates based on an overly restrictive reading of the statute. H.R. Rep. No. 73-85, at 12.

Fourth, the Second Circuit has directed courts to interpret Section 510(b) broadly as a remedial provision. *See Spirnak v. Motors Liquidation Co. GUC Trust (In re Motors Liquidation Co.)*, No. 11 Civ. 7893 (DLC), 2012 U.S. Dist. LEXIS 15838, at *7-8 (S.D.N.Y. Feb. 7, 2012) (citing *Rombro v. Dufrayne (In re Med Diversified, Inc.)*, 461 F.3d 251, 259 (2d Cir. 2006)). The Court therefore should decline to infer extra-textual limitations on that provision.

* * *

None of the cases on which the Investors rely support their strained reading.

First, the Investors continue to rely heavily on *Washington Mutual*, ignoring the fact that the court based its decision on a mistaken belief that the debtors were *not* the "issuers" of the securities.[5] When the court learned that the debtors' affiliates were, in fact, the depositors and

[5] The debtors in *In re Washington Mutual, Inc.* argued that securities were "of" the debtors because their affiliates were *sellers* of the securities. 462 B.R. 137, 146 (Bankr. D. Del. 2011). The court mistakenly believed that "[n]either the Debtors nor their affiliates are the *issuers* of the Certificates," and held that Section 510(b) does not apply to sellers. *Id.* at 147 (emphasis added). Notably, the *Washington Mutual* court expressly recognized that Section 510(b) "address[es] the competing interests of creditors and the buyers of securities *issued by a debtor*." *Id.* at 146 (emphasis added).

thus the issuers of the RMBS certificates, it declined to give its prior decision any weight.[6] This Court should not give *Washington Mutual* any more weight than its own author did after learning that the debtors were the issuers.

Second, the Investors' reliance on an unpublished decision in *Impac Mortg. Holdings, Inc. v. Houston Cas. Co.*, No SACV 11-1845-JST (C.D. Cal. Feb. 26, 2012), attached as Attachment A to Investor Opp'n; (*see* Investor Opp'n at 8) is likewise misplaced. *Impac* interpreted the provisions of two liability insurance policies and determined that, as a matter of California state law and the parties' intent, coverage for RMBS claims was more appropriate under an insured's professional liability policy than under its directors and officers policy. The decision has no bearing on this Court's interpretation of broad remedial provisions of the Bankruptcy Code. *See id.*[7]

B. The Certificates Are Securities of Affiliates of the Debtors

Even under the Investors' proffered reading, Section 510(b) subordinates the Investor Claims because the Trusts were affiliates of the Debtors at the time the claims arose. The only

[6] *See* Mot. to Alter or Amend at ¶¶ 2-3, *In re Wash. Mut., Inc.*, No. 08-12229, filed on Jan. 3, 2012 (Bankr. D. Del.) [Docket No. 9301] ("[T]he Court's implicit determination that the phrase 'securities of the debtor or an affiliate of the debtor' in section 510(b) means securities *issued by* a debtor or its affiliates brings into sharp focus the question of *who* exactly is the 'issuer' of the Certificates . . . . With respect to asset-backed securities such as the Certificates, the 'issuer' is the 'depositor', not the issuing Trust.") (attached as Exhibit 1 hereto); *see also* Order Approving Stipulation and Agreement at 2, *In re Wash. Mut., Inc.*, No. 08-12229, entered on Feb. 16, 2012 (Bankr. D. Del.) [Docket No. 9698] ("ORDERED that, because the Motion to Alter or Amend is still pending, and the portion of the December Order relating to subordination under 510(b) of the Bankruptcy Code is not a final order . . . .") (attached as Ex. 9 to the Kotliar Decl.); Order Den. Mot. to Classify at 3, *In re Wash. Mut., Inc.*, No. 08-12229, entered on May 16, 2012 (Bankr. D. Del.) [Docket No. 10182] (ordering that prior decision was "not dispositive" for classification of claims arising from indistinguishable securities) (attached as Ex. 10 to the Kotliar Decl.).

