



School of
Optimal Governance

Dr. Sankarshan Acharya. 17636 W Neuberry Ridge Dr, Lockport, IL 60441. 815-524-5196. sacharya@pro-prosperty.com

April 2, 2010

The Honorable Mary Walrath, Chief Judge
United States Bankruptcy Court
District of Delaware
824 Market Street, 5th Floor
Wilmington, DE 19801
Deputy: Julia_Johnston@deb.uscourts.gov

Cc: Presiding Honorable Judge Gregory M. Sleet
J. Caleb Boggs Federal Building
844 N. King Street
Room 4324, Unit 19
Wilmington, DE 19801-3569

Sub: **JPMC's takeover of a solvent Washington Mutual is unconstitutional.**¹

Dear Honorable Judge Walrath,

I request you to consider this memo in your judgment of JP Morgan & Chase's September 25, 2008 takeover of Washington Mutual assets (WaMu) for the following reasons:

1. Through my research on moral hazard in banking and financial markets,² I accurately foresaw in 2003 the recent financial meltdown, identified it as being manmade and brewing within the industry, and proposed in March 2003 to the US Congress for preemptive optimal policies to avert the crisis due to the prevailing unsafe banking.³

The Congress must have then taken my warning and policy advice in 2003 seriously, perhaps because the unprecedented bank foreclosure rule it enacted in FDICIA-1991 is based on my published research.

My inference that the Congress responded promptly in 2003 is based on the testimonies it sought in October 2003 from the Federal Reserve Board on safety and soundness of banks and

¹The basic ideas of this memo are from my book "Prosperity: Optimal Governance, Banking, Capital Markets, Global Trade and Exchange Rate," published by Citizens Publishing.

²"Safe Banking to Avoid Moral Hazard," published in 2008 in the Journal of Risk Management in Financial Institutions, and available on the internet at <http://pro-prosperty.com/Research/moralhazard-safebanking.pdf>, "Safe Banking," published in 2003 in the American Academy of Business and available on the internet at, <http://pro-prosperty.com/Research/Safe%20Banking.pdf>, "Optimal Bank Reorganization Policies and Pricing of Federal Deposit Insurance" published in 1989 in the Journal of Finance and working paper, entitled, "An Economic Theory of Constitutional Governance," available at <http://pro-prosperty.com/Research/MoralHazardLiberty.pdf>.

³<http://pro-prosperty.com/Global%20Economy%20Chatterbox/Warning-USCongress-In-2003-On-Home-Mortgage-Debate.html>



the subsequent conference held by the Fed on the topic later in 2003. The Fed had invited me to the 2003 conference, but I could not attend.

The above background is crucial because the Fed, top bankers and Wall Street managers, and top university professors of economics and finance including Nobel Memorial Prize winners have actually failed to forecast the Great Recession, let alone propose preemptive policies to avert it. How they missed such a catastrophic event-that has destroyed about \$50 trillions of wealth worldwide-is narrated in my memos to Presidents Bush and Obama and members of Congress.⁴ These memos track factually how the 2008 Great Recession is manmade, who the actors are and what their modus operandi is. I have been directly involved in this process as a bank regulator, as a researcher and as an active pursuer of policies in public interest. My foray into bank regulatory policies started in the wake of the 1987 market collapse, when I was an assistant professor of finance at NYU. I continued it as a financial economist at the Board of Governance of the Federal Reserve System. I have pursued the course, as a researcher and a pursuer of policies, to serve the best public interest by a determination to prevent future financial crises. This memo is a continuation of such pursuits.

2. As an investor, I saw an immense return on investment in WaMu common stock and bought a few shares the day before the seizure. My monetary investment maybe insignificant. But the non-pecuniary reward is immense in terms of furthering selfless research for society which supports me.

My current research, looking forward, is aimed to restore the trust in banking and governance that made this nation nonpareil on earth, attracting immigrants from all over the world to persevere, innovate and create better ideas, products and services.

My investment assessment was accurate because the CEO of JPMC also saw immense value in acquisition of WaMu on exactly the same day, barely a few hours after I bought the shares of WaMu common stock. The only difference between my investment and JPMC's takeover is that I invested my hard earned savings to buy the common stock of WaMu's parent, WMI, while JPMC swallowed my investment by contriving to wangle away all profitable assets of WMI including Washington Mutual Bank (WMB) for pittance.

3. That JPMC contrived to wangle away the profitable assets of WaMu proves to be true by the disclosure of tangible assets and liabilities of WMI on March 26, 2010 and by the recent letter to shareholders written on March 26, 2010 by the CEO of JPMC. I need not belabor on the data that the Court already has on the parent company's (WMI's) assets and liabilities.

I am submitting below my evaluation of WaMu's assets acquired by JPMC, based on, perhaps inexactly, disclosed statements and my area of asset pricing: (I understand the Court will have financial analysis from an approved expert.)

