UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re :	:	**Chapter 11 Cases**
WASHINGTON MUTUAL, INC., et. al.,	:	**Case No. 08-12229 (MFW)**
DEBTORS.	:	**Jointly Administered**
	:	**Re: D.I. 6696**

THE WMB NOTEHOLDERS' OBJECTION TO THE MODIFIED SIXTH AMENDED JOINT PLAN OF AFFILIATED DEBTORS PURSUANT TO CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE

The WMB Noteholders[1] hereby object to the Modified Sixth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code (the "Plan") [D.I. 6696]. The Plan cannot be approved because it contravenes the payment priorities established in 11 U.S.C. § 726(a) and thus violates 11 U.S.C. § 1129(a)(7). As a result, it effectively denies the WMB Noteholders the opportunity to obtain redress for legitimate and valuable fraud claims against the Debtor relating to the WMB Noteholders' purchases of in excess of $600 million in aggregate principal amount outstanding of Senior Notes and Subordinated Notes issued by non-debtor Washington Mutual Bank ("WMB" or the "Bank").

[1] The WMB Noteholders include Thrivent Financial for Lutherans, AEGON USA Investment Management, LLC (AEGON Life Insurance (Taiwan) and Transamerica Financial Life Insurance Company), PPM America, Inc. (The Prudential Assurance Company, Ltd., JNL VA High Yield Bond Fund, Jackson National Life Insurance Company of New York, and Jackson National Life Insurance Company), New York Life Investment Management LLC, Legal & General Investment Management (Legal & General Investment Management America), The Northwestern Mutual Life Insurance Co. (Northwestern Mutual Life Insurance Co., Northwestern Long Term Care Insurance Company, Northwestern Mutual Series Fund, Inc. and its Select Bond Portfolio, and Northwestern Mutual Series Fund, Inc. and its Balanced Portfolio), ING Direct NV, Sucursal en España, and their affiliates, who are the legal or beneficial holders of, or have control or discretionary investment authority with respect to, in excess of $600 million in aggregate principal amount outstanding of Senior Notes and Subordinated Notes issued by Washington Mutual Bank.

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The Plan suffers from a number of significant defects.

A. First, the Plan provides for interest payments to certain general unsecured creditors before any payments are made to satisfy the subordinated unsecured claims of the WMB Noteholders. Under Section 510(b) of the Bankruptcy Code, WMB Noteholders' Claims, which were **NOT** based upon equity investments, can be subordinated only to "senior or equal" claims (*i.e.*, general unsecured claims payable under Section 726(a)(2)). Thus, at most, the application of Section 510(b) would cause the WMB Noteholders' claims to be subordinated to the bottom of Section 726(a)(2) or to the top of Section 726(a)(3). In either case, the WMB Noteholders' claims would have a higher priority than Section 726(a)(5) interest claims. Thus, as currently formulated, the Plan set forth a priority scheme that is directly contrary to Section 510(b) of the Bankruptcy Code, the findings made by the Court in its opinion (the "Opinion") accompanying its January 7, 2011 Order denying confirmation of the Sixth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code: "The Court agrees that **interest cannot be paid on any unsecured claims until all unsecured claims are paid in full.**" *In re Washington Mutual, Inc.,* No. 08-12229, 2011 WL 57111, at *35 (Bankr. D. Del. Jan. 7, 2011) (emphasis added) (citing 11 U.S.C. § 726(a)). This Plan's treatment of interest also conflicts with caselaw construing Section 726, which holds that post-petition interest is not properly paid until all unsecured claims, including subordinated claims, are paid in full. *In re El Paso Refinery, L.P.,* 244 B.R. 613 (W.D. Texas 2000).

B. Second, the Plan provides for the payment of late claims plus post-petition interest before payments are made on the timely filed claims of

subordinated, unsecured creditors. As with the Plan's payment of interest to general unsecured claims, this aspect of the Plan is directly contrary to 11 U.S.C. §§ 726(a)(2)-(3), which explicitly requires the payment of late claims after the payment of all unsecured claims.

C. Third, the Plan groups all purchasers of Senior WMB Notes—both those that hold direct *and* derivative misrepresentation claims with respect to such notes—together in Class 17(a), yet requires that holders of direct misrepresentation claim release such claims (and, in addition, release direct misrepresentation claims with respect to WMB Subordinated Notes) in order to receive a Class 17(a) distribution. Thus, in order to receive a distribution on a claim in Class 17(a), some members of Class 17(a) are required to relinquish claims that others are not. This grouping of creditors with significantly different claims in the same class, and the disparate treatment of some members of that class, violates Section 1122(a) of the Bankruptcy Code.