[7] The *Impac* plaintiffs argued that securities claims should be covered under both the directors and officers ("D&O") insurance policy *and* its errors and omissions ("E&O") policy. The court explained that finding coverage under the D&O policy would "cause a traditional D&O policy for [companies that engage in the business of securitizing mortgages] to become a de facto E&O policy, i.e. a professional liability policy for entities." The court determined that such a result was not contemplated by the parties. The conclusion that RMBS securities were not intended to fall within the D&O policies' "securities of" provision was one basis for that holding.

issue before the Court is whether the Trusts are "business trusts" and therefore "persons" eligible to be "affiliates."[8] (*See* Investor Opp'n at 10-12.) They are.

1. The Trusts Are "Business Trusts"

The Investors concede that the only court to address asset-backed securitization trusts in this context held that they were business trusts. (*See* Investor Opp'n at 12-13 (discussing *Nationsbank, N.A. v. Commercial Fin. Serv., Inc. (In re Commercial Fin. Serv., Inc.),* Adv. Case No. 98-05166-R (N.D. Okla. July 11, 2003) [Docket No. 174], attached as Ex. 11 to the Kotliar Decl. ("*CFS*")).) In response, they rely almost entirely on two inapposite cases—*Shawmut Bank Conn. v. First Fid. Bank (In re Secured Equip. Trust of E. Air Lines Inc.),* 38 F.3d 86 (2d Cir. 1994) ("*Eastern Airlines*") and *In re Gurney's Inn Corp. Liquidating Trust*, 215 B.R. 659 (Bankr. E.D.N.Y. 1997)—which addressed very different types of trusts. (*See* Investor Opp'n at 11-12)

First, the Investors fail to meaningfully distinguish *CFS*. The Investors argue that "the trust at issue [in *CFS*] was expressly intended to be and registered as a business trust." (Investor Opp'n at 13.) But the Trusts here are also business trusts under applicable state law; indeed, many of the Trusts have the exact same state law status as the trust in *CFS*. (*See* Debtor Opp'n at 11, n.12.) The Investors also argue that the debtor in *CFS* "retained far greater rights in and exercised far greater control over the trust at issue than the Master Servicer here," and that the trust in *CFS* held less substantial property than the Trusts. (Investor Opp'n. at 13.) But these facts, if true, show that the Trusts have far greater independent business purpose than the trust in *CFS*, weighing *in favor* of finding that they are business trusts.

[8] The Investors cannot seriously dispute that if the Trusts are business trusts, the Debtors operated the business or substantially all of the property under the PSAs and thus meet the other requirements to be an affiliate. *See* 11 U.S.C. § 101(2)(C). Their arguments that the Trusts have no business to operate, and the like, are simply variations on the theme that the Trusts are not business trusts. (*See* Debtor Opp'n at 14-19.)

Second, *Eastern Airlines* does not suggest a contrary result. As explained in the Debtors' Opposition, the trust there simply facilitated secured loans between the debtor and its banks. The debtor received cash from the financing and paid rent to the trusts that flowed to trust investors. There was no third party. The court recognized that the economic substance of the transaction was simply a loan agreement between the debtor and the banks, and the trust had no independent business purpose. *Eastern Airlines*, 38 F.3d at 88. Here, however, the Investors own the rights to payment from thousands of mortgage loans that must be actively serviced to maximize value. (*See* Debtor Opp'n at 13-14.) That ongoing management of the loans—delegated to the Debtors at issuance and continuing without the Debtors to this day—is the business of the Trusts, rendering them unlike the trust in *Eastern Airlines*.

Finally, *Gurney's Inn* is likewise inapposite. The court there relied on express provisions in the trust documents stating that it was not a business trust, prohibiting the trustee from engaging in any business, and providing that the sole purpose of the trust was "to receive by assignment all the assets and liabilities of Gurney's [Corp.] and to conserve and protect the Trust Estate and collect and distribute the income and proceeds to the Trust Certificate holders after the payment of or provision for, expenses and liabilities." *In re Gurney's Inn Corp.*, 215 B.R. at 667. The Trust documents here contain no such language and the Trusts *do* have a substantial business role in managing the loans, which requires much more than simply collecting payments. (*See* Debtor Opp'n at 12, n.13.)

2. The "Insider" Argument Is a Red-Herring

Even though it has no relevance to the subordination issue before the Court, the Investors argue that if the Trusts are affiliates for the purposes of Section 510(b), they must also be "insiders" and thus their votes would not count in determining assenting impaired classes in a cramdown plan. (Investor Opp'n at 13-14.) This is flatly wrong.

