Docket #8488 Date Filed: 8/15/2011

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	
	:	Case No. 08-12229 (MFW)
WASHINGTON MUTUAL, INC, et al.,[1]	:	
	:	Jointly Administered
Debtors.	:	

AMENDED POST-TRIAL MEMORANDUM OF CERTAIN TRUST PREFERRED HOLDERS

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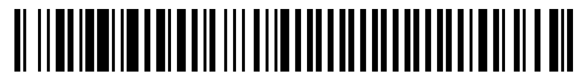
[1] The Debtors in these Chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Washington Mutual, Inc. (3725) and WMI Investment Corp. (5396). The Debtors' principal offices are located at 1301 Second Avenue, Seattle, Washington 98101.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Certain holders of interests (the "Trust Preferred Holders")[2] subject to treatment under Class 19 of the modified sixth amended plan [Docket Nos. 6696, 6964, and 7038] (the "Plan") filed by Chapter 11 debtors Washington Mutual Inc. ("WMI") and WMI Investment Corp. (the "Debtors"), by and through their undersigned counsel, respectfully submit this post-trial memorandum, following this Court's seven-day hearing (July 13-15, 18-21, 2011) (the "Hearing") on the Plan.

PRELIMINARY STATEMENT

1. Centerbridge and Aurelius actively traded in the Debtors' securities while in possession of material non-public information.

2. Centerbridge and Aurelius were part of the "Settlement Note Holder Group,"[3] which exercised extraordinary influence over settlement negotiations between the Debtors and JPMorgan Chase ("JPMC") and was integrally involved in resolving the key issues in this bankruptcy proceeding. Indeed, the vast majority of the assets of the estate comprise disputed claims between the Debtors and JPMC. Accordingly, nothing could be more material to the value of the estate, and hence to the value of the Debtors' securities, than the potential settlement of such claims. With knowledge of the progression of settlement negotiations with JPMC, [redacted], and, on information and belief, stand to make millions more under the proposed Plan.

3. The Settlement Note Holders were directly involved in negotiations with the Debtors and JPMC. Throughout approximately one year of negotiations, the parties exchanged

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[2] The complete list of Trust Preferred Holders is set forth in the *Amended Statement of Arkin Kaplan Rice LLP and Campbell & Levine LLC Pursuant to Rule 2019 of the Federal Rules of Bankruptcy Procedure*, dated July 19, 2011. [D.I. 8271]

[3] The "Settlement Note Holders" consist of Appaloosa Management, L.P. ("Appaloosa"), Aurelius Capital Management LP ("Aurelius"), Centerbridge Partners, LP ("Centerbridge") and Owl Creek Asset Management, L.P. ("Owl Creek").

at least nine term sheets during the march toward an inevitable settlement. The progress of settlement negotiations made certain propositions clear:

- The Debtors and JPMC agreed, as of the first exchange of term sheets in March 2009, that JPMC would pay over to the Debtors $4.08 billion in disputed bank deposits. The parties never deviated from that agreement.

- The Debtors and JPMC agreed, as of the first exchange of term sheets in March 2009, that JPMC would receive the Trust Preferred Securities, a value of approximately $4 billion. The parties never deviated from that agreement.

- Throughout 2009 and early 2010, the Debtors and JPMC steadily narrowed their differences with respect to the division of billions of dollars of tax refunds, with JPMC conceding, over time, an increasing share of the refunds to be made available for distribution to the Debtors' creditors (including, in large part, the Settlement Note Holders).

4. Based on this information, Aurelius and Centerbridge had an insight into settlement negotiations that the public simply did not. This was a crucial advantage. As Centerbridge managing director Vivek Melwani conceded, Centerbridge's returns depend on its ability to assess risk. (July 21 Tr. at 50:13-22.) And in a bankruptcy case, this includes assessments of the outcome of litigation and, relatedly, the probability of reaching a settlement and the terms of a potential settlement. (*Id.* at 51:1-18.) It is therefore not surprising that Centerbridge incorporated information from the settlement negotiations into its models. (July 21 Tr. at 34:10-19.) Nor is it surprising that Aurelius did the same. (July 19 Tr. 94:16-97:10.) This information helped Aurelius and Centerbridge assess potential outcomes in the case, which better enabled them to assess risk, and thus to make their investment decisions.