D. Fourth, as a result of the Plan's providing for (i) interest payments to certain unsecured creditors and before payments are made to satisfy claims of other unsecured creditors, (ii) payment of late claims plus post-petition interest before payments are made on the timely filed claims of subordinated, unsecured creditors, and (iii) the release of the WMB Noteholders' misrepresentation claims, the Plan results in the WMB Noteholders' receiving less than the would under a Chapter 7 liquidation in contravention of Section 1129(a)(7) of the Bankruptcy Code.

The Plan cannot be confirmed in the face of these critical defects.

BACKGROUND

A. OVERVIEW OF THE WMB NOTEHOLDERS

1. The WMB Noteholders are a group of institutional investors, comprised chiefly of insurance companies, who collectively purchased, at or near par, *in excess of $600 million* in WMB Senior Notes and WMB Subordinated Notes. These institutional investors hold and manage the funds of insurance companies that millions of average American rely upon to pay claims upon the occurrence of catastrophic life events.

2. The WMB Noteholders—unlike many purchasers of WMB securities who acquired their positions for a fraction of their value after the Debtors' fraud was disclosed and who stand to receive a windfall under the Plan—bought their notes well in advance of the disclosure of any malfeasance at the Bank, and have suffered substantial monetary losses. *See* Verified Statement of Grant & Eisenhofer P.A. Pursuant To Rule 2019 Of The Federal Rules Of Bankruptcy Procedure (Docket No. 3754). The WMB Noteholders —and the millions of American who turn to them in their darkest hours—are true victims of the Debtors' fraud.

B. OVERVIEW OF THE WMB NOTEHOLDERS' CLAIMS

3. A very real and damaging fraud undergirds the WMB Noteholders' Misrepresentation Claim—in fact, a securities fraud class action challenging the very misrepresentations of which the WMB Noteholders complain is currently pending against WaMu in the United States District Court for the Western District of Washington, having survived defendants' motions to dismiss. *See In re Washington Mut., Inc. Sec., Derivative & ERISA Litig.*, No. 2:08-md-1919 MJP (W.D. Wash.). That case has now purportedly been settled by the Defendants for an amount that is reported to exceed $100 million. The WMB Noteholders, unlike many other late-in-the-game investors, were

wholly unaware of the risks they were undertaking when they chose – from the thousands of investment options at their disposal – to invest their capital with the Bank.

C. PROCEDURAL BACKGROUND

4. The Debtors objected to the Misrepresentation Claim in their Corrected Twentieth (20th) Omnibus (Substantive) Objection to Claims (the "First Objection"), claiming that the WMB Noteholders lacked standing to assert a direct misrepresentation claim and that the WMB Noteholders failed to state a claim in conformity with the pleading requirements applicable to a complaint, an adversary proceeding, or the federal securities laws. *See* Dkt. No. 2205, Case No. 08-12229 (Bankr. D. Del. Jan. 22, 2010).[2] The Court roundly rejected these arguments during oral argument on April 6, 2010, finding that the WMB Noteholders had standing to assert their properly-pled Misrepresentation Claim and ordering discovery to proceed.[3] The Court entered an order denying the First Objection on April 21, 2010. *See* Dkt. No. 3549, Case No. 08-12229 (Bankr. D. Del. Apr. 21, 2010).

5. Subsequently, on October 17, 2010, the Debtors filed their Fifty-Fifth (55th) Omnibus (Substantive) Objection To Claims, in which they argued that the WMB Noteholders' misrepresentation claims were subject to mandatory subordination pursuant to Section 510(b) of the Bankruptcy Code. At oral argument on January 6, 2011, the

[2] The WMB Notehoders have retained the undersigned counsel to represent them solely with respect to the Misrepresentation Claim. As to claims other than the Misrepresentation Claim, the WMB Noteholders will continue to be represented by Bracewell & Giuliani LLP. Accordingly, the Misrepresentation Claim alone is addressed herein.