Section 510(b) subordination turns on affiliate status *at the time the claims arose*. *See In re Wash. Mut., Inc.*, 442 B.R. 314, 363 (Bankr. D. Del. 2011). Insider status for voting purposes under Section 1129(a)(10) turns on affiliate status *at the time the vote is taken*. *See 455 CPW Assocs. v. Greater N.Y. Sav. Bank (In re 455 CPW Assocs.)*, 99-5068, 2000 U.S. App. LEXIS 23470, at *19-20 (2d Cir. Sept. 14, 2000). Because the Debtors sold all of their servicing operations, the Trusts are no longer affiliates of the Debtors or "insiders." The Trusts' affiliate status at the time the Investor Claims arose thus will have no impact on any plan vote.[9]

II. THE CLAIMS SHOULD BE SUBORDINATED UNDER SECTION 510(A)

The Investors ask this Court to ignore that the non-subordination they propose would give them greater recoveries than they would be entitled to from the Trust Claims under the Certificates' waterfall provisions, at the direct expense of other Certificateholders' recoveries, including those of more senior Certificateholders. The Investors' sole support for this untenable result is their assertion that fraud claims are outside the contractual waterfall. (*See* Investor Opp'n at 14.) But, this ignores that the extra-contractual fraud claims must be subordinated as a matter of law under Section 510(a) and state law.

First, courts have specifically rejected the argument that Section 510(a) subordination can be avoided through assertion of a fraud claim. (*See* Debtor Opp'n at 20-21.) *In re Coronet Capital* is directly on point. There, the court affirmed the application of Section 510(a) to subordinate "extracontractual" fraud claims. *Levine v. Resolution Trust Corp. (In re Coronet Capital Co.)*, 94 Civ. 1187 (LAP), 1995 U.S. Dist. LEXIS 10175, at *12 (S.D.N.Y. July 12, 1995) (Preska, J.). As the court explained, even if the noteholders had been defrauded, "there is no reason why their risk of loss from their subordinated Notes should be shifted to [other

[9] It is also worth noting that the RMBS Trust Settlement was negotiated with the holders of Certificates, who have not been "affiliates" of the Debtors at any time, and contemplates that those independent Certificateholders will direct the Trustees (also never affiliates of the Debtors) to approve the Trust Settlement.

creditors]." *Id.* at *21. This conclusion is consistent with "the settled rule that fraud of the debtor will not impair the enforceability of a subordination provision." *In re Walnut Equip. Leasing Co.*, 97-19699 DWS, 1999 Bankr. LEXIS 1460, at * 23-24 (Bankr. W.D. Pa. Nov. 23, 1999) (citing *In re Eaton Factors Co.*, 3 B.R. 20 (Bankr. S.D.N.Y. 1980)).[10]

Second, this result is compelled by the implied covenant of good faith and fair dealing. The Investors argue that the covenant cannot imply subordination of their claims because the agreement is silent on fraud claims. (*See* Investor Opp'n at 16.) On the contary, the covenant "is breached when a party to a contract acts in a manner that, *although not expressly forbidden by any contractual provision*, would deprive the other party of the right to receive the benefits under their agreement." *ARB Upstate Commc'ns LLC v. R.J. Reuter, L.L.C.*, 93 A.D.3d 929, 934 (N.Y. App. Div. 3d Dep't 2012) (emphasis added). "The appropriate analysis . . . is first to examine the [relevant contracts] to determine 'the fruits of the agreement' between the parties, and then to decide whether those 'fruits' have been spoiled." *Empresas Cablevision, S.A.B. de C.V. v. JPMorgan Chase Bank, N.A.*, 680 F. Supp. 2d 625, 632 (S.D.N.Y. 2010), a*ff'd in part and remanded in part*, 381 Fed. Appx. 117 (2d Cir. 2010) (alterations in original) (quoting *Metro. Life Ins. Co. v. RJR Nabisco, Inc.*, 716 F. Supp. 1504, 1518 (S.D.N.Y. 1989)). The fruits of the agreement here—Subsequent Recoveries flowing through the Trusts' subordination waterfall—would be spoiled by the dilutive Investor Claims recovering *pari passu* with the Trust Claims. *See Shamis v. Ambassador Factors Corp.*, 95 Civ. 9818 (RWS), 2000 U.S. Dist. LEXIS 13581, at *53 (S.D.N.Y. Sept. 21, 2000) ("A party's acts may infringe on the implied covenant of good faith when the party acts so directly to impair the value of the contract for another party that it