5. While the Settlement Note Holders did not produce copies of these models or their internal trading communications in connection with the Hearing, one does not need to examine these documents to conclude that Aurelius and Centerbridge used the settlement negotiation information they received to their advantage. Rather, their trading patterns tell the story.

6. After Aurelius and Centerbridge learned in March 2009 that the parties were in agreement that JPMC would pay over the $4.08 billion in disputed deposits, each made significant purchases of senior bonds, which they knew would be made whole by a return of the deposits. Next, after Centerbridge learned in July 2009 of the contents of the term sheets that the Debtors and JPMC had exchanged in April (in which JPMC again agreed to turn over the deposit and also proposed that the Debtors' would receive 15% of the $2.6 - $3 billion in expected tax refunds), Centerbridge bought additional senior bonds as well as subordinated bonds, which Centerbridge then knew would benefit from such an agreement. (In contrast, Appaloosa, which also received this information, immediately restricted itself from trading.) Centerbridge then engaged in settlement negotiations directly with JPMC, which resulted in an exchange of proposals that brought the two sides even closer in their respective positions regarding tax sharing. Centerbridge continued to trade after these proposals were made. Finally, when Aurelius and Centerbridge learned in November and December 2009 that the Debtors had accepted JPMC's proposal that the First Tax Refund be split 30%/70% in JPMC's favor, they purchased massive amounts of the Debtors' PIERS securities, even at increased prices, because they then knew that the likelihood of recovery for those securities had increased. (*Infra* ¶ 42.)

7. At the same time, ordinary investors were aware of none of this information. They instead were left to make their investment decisions based solely on publicly available information, which, of course, told a very different story than the one available to Aurelius and Centerbridge. For instance, while Aurelius and Centerbridge knew that JPMC had consistently offered from the start to pay over substantially all of the $4.08 billion in disputed deposits, ordinary investors were aware only that JPMC and the Debtors each were claiming ownership of the deposits through litigation. (*Infra* ¶ 21.) And while Aurelius and Centerbridge were intimately familiar with the precise proposals of the Debtors and JPMC with respect to the tax

refunds at any given time, ordinary investors were left to make do with the Debtors' public disclosures, which stated only that JPMC "has asserted significant claims to" the First Tax Refund (as defined below), and that "there are competing claims of ownership" as to the Second Tax Refund (as defined below). (EC 39 at 12.)

8. The conduct of Aurelius and Centerbridge has tainted the plan process and serves to undermine public confidence in the bankruptcy process generally. This blatant case of insider trading reinforces the unfortunate public perception that powerful financial firms will make profits by any means available, including through unfair advantage. Such behavior, if condoned, ultimately threatens the integrity not only of the securities markets, but also of the bankruptcy process.[4]

STATEMENT OF FACTS

A. The Settlement Note Holders Begin to Drive Settlement Negotiations

9. On September 25, 2009, JPMC acquired WMI's banking operations through a transaction facilitated by the FDIC. These operations consisted of Washington Mutual Bank ("WMB") and WMB's wholly owned subsidiary, Washington Mutual FSB. One day later, on September 26, 2008, WMI filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code. [D.I. 1.] In the wake of (or shortly before) WMI's bankruptcy petition, each of the Settlement Note Holders began to acquire substantial stakes in WMI's debt securities at significantly discounted rates. (AOC 62 (Appaloosa); AU 8 (Aurelius); AOC 54 (Centerbridge); AOC 19 (Owl Creek).)

10. From the outset of the bankruptcy, the four Settlement Note Holders sought to

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[4] These abuses could have been easily avoided in ways that would have permitted both Aurelius and Centerbridge to participate in negotiations while continuing to trade. For instance, Aurelius and Centerbridge could have created ethical walls for the duration of the bankruptcy to ensure that those who participated in the negotiations could not influence investment decisions in any way. Such an approach would have maintained the integrity both of the settlement negotiations and of the securities markets. With the exception of one two-month period by Aurelius in connection with the First Confidentiality Period, neither fund took this approach.

exercise influence over settlement negotiations. To that end, all four Settlement Note Holders hired outside counsel to represent them. Centerbridge and Appaloosa hired Fried, Frank, Harris, Shriver & Jacobson LLP ("Fried Frank"), while Aurelius and Owl Creek (together with other note holders) hired the law firm White & Case LLP ("White & Case"). (July 18 Tr. at 49:4-16; July 20 Tr. at 107:1-108:3.)[5]