[3] Undeterred by the Court's clear rejection of their arguments, the Debtors filed a second objection to the Misrepresentation Claim, asserting the exact same arguments that the Court previously rejected. *See* Debtors' Fifty Fifth (55th) Omnibus (Substantive) Objection To Claims (the "55th Objection") (Docket No. 5616). The WMB Noteholders opposed the 55th Objection. *See* The WMB Noteholders' Response And Opposition To The Debtors' Fifty-Fifth (55th) Omnibus (Substantive) Objection to Claims (Docket No. 5766). The Court has not specifically addressed this aspect of the 55th Objection.

Court accepted the Debtor's argument and ruled that the WMB Noteholders' misrepresentation claims were subject to subordination under Section 510(b). In the Opinion, which dealt with confirmation of the Plan and was not specifically directed toward the issues in the 55th Objection, the Court addressed the subordination arguments that had been made in the 55th Objection and explained why subordination was appropriate under Section 510(b). Opinion at *41-42.

D. TREATMENT OF THE WMB NOTEHOLDERS' MISREPRESENTATION CLAIM UNDER THE PLAN

1. Treatment Of Senior, Unsubordinated (Derivative) Claims

6. Under the Plan, the WMB Noteholders' derivative claims, which were not subordinated pursuant to Section 510(b) of the Bankruptcy Code, fall under Class 17.[4] Class 17, in turn, has been split into two class: Class 17(a) for the WMB Senior Notes claims and Class 17(b) for the WMB Subordinated Notes claims. *See* Plan at 21.1(a), 21.1(c).

7. In order to receive a pro rata distribution of $335 million stemming from certain tax refunds inuring to the BB Liquidating Trust and certain other cash distributions (up to $10 million), WMB Senior Noteholders must release all of their claims, *both direct and derivative*, against the Debtors. *See* Plan at 21.1(a), 43.6. Those holders of WMB Senior Notes not only are required to give up their misrepresentation claims related to the WMB Senior Notes, but they also must give up their direct misrepresentation claims related to the WMB Subordinated Notes. Thus, Section 1.175 of

[4]In the Second Objection (Docket 5616), Debtors, in connection with the WMB notes held by members of the WMB Noteholders, moved to subordinate the WMB Noteholders' direct misrepresentation claims under Section 510(b) of the Code. As noted above, the Court agreed that those claims should be subordinated. Opinion at *41-42. The WMB Noteholders, however, also have certain derivative claims as current holders of WMB notes that were not subject to subordination. Those derivative claims remain in Class 17.

the Plan provides that "for the avoidance of doubt, to the extent that a holder of an Allowed WMB Senior Notes Claim receives a distribution pursuant to the Plan, such holder shall be deemed to have released any and all Section 510(b) Subordinated WMB Note Claims that such holder may have"; and Section 21.1(a) of the Plan provides that "to the extent that such WMB Senior Notes Claim is determined pursuant to Final Order of the Bankruptcy Court to be an Allowed Claim . . . such holder shall be deemed to have consented to the releases provided in Section 43.6 of the Plan . . . ." Significantly, those holders of Senior WMB Notes that do not have direct misrepresentation claims against WMI receive the same pro rata distribution from Class 17A as holders of both direct and derivative claims—yet they are not forced to abandon their direct claims with respect to both the WMB Senior Notes and WMB Subordinated Notes.

8. The Treatment of the Holders of WMB Subordinated Notes in Class 17(b) is even more draconian. All WMB Subordinated Notes, to the extent they are not Section 510(b) Subordinated Notes, are simply deemed disallowed under the Plan and do not receive any distribution, regardless of whether they hold direct claims, derivative claims, or both.

9. Requiring the WMB Noteholders to release their Misrepresentation Claims related to both the WMB Senior Notes and the WMB Subordinated Notes as a condition of receiving a distribution is both inequitable and impermissible under the Bankruptcy Code.

2. The Treatment Of The Subordinated (Direct Misrepresentation) Claims Under The Plan

10. Under the Plan, in the event that the WMB Noteholders' claims were subordinated under Section 510(b), they were designated as "Allowed Subordinated

Claims." Plan at ¶¶ 1.22, 1.176, 1.188. As "Allowed Subordinated Claims," they were to be included in Class 18 under the Plan. *Id.* at ¶ 22.1. Thus, under the Modified Sixth Plan, when read in conjunction with this Court's decision subordinating the claims under Section 510(b), the WMB Noteholders' claims appear to be included in Class 18.[5]

11. Class 18, which consists of Subordinated Claims, provides that there will be no payment to the subordinated unsecured claims included therein until "all Allowed Claims and **Postpetition Interest Claims in respect of Allowed Claims** … are paid in full…." Plan at ¶22.1 (emphasis added).