[10] *See also Kira v. Holiday Mart, Inc. (In re Holiday Mart, Inc.)*, 715 F.2d 430, 433 (9th Cir. 1983) ("Even if the securities holders were able to prove the company defrauded them, they would not have shown their position should be improved at the expense of the general creditors. That is the relationship at issue, and fraudulent dealings by the company do not alter it.").

may be assumed that they are inconsistent with the intent of the parties.") (quotation omitted).

III. THE CLAIMS SHOULD BE SUBORDINATED UNDER SECTION 510(C)

Finally, the Investors cannot deny that absent subordination, there will be two recoveries with respect to each Certificate they purchased: one to the Investor for its securities claim and one to the current Certificateholder for its Trust Claim.[11] In addition, the Certificateholders still have their rights to future payments from the mortgage loans in their Trusts, to the exclusion of all other creditors. This Court need not and should not allow the Investors another recovery on *equal priority* with the only payments going to general unsecured creditors (and at odds with the agreed allocation among Certificateholders). The Debtors do not seek "categorical" subordination or a wholesale re-ordering of priorities. Rather, it is the Investors' contractual agreements with other creditors and the effect of their overlapping claims that would, absent subordination, give rise to the inequities that the Debtors seek to avoid.

CONCLUSION

For the foregoing reasons, the Debtors respectfully request that the Court grant their Motion for Summary Judgment in its entirety and deny the Investors' Rule 3013 Motion.

[11] Those two recoveries will both go to the Investor for any Certificate it did not sell. Selling the Certificates changes the beneficiary of the recovery under the PSAs, but the Investors' argument that the seller's securities claim should not be subordinated because the seller no longer hold the right to the first recovery is nonsense. If that were the rule, all Certificateholders would be incentivized to sell (and imputed in that sale price would be the expected recovery on the Trust Claims) and thereby double the recovery available on each Certificate. Due to the estates' limited resources, the equitable result is obvious: one Certificate, one recovery, paid through the Trusts according to the waterfall.

Dated: May 7, 2013
New York, New York

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Exhibit 1

Motion to Alter or Amend,
***In re Washington Mutual, Inc.*, No. 08-12229,**
filed on Jan. 3, 2012 (Bankr. D. Del.) [Docket No. 9301]

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	)	Chapter 11
	)	
WASHINGTON MUTUAL, INC., et al.,[1]	)	Case No. 08-12229 (MJW)
	)	Jointly Administered
Debtors.	)	
	)	Hearing Date : Feb. 1, 2012, 10:30 a.m.
	)	Objection Deadline : Jan. 20, 2012, 4:00 p.m.
	)	Related Docket Nos. 9224, 9225

MOTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO ALTER OR AMEND THE COURT'S OPINION AND ORDER REGARDING SUBORDINATION OF THE CLAIM OF TRANQUILITY MASTER FUND, LTD.

The Official Committee of Unsecured Creditors (the "Committee") of Washington Mutual, Inc., et al. (the "Debtors"), by and through its undersigned counsel, hereby moves this Court (the "Motion"), pursuant to Rule 59(e) of the Federal Rules of Civil Procedure as made applicable by Rule 9023 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), to alter or amend that portion of the Court's Opinion and Order (D.I. 9224, 9225) (the "Opinion" and the "Order," respectively) in which the Court ruled that the Debtors have not stated a basis for subordination of the claim asserted by Tranquility Master Fund, Ltd. ("Tranquility") in proof of claim number 2206 as amended by proof of claim number 3925 (the "Claim"). In support of this Motion, the Committee respectfully represents as follows:

PRELIMINARY STATEMENT

1. A motion to alter or amend a judgment under Bankruptcy Rule 9023 is a request for extraordinary relief, and the Committee does not bring this Motion lightly. The Committee will not rehash prior arguments. The Opinion and Order must be altered or amended,

[1] The Debtors in these chapter 11 cases along with the last four digits of each Debtor's federal tax identification number are: (i) Washington Mutual, Inc. (3725); and (ii) WMI Investment Corp. (5395). The Debtors' principal offices are located at 925 Fourth Avenue, Seattle, Washington 98104.

however, to correct a clear error of law and prevent manifest injustice to the unsecured creditors of the Debtors' estates.