⁴See, pro-prosperty.com, and, in particular, "Mythology of Market Discipline Unraveled by Market Crash: A New Philosophy of Governance," memo to President and Congress, available on the internet, <http://pro-prosperty.com/Mythology%20of%20Market%20Discipline%20Unraveled%20by%20Market%20Crash.html>

JPMC's 2009 Earnings: 100.434B⁵

JPMC's 2009 EBIT: 64.390B⁴

JPMC's 2009 Tax: 4.415⁴

JPMC's 2009 Cash flow (for Debt & Equity) = EBIT-tax = 59.975B

JPMC's 2009 Cash flow as a percent of earnings = $59.975/100.434 = .6$

JPMC's CEO states in his March 26, 2010 memo to shareholders about 30B of earnings from WaMu in 2009. The Court may need to reconfirm this from JPMC.

Acquired WaMu's 2009 incremental cash flow, approximately = $.6 \times 30 = 18B$

A conservative estimate of cost of capital⁶ in a low interest rate environment = 0.05.

Fair Value of WaMu Assets = $18/.05 = 360B$ assuming no growth.

The Acquired WaMu debt is 220B even if senior bondholders are added.

This makes the acquired WaMu's equity worth $360-220=140B$. This equity belongs to the parent company, WMI. Now, WMI is solvent on a liquidation basis, even without the 140B that it should have rightfully owned in the transferred WaMu assets.

At the time of takeover, when I purchased a few shares of WMI, the true value of equity would have earned me a very high rate of return. JPMC knew it too, as the facts presented by its CEO's letter to his shareholders now prove.

The FDIC nevertheless seized this true WMI equity value from me and many other real families in USA and around the world to hand the same over to JPMC with an alibi that some bank run of \$16B from WMB had taken place. But the FDIC confidentially communicated to JPMC about three weeks before the date of seizure that JPMC could receive the valuable WaMu assets, as per news reports published later. Such confidential communication may have ruffled some uninsured depositors to transfer their funds, maybe to JPMC that was known to them as the acquirer of WMB.

In any case, WaMu had an enormous cash balance, access to Federal Reserve funds, and impending TARP money at the time of seizure. The flimsy alibi of FDIC is simply untenable at best. At worst, it amounts to an unconstitutional usurpation of private wealth, like my hard-earned household savings, to someone favored by a regulatory agency that had utterly failed to serve the taxpayers due to perpetuation of manmade banking shenanigans that have caused the crisis, as per my analysis.⁷

⁵ <http://finance.yahoo.com/q/is?s=JPM&annual>

⁶ It should be a risk adjusted weighted cost of capital for debt and equity. But since the equity stake in the acquired assets is low, debt will dominate the cost of capital estimate.

⁷ "Mythology of Market Discipline Unraveled by Market Crash," memos written to the President and Congress on

4. The trust in American banking and governance is vital to enhance prosperity of individuals based on their training, skills and perseverance. Prosperity is preserved as credit, which means trust. Bankers, their regulators, courts and government must preserve this trust for society to prosper. Trust is destroyed if private household credit/property/prosperity is transferred to favored bankers. Such transfers are unconstitutional. They amount to slavery of those who work hard by the others who game to beget such transfer.
5. The constitutional principle of free market economy was not followed to determine the true value of WaMu through, e.g., open bidding. The most prominent decision maker during the 2008 crisis was the Federal Reserve Board because it only could create money. JPMC is a prominent member of the board of directors of the Federal Reserve Bank of New York which handled the 2008 crisis in behalf of the Federal Reserve Board. The intention of JPMC to acquire WaMu was well known. Massive naked short selling of WaMu common stock took place during the time. The SEC banned short selling of most financial companies, except WaMu. News reports published later show that JPMC dissuaded other potential bidders of WaMu.

The only rational inference from these facts is that the government regulators facilitated a surreptitious transfer of WaMu to JPMC by depriving the hard earned savings of investors in WaMu securities and by irreparably decimating the trust in American banking and governance in addition to tangible losses of wealth of about \$50 trillion worldwide. That I lost little in the capital destruction process is incidental. What is crucial is that I am living in a trustless environment of the type that ruled the roost during the scary Great Depression. I pray that the Great Depression does not recur, but praying within my *Universal Religion* means searching for the truth of how *We the People* should govern ourselves to keep our earned dignity, prosperity and mutual trust.⁸

Only your Court can determine whether an unconstitutional transfer of private property has taken place in the acquisition of WaMu by JPMC. If true, WMI should be restored to its pre-seizure status. I have trust in the Court. But I have to also render my duty in furtherance of mutual trust. I have, therefore, found it prudent to offer this input, not just as a small investor, but also as a selfless researcher who sacrificed a lot for scripting a rational economic theory of constitutional governance.

My economic theory turns out to be the antithesis of the prevailing dogma that the market participants can accurately price assets under the current system of governance. That the markets abjectly failed to price assets was obvious during 2008, with frequent public expression of anxiety by top government regulators that the markets had collapsed and that the "illiquid" assets could not be priced. This failure vindicates my research as detailed in academic papers and policy memos.

With profound regards,



March 7 and February 27, 2010, available on the internet, here <http://pro-prosperty.com/Mythology%20of%20Market%20Discipline%20Unraveled%20by%20Market%20Crash.html>
⁸ <http://pro-prosperty.com/Research/A%20Unifying%20Philosophy%20of%20Governance.pdf>