ARGUMENT

12. The Bankruptcy Court should deny confirmation of the Plan because it fails to meet the confirmation requirements set forth in the Bankruptcy Code. Section 1129(a) of the Bankruptcy Code provides that the court shall confirm a plan only if *all* of the requirements of Section 1129(a)(1)-(13) are met. 11 U.S.C. § 1129(a). As a proponent of a Chapter 11 plan, the Debtors bear the burden of establishing that the Plan complies with each of the confirmation requirements of Section 1129(a) by a preponderance of the evidence. *See, e.g., Armstrong World Indus., Inc.*, 348 B.R. 111, 120 n.15 (D. Del 2006) (plan proponent must establish by preponderance of the evidence the satisfaction of requirements of Bankruptcy Code Sections 1129(a) and 1129(b)); *In re Exide Techs.*, 303 B.R. 48, 58 (Bankr. D. Del. 2003) (same). Moreover, the Bankruptcy

[5] In the Opinion, when the Court explained why it was accepting the Debtor's argument that the WMB Noteholders' claims were subject to subordination, it stated that "the placement of the WMB Noteholders in Class 17 was appropriate." Opinion at *42. The WMB Noteholders' believed that this was an inadvertent error on the part of the Court (since their claims would only be in Class 17 if not subordinated under Section 510(b)), and thus on January 21, 2011, they filed a Motion To Clarify The Placement Of The WMB Noteholders' Claims Under The Sixth Amended Joint Plan Of Affiliated Debtors Pursuant To Chapter 11 Of The United States Bankruptcy Code, asking the Court to clarify that their claims should be in Class 18 under the Sixth Amended Plan (which is the same as the Modified Sixth plan in this respect). The Court has not yet ruled on that motion for clarification.

Court has an independent duty to determine whether a plan proponent has met its evidentiary burden under Section 1129(a) prior to entering an order confirming a Chapter 11 plan. *See, e.g., In re Lernout & Hauspie Speech Prods., N.V.*, 301 B.R. 651, 656 (Bankr. D. Del. 2003).

13. The Plan cannot be confirmed because it suffers from a number of significant defects. First, the Plan improperly provides for the payment of post-petition interest on certain unsecured claims prior to the payment in full of the WMB Noteholders' unsecured claims. Second, the Plan also improperly provides for the payment of late-filed unsecured claims, including post-petition interest thereon, prior to the WMB Noteholders' timely filed unsecured claims. Third, the Plan impermissibly groups disparate creditors together in the same class and then proceeds to treat them differently by requiring some to release claims as a condition of distribution. Finally, in providing for payment of post-petition interest and late-filed claims, as well as in requiring the WMB Noteholders' to waive their misrepresentation claims, the Plan results in the WMB Noteholders receiving less than they would were the Debtors to be liquidated under Chapter 7.

I. PAYMENT OF POST-PETITION INTEREST PRIOR TO PAYMENT OF CLASS 18 CLAIMS IS IMPROPER

14. The WMB Noteholders' direct misrepresentation claims have been subordinated and placed in Class 18 of the Plan, which provides that there will be no payment on the subordinated unsecured claims included therein until "all Allowed Claims and **Postpetition Interest Claims in respect of Allowed Claims** … are paid in

full…." Plan at ¶22.1 (emphasis added).[6] This aspect of the Plan is in direct conflict with the legislative history of Section 726, the clear language of Sections 726(a) and 510(b), the case law construing Section 726(a)(5), and this Court's statement that interest cannot be paid on unsecured claims until all unsecured claims are paid (Opinion at *35 (citing 11 U.S.C. § 726(a)), thus rendering this provision of the Plan unconfirmable.[7]

15. The legislative history of Section 726 makes it clear that Congress intended that post-petition interest is not to be paid until all other claims are satisfied and a surplus of assets remains to be returned to the Debtor. S. REP. 95-989, S. Rep. No. 989, 95TH Cong., 2ND Sess. 1978, 1978 U.S.C.C.A.N. 5787, 1978 WL 8531 ("[L]ike prepetition penalties, **such interest will be paid from the estate only if and to the extent that a surplus of assets would otherwise remain** for return to the debtor at the close of the case.") (emphasis added).