2. With respect to subordination, the Court stated in the Opinion that the WaMu and WMALT Trusts (the "Trusts") "issued" the securities purchased by Tranquility (the "Certificates") that are the subject of the Claim.[2] The Court said: "Neither the Debtors nor their affiliates are the issuers of the Certificates." Op. at 20. This ruling, coupled with the Court's implicit determination that the phrase "securities of the debtor or an affiliate of the debtor" in section 510(b) means securities *issued by* a debtor or its affiliates, *id.* at 18-20, brings into sharp focus the question of *who* exactly is the "issuer" of the Certificates.

3. The statutory and regulatory authorities under which Tranquility brings its claim provide the answer to this question, and the answer is contrary both to the Court's Opinion and to what Tranquility represented in its final brief to the Court.[3] With respect to asset-backed securities such as the Certificates, the "issuer" is the "depositor", not the issuing Trust. The statutes are all explicit and clear on this point, as will be discussed below. Securities Act of 1933, § 2(a)(4) (the "Securities Act"), 15 U.S.C. § 77b(2)(a)(4); Securities Exchange Act of 1934 (the "Exchange Act"), § 3(a)(8), 15 U.S.C. § 78c(a)(8); Cal. Corp. Code § 25010(a). The applicable federal regulations are in accord. Securities and Exchange Commission ("SEC") Rule 191, 17 C.F.R. § 220.191; SEC Rule 3b-19, 17 C.F.R. § 240.3b-19; SEC Regulation AB, 17 C.F.R. § 229.1101(e) & (f). Here, although the Trusts were "issuing entities," they were not the "issuers" of the securities *as a matter of law*. The "issuers" were the depositors, WaMu Asset Acceptance Corp. ("WAAC") and Washington Mutual Mortgage Securities Corp. ("WMMSC"),

[2] Unless otherwise defined herein, all capitalized terms shall have the meanings ascribed to them in the Opinion.
[3] Tranquility Master Fund, Ltd.'s Response to the Official Committee of Unsecured Creditors' Supplemental Brief Objecting To Tranquility's Amended Proof of Claim ("Tranquility's Supp. Response") (D.I. 8265) (filed July 18, 2011).

both wholly-owned subsidiaries of Washington Mutual Bank ("WMB"). Accordingly, the "issuers" of the securities were indeed affiliates of the Debtors. The correction of this error of law will lead to the proper subordination of Tranquility's claim.

4. Unfortunately, none of the parties clearly and concisely referenced for the Court these explicit definitional sections of the Securities Act, the Exchange Act, SEC Rule 191, SEC Rule 3b-19, SEC Regulation AB, or the California Corporations Code. The Committee regrets that this was not done. Nevertheless, the Third Circuit has said that reconsideration under Fed. R. Civ. P. 59(e) is "the appropriate means of bringing to the court's attention manifest errors of fact or law," and that it is an abuse of discretion for a court to refuse to consider a new argument in a motion to alter or amend a judgment when that argument addresses a clear error of law. *Max's Seafood Cafe ex. Rel. Lou-Ann, Inc. v. Quinteros*, 176 F.3d 669, 678 (3d Cir. 1999).

5. Correction of this error of law will also prevent manifest injustice to unsecured creditors, by causing the subordination of this securities fraud claim as Congress intended.

RELEVANT BACKGROUND

6. The facts and the procedural history of this dispute are well known to the Court and will not be repeated here except as relevant to this Motion.