11. The Settlement Note Holders and their respective counsel were involved in settlement discussions from the start. On January 22, 2009, White & Case delivered to Fried Frank and Jim Bolin of Appaloosa a proposed term sheet outlining the terms of a potential settlement that Aurelius (and others) "would be prepared to support." (EC 107 at LW_WAMU_018890.) Approximately one month later, on March 5, 2009, the Debtors circulated a proposed settlement term sheet of their own to White & Case, Fried Frank and counsel to the Official Committee of Unsecured Creditors (the "Creditors Committee"). (EC 110.) Both of these proposals contemplated that JPMC would pay over to the Debtors approximately $4 billion in deposits held in WMI's name at WMI's former banking subsidiaries now controlled by JPMC; that JPMC would receive the Trust Preferred Shares; and that tax refunds due to the Debtors (which were anticipated to be in the billions of dollars) would be split in some form among the Debtors, JPMC and the FDIC. (EC 107 at LW_WAMU_018890; EC 110 at WGM_00000302.)

12. The Settlement Note Holders also demanded that they be included in the Debtors' impending settlement negotiations with JPMC. (July 21 Tr. at 101:17-21.) The Debtors agreed because, as WMI's chief restructuring officer Bill Kosturos testified, "it's very important to have your major constituency creditors who hold very large positions in the case participating in

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[5] The Debtors agreed to share confidential information with Fried Frank and White & Case subject to separate confidentiality agreements. (July 21 Tr. at 100:7-101:4; DX 408.) These agreements precluded White & Case and Fried Frank from sharing information they received from the Debtors with their respective clients unless those clients also were subject to a confidentiality agreement. (*Id.*; DX 408 ¶ 1.)

negotiations." (*Id.* at 101:19-102:3; *id.* at 156:2-157:2.) The Debtors, however, considered such negotiations to be confidential and required the Settlement Note Holders to sign confidentiality agreements. (July 21 Tr. at 102:4-8.)

13. On March 9, 2009, the Settlement Note Holders entered into substantially identical agreements with the Debtors. (EC 2; EC 24; EC 111; EC 141.) Pursuant to these agreements, the Settlement Note Holders agreed to use the Confidential Information they received only for purposes of participating in settlement negotiations: "Participant agrees to use Confidential Information only for the purpose of participating in the Cases and further agrees not to use Confidential Information in any manner inconsistent with this Agreement." (EC 2 ¶ 1; EC 24 ¶ 1; EC 111 ¶ 1; EC 141 ¶ 1.)[6] The Settlement Note Holders agreed either to refrain from trading the Debtors' securities during the term of the agreement, or to erect an ethical wall separating their traders from those participating in the negotiations. (EC 2 ¶ 2; EC 24 ¶ 2; EC 111 ¶ 2; EC 141 ¶ 2.)

B. The Settlement Note Holders and Their Counsel Are Integrally Involved in Negotiations with JPMC

14. On March 10, 2009, the Settlement Note Holders, certain other creditors, and attorneys from Fried Frank and White & Case attended a meeting at Sullivan & Cromwell's mid-town Manhattan offices to explore a potential settlement. (July 18 Tr. at 64:16-65:4; July 20 Tr. at 234:24-235:18; July 21 Tr. at 101:5-16.) Also present at the meeting were the Debtors and their counsel from Weil Gotshal, and the FDIC. (July 18 Tr. at 64:16-65:4; July 21 Tr. at 101:11-16.)

15. In anticipation of this meeting, the Debtors circulated a term sheet outlining a potential settlement offer to JPMC. (July 21 Tr. at 103:17-19.) At the meeting, the Debtors also

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[6] Aurelius managing director Dan Gropper agreed that "Confidential Information" (as defined) could be used only for the purpose of participating in the bankruptcy case. (July 18 Tr. at 138:20-139:6.)

disclosed to the Settlement Note Holders that the estimated size of the Debtors' anticipated tax refund (the "First Tax Refund") would be between $2.6 billion and $3 billion. (July 18 Tr. at 65:5-19; July 20 Tr. at 231:23-232:7; *id.* at 234:24-18; July 21 Tr. at 102:22-103:11.) Aurelius, Centerbridge and the other Settlement Note Holders rejected the Debtors' proposal. (July 18 Tr. at 66:2-7; July 21 Tr. at 103:12-14; *id.* at 103:22-104:7.) After a "lengthy meeting," the Debtors consented to the Settlement Note Holders' more aggressive proposal, even though they did not approve of it. (July 21 Tr. At 103:22-104:7, *id.* at 105:3-10; *id.* at 141:1-14.) White & Case, rather than the Debtors, presented this proposal to JPMC. (July 21 Tr. at 103:22-104:7; *id.* at 105:3-10; *id.* at 142:1-7.)