16. As the Court has found, the WMB Noteholders' misrepresentation claims are general unsecured claims. Opinion at *105 ("Therefore, there claim against the Debtors is a general unsecured claim"). Thus, there can be no dispute that, had the WMB Noteholders' claims not been subordinated pursuant to Section 510(b) by order of this Court, such claims would be payable as general unsecured claims under Section 726(a)(2). Under Section 510(b), this Court can only subordinate the WMB Noteholders' claims "to all claims or interests *that are senior to or equal* the claim or interest

[6] To date, no order has been entered subordinating the WMB Noteholders' misrepresentation claims pursuant to the Court's oral decision on January 6, 2011. Due to that ruling, the WMB Noteholders have assumed that their misrepresentation claims will be included in Class 18. It would be inequitable, to say the least, for the Debtors to withdraw their request to subordinate those claims in order to put those claims in class 17(b) of the Plan—which claims are deemed disallowed. The Debtors should be required to confirm that those claims will be included in Class 18.

[7] In the event the Court rules that post-petition interest is payable to general unsecured claims prior to payment on the WMB Noteholders' subordinated unsecured claims, the WMB Noteholders reserve the right to argue for the application of the federal judgment rate of interest to prepetition unsecured claims and to adopt arguments that may be submitted by other parties in objections to the Plan on this point.

represented by such security… .” Section 510(b) (emphasis added). Given that, but for subordination, the WMB Noteholders claims would have been payable under Section 726(a)(2), the only claims that are “senior to or equal” the WMB Noteholders’ claims are claims payable under Section 726(a)(1) and unsubordinated Section 726(a)(2) general unsecured claims. There are no other claims “senior to or equal” to the WMB Notes Claims to which they can be subordinated. As such, the WMB Notes claims fall at the bottom of Section 726(a)(2) or somewhere between Sections 726(a)(2) and (a)(3). They do not come after (a)(3) and certainly do not fall below payment of post-petition interest under Section 726(a)(5).

17. This placement of the WMB Note Claims at the bottom of Section 726(a)(2) causes the Plan’s proposed distribution of interest (and, as discussed below, payment on late-filed claims) before payment of the subordinated WMB Note Claims to violate the absolute priority rule and thus runs afoul of Section 1129(b)(7). As this Court recognized in holding that interest cannot be paid on any unsecured claims until all unsecured claims are paid in full, the distribution scheme of Section 726(a) is subject to the subordination provisions of Section 510. Opinion at *35 (citing 11 U.S.C. § 726(a)). Section 726(a)’s reference to Section 510, however, cannot mean that any subordinated claim is paid only after interest is distributed to non-subordinated claims under Section 726(a)(5). Such a distribution scheme would conflict with Section 510’s clear mandate that subordinated claims are subordinated only to “senior or equal” claims.[8] A Section

[8] While claims that arise from equity investments are subordinated under Section 510(b) to the level of equity, which would place them in Section 726(a)(6), *see* Opinion at *35 (“if the LTW claims are subordinated at all, they would be subordinated to the level of common stock, which gets paid, under Section 726 only after all creditors get paid post-petition interest”), the WMB Noteholders’ claims do not derive from equity investments and thus cannot be subordinated to the level of common stock.

726(a)(5) post-petition interest claim is indisputably *not* senior or equal to a subordinated Section 726(a)(2) general unsecured claim, such as the WMB Notes Claims.

18. The only argument that would support the interpretation of a Section 726(a)(5) post-petition interest claim as "senior or equal" to a subordinated general unsecured claim is that post-petition interest somehow attaches to an unsecured claim, such that it is part of the claim itself. That very argument, however, has been rejected by caselaw on this issue. In *In re El Paso Refinery, L.P.,* 244 B.R. 613 (Bankr. W.D. Tex. 2000), the Bankruptcy Court considered the question of whether post-petition interest was properly payable under Section 726 on certain unsecured claims prior to payment of a creditor's unsecured claim for post-petition interest and attorney's fees relating to a mechanic's and materialman's lien, which claim had been deemed a general unsecured claim per a consent agreement with the debtor, albeit subordinated to all other general unsecured claims. The Bankruptcy Court concluded that the distribution scheme set out in Section 726 requires the full payment of all unsecured claims, including "garden variety" subordinated claims, prior to the payment of post-petition interest under Section 726(a)(5). The *El Paso Refinery* Court reasoned that payment of interest pursuant to Section 726(a)(5) is not "distribution of a piece of creditors' prepetition secured claims," but is instead an equitable remedy designed to compensate all creditors for the loss occasioned by the estate's detention of money during the bankruptcy case. 244 B. R. at 620-21. As such, "a payment of interest is separate and distinct from the claim on which it is paid," *id.,* and unsecured, subordinated claims should be paid in full before any equitable distribution of interest.[9]