7. Tranquility claims to have purchased Certificates from 56 tranches of securities in 21 separate series. Of these, five of the tranches were registered with the SEC; the other 51 tranches were unregistered and sold pursuant to private placement memoranda ("PPMs"). The tranches sold under PPMs were all lower-rated tranches from the same Trusts as those of the registered tranches. As Tranquility itself noted, "Each PPM attached and incorporated a Prospectus and a Prospectus Supplement that had been filed with the securities and Exchange Commission as part of the registration statements for WaMu's mortgage-backed

securities. … And each PPM contained numerous terms that were defined in the Prospectus Supplement." Tranquility Response to Debtors' Objection to Proof of Claim No. 2206 (D.I. 3641) (filed May 4, 2010), Ex. 1, ¶ 5. Attached as Exhibit A is a summary (based on existing exhibits already before the Court) of the 56 tranches, referencing the applicable exhibits containing the pertinent prospective supplements and PPMs where applicable. In 52 of the 56 tranches, WAAC was the "depositor"; in the remaining four, WMMSC was the "depositor". *See* Ex. A.

JURISDICTION

8. This Court has jurisdiction to consider this Motion pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). The statutory predicate for the relief requested herein is Fed. R. Civ. P. 59(e) as made applicable by Bankruptcy Rule 9023.

RELIEF REQUESTED

9. The Committee seeks to alter or amend that portion of the Court's Opinion and Order in which the Court ruled that the Debtors have not stated a basis for subordination of the Claim. The Committee requests entry of an order finding that WAAC and WMMSC were the issuers of the Certificates, and that because WAAC and WMMSC were affiliates of the Debtors under section 101(2)(B) of the Bankruptcy Code, section 510(b) applies to subordinate the Claim.

ARGUMENT

A. STANDARD

10. A motion to alter or amend a judgment may be filed pursuant to Bankruptcy Rule 9023, which incorporates Fed. R. Civ. P. 59(e). To prevail on a motion to alter or amend the judgment, the movant must show, in pertinent part: "the need to correct a clear

error of law or fact or to prevent manifest injustice." *Max's Seafood*, 176 F.3d at 677; *see also Maymi v. Phelps*, No. 10-638, 2011 WL 6034480, at *1 (D. Del. Dec. 5, 2011) (same). While a motion for reconsideration should not be used to rehash arguments that were already argued and that the Court already decided, *In re Edison Bros., Inc.*, 268 B.R. 409, 412 (Bankr. D. Del. 2001), "reconsideration is the appropriate means of bringing to the court's attention manifest errors of fact or law," *Max's Seafood*, 176 F.3d at 678 (holding that district court abused its discretion when it failed to address clear error of law raised in motion for reconsideration).

B. BASIS FOR RELIEF

11. The first applicable federal statute is the "Definitions" section of the Securities Act. Tranquility brings Count III of its claim under the Securities Act. Section 2(a)(4) provides, in pertinent part:

> When used in this title, unless the context otherwise requires--
>
> (4) The 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. § 77b(2)(a)(4) (emphasis added).

12. This definition applies to control person liability under Section 15 of the Securities Act, 15 U.S.C. § 77o.

13. Exactly the identical definition appears in the analogous portion of the Exchange Act. Specifically, Section 3(a)(8) provides, in pertinent part:

> When used in this title, unless the context otherwise requires--
>
> (8) The 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) (emphasis added).

14. The applicable federal regulation promulgated under the Securities Act is SEC Rule 191, which states quite clearly:

> Rule 191 -- Definition of "issuer" in Section 2(a)(4) of the Act in Relation to Asset-Backed Securities.
>
> The following applies with respect to asset-backed securities under the Act. Terms used in this section have the same meaning as in Item 1101 of Regulation AB (Rule 229.1101 of this chapter).
>
> **a. The depositor for the asset-backed securities acting solely in its capacity as depositor to the issuing entity is the "issuer" for purposes of the asset-backed securities of that issuing entity.**

17 C.F.R. § 230.191 (emphasis added).

15. The applicable federal regulation under the Exchange Act, SEC Rule 3b-19, is substantively identical. (It omits the citation for Regulation AB.)