[9] *El Paso Refinery* was a decision issued on the motion of certain general unsecured creditors for reconsideration of the Bankruptcy Court's prior order that payment should be made on creditor Glitch Field

19. Additional caselaw is in accord with *El Paso Refinery* that interest is payable under Section 726(a)(5) only after unsecured claims, both general and subordinate, have been paid and any remaining funds would fall to the debtor (or its stockholders). *See*, *e.g.*, *In re Frontier Props., Inc.*, 979 F.2d 1358, 1366-67 (9th Cir. 1992) ("Thus § 726(a)(5) provides for payment of post-petition interest on all claims only as a last priority before the distribution of any surplus to the debtor.") (citing 11 U.S.C. § 726(a)(6) (1988)); *In re Comstock Fin. Svcs., Inc.*, 111 B.R. 849, 860 (C.D. Cal.. 1990) ("The only time such interest is allowable is if the estate is a surplus estate, meaning that there is enough money to pay all claims and still return money or property to the debtor."); *In re West Marketing Corp.*, 155 B.R. 399, 404 (Bankr.N.D.Tex. 1993) ("any obligation to pay postpetition interest on general unsecured claims is not fixed until the bankruptcy estate pays in full the principal amount of all allowed claims in full.").[10]

Service's subordinated unsecured claim before the distribution of interest to the general unsecured creditors under Section 726(a)(5). On reconsideration, the *El Paso* Court determined it had erred in ruling that Glitch should be paid in full before interest was distributed to the general unsecured creditors because the Court had failed to recognize that Glitch's claim had been subordinated per consent agreement. Under this consent agreement, Glitch's claim for post-petition interest and attorney's fees (which would otherwise be unallowable as a general unsecured claim), was allowed but subordinated to the full distribution on all other allowed general unsecured claims provided under applicable law, which the *El Paso Refinery* Court interpreted as including interest distribution under Section 726(a)(5). The *El Paso Refinery* Court thus contrasted the Glitch subordinated claim, which was the creature of a consent settlement only, with "garden variety" subordinated claims as established under the Bankruptcy Code. 244 B.R. at 624-25. Had Glitch's claim otherwise been an allowable, albeit subordinated, unsecured claim—as the *El Paso* Court initially thought it was and like the claims of the WMB Noteholders here—the Bankruptcy Court made clear it would have to be satisfied in full prior to any distribution of interest on unsecured claims. As the Court said, "If this had been a garden variety subordination claim, then our prior ruling and analysis would have been correct (i.e., subordinated claims are usually paid prior to interest under § 726(a)(5)." *Id.* at 625.

[10] To the extent that the Debtor seeks to provide to the PIERS Claims (Class 16), which sit above the WMB Noteholders' Claims in Class 18 under the Plan, more than they would be entitled to if the full contract rate of post-petition interest was to be paid to other unsecured creditors, the WMB Noteholders reserve the right to object to any attempt to provide additional funds to Class 16 which can then be returned to other unsecured creditors as the result of an agreement between the members of Class 16 and other unsecured creditors. Put differently, to the extent that this Court accepts the arguments set forth in this objection, or requires that interest be paid at the federal judgment rate, any monies that are not to be paid under the current plan in post-petition interest should first go to Class 18 before going to Classes 16 or 17, which have their recoveries capped under agreements that have been reached with the Debtors.

II. THE PLAN'S TREATMENT OF LATE-FILED CLAIMS IS IMPROPER

20. Under Section 16.2 of the Plan, late-filed claims are to be paid prior to subordinated, unsecured claims:

> 16.2 Class 12A -- Late-Filed Claims: Commencing on the Effective Date, and subject to the priorities set forth in the Subordination Model, each holder of an Allowed Late-Filed Claim shall receive, in full satisfaction, release and exchange of such holder's Allowed Late-Filed Claim and Postpetition Interest Claim, such holder's Pro Rata Share of Liquidating Trust Interests, in an aggregate amount equal to (a) such holder's Allowed Late-Filed Claim and (b) in the event that all Allowed Claims (other than Subordinated Claims) are paid in full, such holder's Postpetition Interest Claim, … .

As with the Plan's proposed distribution of interest prior to payment of the WMB Noteholders' claims, this provision is directly contrary to 11 U.S.C. §§ 726(a)(2) & (3) and violates the absolute priority rule. Section 726(a) provides that claims are paid "second, in payment of any allowed unsecured claim" and then "third, in payment of any allowed unsecured claim proof of which is tardily filed…." 11 U.S.C. §§ 726(a)(2) & (3). There is no provision in Section 726 under which timely-filed unsecured claims (whether or not subordinated) are to be paid **after** late-filed claims.[11] Further, as discussed above, there is no basis for payment of post-petition interest with respect to late filed claims prior to payment of allowed subordinated unsecured claims under Section 726(a)(5). Accordingly, Section 16.2 of the Modified Sixth Plan is contrary to law, violates Section 510(b) of the Bankruptcy Code, and should be rejected by this Court.

[11] While unsecured claims that are subordinated to the level of equity under 11 U.S.C. § 510(b) are moved below late-filed claims, *see* Opinion at *35 (holding that post-petition interest that is payable pursuant to Section 726(a)(5) comes before claims subordinated to the level of equity under Section 510(b)), unsecured claims that are merely subordinated, but not to the level of equity, remain unsecured claims and thus come before late-filed claims and interest under the scheme established in Section 726(a).

III. THE PLAN CANNOT BE CONFIRMED BECAUSE IT IMPROPERLY GROUPS DISPARATE CREDITORS TOGETHER

21. Under the Plan, all purchasers of Senior WMB Notes are grouped together in Class 17A—regardless of whether such purchasers have asserted only derivative claims *or* both derivative and direct claims. Under Section 1122(a) of the Bankruptcy Code, "a plan may place a claim or an interest in a particular class *only if* such claim or interest is substantially similar to the other claims or interests of such class." 11 U.S.C. § 1122(a) (emphasis added). The WMB Noteholders' direct Misrepresentation Claims—which are based on the harm *they suffered individually* by virtue of having been induced by the Debtors' fraud into purchasing WMB Notes at artificially inflated prices—are fundamentally different from the derivative claims asserted by other holders of WMB Senior Notes—which are based on harm suffered by the Debtors as corporate entities. Grouping these fundamentally different claims in the same class violates Section 1122(a).

22. In grouping these claims together, the Plan also provides for disparate treatment of creditors in the same class in contravention of Section 1123(a)(4). Section 1123(a)(4) mandates that a plan "provide the same treatment for each claim or interest of a particular class." The requirement that claims of the same class be treated equally is absolute and unconditional. The Plan violates Section 1123(a)(4) by treating holders of WMB Senior notes who have asserted misrepresentation claims differently than those who have not asserted misrepresentation claims. Simply put, while all members of Class 17A receive the same *pro rata* distribution from the funds allocated to the class (based upon the amount of Senior Notes held), the WMB Noteholders (and other purchasers of WMB Senior notes who have asserted direct claims against the Debtors) are being forced

to give up a valuable direct claim that other purchasers of WMB Senior Notes never even had in the first place. This disparate treatment violates Section 1123(a)(4).

23. The only assets available to creditors who have been placed in Class 17 are the proceeds of the settlement of a derivative action. These proceeds, by definition, cannot have been – and were not – calculated by reference to the direct harm suffered by the WMB Noteholders in purchasing their notes at artificially inflated prices. This disparate treatment has denied the WMB Noteholders the chance to receive full recompense for all damages flowing from their Misrepresentation Claim. The Bankruptcy Code makes clear that claims cannot be adjudicated through their treatment in a plan. Rather, creditors are entitled to a claims process whereby claims are objected to, a contested matter is initiated, and the parties are put on notice that litigation is required to make a final determination as to whether a claim is allowed. *See, e.g., Sun Fin. v. Howard (In re Howard)*, 972 F.2d 639, 641 (5th Cir. 1992); *Simmons v. Savell (In re Simmons)*, 765 F.2d 547, 559 (5th Cir. 1985). Here, the Debtors' First Objection was flat-out denied, while their Second Objection remains pending. Rather than permitting the WMB Noteholders to pursue their claims through the appropriate channels, the Debtors attempt through the Plan to force the holders of WMB Senior Notes to waive their Misrepresentation Claims in exchange for a share in the Chapter 11 proceeds. Using a plan to adjudicate claims is not permissible under the Bankruptcy Code and requires rejection of the Plan. Finally, Section 32.6 of the Plan provides that if a creditor does not elect to grant the third party release within one year, it forfeits its distribution. Because it is unclear (and unlikely) that WMB Noteholder claims will resolved within