> Rule 3b-19 -- Definition of "issuer" in Section 3(a)(8) of the Act in Relation to Asset-Backed Securities.
>
> The following applies with respect to asset-backed securities under the Act. Terms used in this section have the same meaning as in Item 1101 of Regulation AB.
>
> **a. The depositor for the asset-backed securities acting solely in its capacity as depositor to the issuing entity is the "issuer" for purposes of the asset-backed securities of that issuing entity.**

17 C.F.R. § 240.3b-19 (emphasis added).

16. The applicable California statute under which Tranquility brings Counts I and II of its claim is the California Corporations Code, specifically sections 25504 and 25504.1. The applicable definition is set forth in Section 25010(a), in words identical to those of both the Securities Act and the Exchange Act:

> With respect to . . . collateral-trust certificates, or with respect to certificates of interest . . . **" 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 the security is issued.

Calif. Corp. Code § 25010(a).

17. The statutes and regulations regarding asset-backed securities accordingly draw a very clear distinction between an "issuer" and an "issuing entity." The "issuer" is the "depositor," and "*Depositor* means the depositor who receives or purchases and transfers or sells the pool assets to the issuing entity." Item 1101 of Regulation AB, 17 C.F.R. § 229.1101(e) (italics in original). The "issuing entity," by contrast, "means "the trust or other entity created at the direction of the sponsor or depositor that owns or holds the pool assets and in whose name the asset-backed securities supported or serviced by the pool assets are issued"—here, the Trusts. 17 C.F.R. § 229.1101(f). *See also* Talcott J. Franklin & Thomas F. Nealon III, *Mortgage and Asset Backed Securities Litigation Handbook* Appendix A (2011) (stating in definition of "Depositor" that "the Depositor is considered the statutory issuer of CMBS, although technically CMBS are issued by the Trust"). Here, WAAC and WMMSC are the "issuers" and the Trusts are merely passive "issuing entities".

18. The legislative history explains this structure, clarifying that "although the actual issuer is the trustee, the depositor is the person responsible for the flotation of the issue," so "information relative to the depositor and to the basic securities is what chiefly concerns the investor—information respecting the assets and liabilities of the trust rather than of the trustee." H.R. Rep. No. 85, 73 Cong., 1st Sess. 13 (1933). "For these reasons the duty of furnishing this information is placed upon the actual manager of the trust and not the passive trustee, and this purpose is accomplished by defining 'issuer' as in such instances referring to the depositor or manager." *Id.* This depositor-as-issuer structure was not an accident or anomaly, but rather part

of a larger legislative and regulatory scheme, as evidenced by the fact that the SEC simultaneously promulgated Rule 191 and "an identical rule for purposes of the Exchange Act," which it codified at 17 C.F.R. § 240.3b-19. *Asset-Backed Securities*, 70 Fed. Reg. 1506, 1526 n.155 (Jan. 7, 2005); *see also id.* at 1526 ("We are clarifying that the depositor for the asset-backed securities, acting solely in its capacity as depositor to the issuing entity, is the 'issuer' for purposes of the asset-backed securities of that issuing entity").[4]

19. All of the above authority applies to tranches sold pursuant to PPMs as well as to tranches that were registered with the SEC. The California Corporate Code, under which Tranquility pursues its claims under Counts I and II, uses the exact same language as appears in the Securities Act and the Exchange Act. Furthermore, the PPMs explicitly "attached and incorporated a Prospectus and a Prospectus Supplement that had been filed with the Securities and Exchange Commission as part of the registration statements for WaMu's mortgage-backed securities," as Tranquility itself acknowledged.[5] These lower-rated tranches sold under PPMs involved the same "depositor"/ "issuer" as the registered offered certificates, involved the same "issuing entity" as the registered offered certificates, were issued pursuant to and are held subject to the same pooling and servicing agreement as the registered offered securities, were backed by the same pool of mortgage loans as the registered offered certificates, and were an integral part of the same securitization transaction (their issuance and existence is

[4] In analyzing who is the "issuer" of a security under the Exchange Act, the Seventh Circuit held that it "need not look beyond" the definition of "issuer" in that statute even though colorable policy reasons existed for expanding that definition. *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765, 767-68 (7th Cir. 1979) (plaintiff did not have standing to sue under section 16(b) of Exchange Act because he did not own securities of "issuer" as defined by Exchange Act). Given the identical language defining "issuer" in the Securities Act and the Exchange Act, no reason exists to believe that the Securities Act's definition should be treated any less dispositively. And given that the California statute uses exactly the same language in defining "issuer," no reason exists to treat Tranquility's California claims any differently from its federal claim.