this one year deadline, the Plan improperly adjudicates the WMB Noteholders' claims by eliminating any distribution before determination of the allowance of the claims.

IV. THE PLAN CANNOT BE CONFIRMED BECAUSE IT RESULTS IN THE WMB NOTEHOLDERS RECEIVING LESS THAN THEY WOULD IN THE EVENT OF A CHAPTER 7 LIQUIDATION

24. Section 1129(a)(7) of the Bankruptcy Code requires that prior to confirmation of a plan, each holder of a claim or interest in an impaired class:

> (i) has accepted the plan; or
>
> (ii) will receive or retain under the plan on account of such claim or interest in property of a value, as of the effective date of the plan, that is not less than the amount that such holder would receive or retain if the debtor were liquidated under chapter 7 of this title on such date . . .

11 U.S.C. § 1129(a)(7)(a). To satisfy the best interests test, the plan proponent must show that every creditor in a class that votes against confirmation will receive at least as much under the proposed chapter 11 plan as such creditor would receive if the debtor were liquidated under Chapter 7 of the Bankruptcy Code. *See In re PWS Holding Corp.*, 228 F.3d 224, 249-50 (3d Cir. 2000); *In re Lason, Inc.*, 300 B.R. 227, 232 (Bankr. D. Del. 2003); *In re Stone & Webster, Inc.*, 286 B.R. 532, 544-45 (Bankr. D. Del. 2002). Here, the Plan fails to satisfy Section 1129(a)(7) because it results in the WMB Noteholders receiving less for their misrepresentation claims than they would in a Chapter 7 liquidation.

25. Under the Plan's provisions, WMB Noteholders do not receive any payment on their subordinated, unsecured claims until after post-petition interest is paid to unsecured, unsubordinated creditors of the Debtor. Since at present, all unsecured, unsubordinated creditors are slated to receive 100 percent of the value of their claims, plus post-petition interest (with the exception of PIERS preferred claims), while

unsecured claims in Class 18 are slated to receive nothing, it is apparent that under the Plan the WMB Noteholders' misrepresentation claims would receive much less (i.e., zero versus 100 percent) than if there were a Chapter 7 liquidation.

26. The only assets available to creditors who have been placed in Class 17 are the proceeds of the settlement of a derivative action. These proceeds, by definition, cannot have been – and were not – calculated by reference to the direct harm suffered by the WMB Noteholders in purchasing their notes at artificially inflated prices. This disparate treatment has denied the WMB Noteholders the chance to receive full recompense for all damages flowing from their Misrepresentation Claim.

27. Moreover, the Plan's compulsory granting of releases in exchange for distribution violates Section 1129(a)(7) because under the Plan a non-release-granting creditor will not receive a distribution it would otherwise have received under a Chapter 7 liquidation. *See*, e.g., *In re Conseco, Inc.,* 301 B.R. 525, 528 (Bankr. N.D. Ill. 2003) ("These provisions violated the best interests of creditors test because they forced creditors to accept the releases or give up the distribution to which they were entitled under § 1129(a)(7)(ii)").

RELIEF SOUGHT

WHEREFORE, for all the above reasons, the WMB Noteholders request that the Court enter an order denying confirmation of the Plan and granting such other and further relief as may be just and proper.

Dated: May 13, 2011

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11 Cases
	)	
WASHINGTON MUTUAL, INC., et al.,	)	Case No. 08-12229 (MFW)
	)	
Debtors.	)	Jointly Administered

CERTIFICATE OF SERVICE

I, David P. Primack, hereby certify that on the 13th day of May 2011, I caused a true and correct copy of ***The WMB Noteholders' Objections to the Modified Sixth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code*** to be served upon all parties via CM/ECF and the parties listed below in the manner indicated:

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