[5] Tranquility Response to Debtors' Objection to Proof of Claim No. 2206 (D.I. 3641) (filed May 4, 2010), Ex. 1, ¶5.

necessary for the overall securitization transaction structure as they provide the subordination required for the creation of senior classes and the desired ratings on such senior classes).

20. The Debtors in their argument mistakenly implied that the Trusts – which the Court held are not affiliates of the Debtors – issued the Certificates that Tranquility purchased. But in accordance with the law cited above, Tranquility's own admissions identify the depositor – WAAC or WMMSC—as the "issuer" of the Certificates that Tranquility purchased.[6] Tranquility also makes much of a statement that Debtors made in a footnote which was based on an erroneous assumption that the Trusts were the issuers. *See* Tranquility Supp. Response at 6. However, Tranquility cannot bypass an error of law by admission or purported estoppel. What the Debtor erroneously said does not determine what is the law. *See In re SemCrude , L.P.*, 436 B.R. 317, 322 (Bankr. D. Del. 2010) (citation omitted) ("There is also support in this Circuit for the principle that 'judicial admissions are restricted in scope to matters of fact.... A legal conclusion—e.g., that a party was negligent or caused an injury—does not qualify [as] a judicial admission' "). For instance, what if the Debtor had said in a footnote that the federal statute of limitations for fraudulent conveyance under section 548 of the Bankruptcy Code were three years? The erroneous statement would not change the law that the correct statute of limitations is two years. Nor could the admission justify applying the error as if it were the law.[7]

[6] It is undisputed that WAAC and WMMSC were the "depositors" for the securities issuances that form the basis of the Claim. *See, e.g.*, WAAC Form S-3 filed February 28, 2005, at ii (identifying WAAC as "depositor" and stating that "WAAC, as depositor, will sell the securities, which may be in the form of mortgage pass-through certificates, mortgage-backed notes or mortgage trust certificates."). Tranquility, in its proofs of claim, also acknowledges that WAAC is the depositor. *See* Tranquility Amended Proof of Claim (No. 3925) at 12 ("WaMu Asset Acceptance participated in the securitization of the underlying mortgages at issue. In particular, it served as the 'Depositor' of the certificates . . . .").

[7] Tranquility's own proof of claim acknowledges that WAAC was the issuer of the Certificates. Although Tranquility's allegation is not determinative of the law, it is notable that Tranquility's proof of claim alleges that "WaMu Inc. authorized and designed WaMu's strategy to finance WaMu's operations and earn profits from the

21. In short, the Trusts were not the issuers of the Certificates. Rather, WAAC and WMMSC, as depositors, were the issuers of the Certificates. The Court has already determined that WAAC was an affiliate of the Debtors, *see* Op. at 18, n.4, and WMMSC was as well. Therefore, the Certificates were issued by "affiliates" of the Debtors, and Tranquility's Claim must be subordinated under section 510(b) of the Bankruptcy Code.

NOTICE

22. Notice of this Motion is being given to: (i) the Office of the United States Trustee; (ii) counsel to the Debtors; (iii) counsel to Tranquility; (iv) counsel to the Equity Committee; and (v) parties that have requested service pursuant to Bankruptcy Rule 2002.

WHEREFORE, the Committee respectfully requests that the Court (i) alter or amend that portion of the Opinion and Order in which the Court ruled that the Debtors have not stated a basis for subordination of the Claim; (ii) enter an order finding that WAAC and WMMSC, which are both affiliates of the Debtors pursuant to section 101(2)(B) of the Bankruptcy Code, were the issuers of the securities underlying Tranquility's Claim, and that accordingly section 510(b) applies to subordinate the Claim; and (iii) grant the Committee such other and further relief as the Court deems just, proper and equitable.

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sale of the Certificates, including by . . . causing WaMu Asset Acceptance, which served as the issuer of the Certificates, to file, and/or provide, in conjunction with other WaMu entities, materially false and misleading Offering Documents to the market and to investors such as Tranquility . . . ." Amended Proof of Claim (No. 3925) at 43 (emphasis added). Tranquility also acknowledges that the Certificates were issued through the Trusts, and not by the Trusts themselves. *Id.* at 52.

Dated: January 3, 2012
Wilmington, Delaware

Respectfully submitted,

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