16. The next day, the Debtors' counsel memorialized White & Case's oral settlement proposal in a written term sheet. (EC 221; AU 18; July 21 Tr. at 106:18-107:13.) The term sheet proposed, among other things, that the Debtors would receive the full amount of the disputed deposit accounts and JPMC would receive the "Trust Preferred Securities." (EC 221 at LW_WAMU_013517; AU 18 at WaMu_Aurelius_12306.) The term sheet further proposed that the Debtors would receive all tax refunds paid to date and the first $500 million in additional tax refunds, with the remainder to be split 60%/40% in the Debtors' favor. (EC 221 at LW_WAMU_013517; AU 18 at WaMu_Aurelius_12306.) Any additional refunds resulting from a change in the tax laws would be split 80%/20% in the Debtors' favor. (EC 221 at LW_WAMU_013517; AU 18 at WaMu_Aurelius_12306.) The Debtors' counsel transmitted this proposal to JPMC on March 12, 2009. (EC 142; EC 143; AU 18.) It was never made public. (July 18 Tr. at 151:24-152:1.)

17. JPMC responded to the Debtors' term sheet on March 18, 2009, by email from JPMC's counsel Ms. Hydee Feldstein with an attached term sheet. (EC 8; EC 9; EC 29; EC 30; AU 19; July 21 Tr. at 107:16-108:3.) Ms. Feldstein indicated that the term sheet reflected

JPMC's "perspective of what we think are our clients' respective rights and what we believe you and we are legitimately entitled to claim and likely to prevail upon at the end of the day." (EC 8 at WGM_00033669.) JPMC agreed to release to the Debtors the $4.08 billion in deposits held at WMB, subject to an agreement on the apportionment of tax refunds already received. (EC 9 at WGM_00033671.) JPMC also agreed to a substantial number of other terms proposed by the Debtors, including the Debtors' proposals regarding "Trust Securities," "Rabbi Trusts," "Split Dollar Policies," "Two disputed Pac Life Policies," "Visa B Shares," and "Contracts and Licenses," but differed on other proposed items, including ownership of certain tax refunds. (EC 9 at WGM_00033671-74.) Aurelius, Centerbridge, Appaloosa and Owl Creek each received copies of Ms. Feldstein's email and JPMC's counterproposal. (EC 29; EC 30; EC 144; EC 145.) The Settlement Note Holders knew that the return of the disputed deposits alone would make the Debtors' senior bonds whole, or nearly completely so. (July 20 Tr. at 276:7-11.)

18. The Debtors and JPMC exchanged an additional set of term sheets in April 2009. (EC 10; EC 11.) These term sheets reveal that the parties were in substantial agreement on a large number of items. Most notably, both the Debtors and JPMC once again agreed that JPMC would pay over the $4.08 billion in disputed deposits (subject, in JPMC's proposal, to allocation of tax refunds already received), and that the parties would cooperate to transfer ownership of the Trust Preferred Securities to JPMC. (EC 11 at WGM_00000325.) JPMC also made several significant concessions on open issues, including the key issue of ownership of future tax refunds. The Debtors had proposed to retain existing tax refunds, to split future refunds evenly, and to split any refunds received as a result of any future extension of the net operating loss carryback period in a ratio of 80%/20% in favor of the Debtors. (*Id.* at WGM_00000325-26.) In response, JPMC dropped its demand for receipt of all existing tax refunds, and instead proposed

that those refunds be split 85%/15% in favor of JPMC. (*Id.*) JPMC also proposed an even split of any additional refunds resulting from changes in the tax laws. (*Id.*)

19. The Debtors' counsel Brian Rosen shared these term sheets with White & Case and Fried Frank, but explicitly stated that the Debtors considered the negotiations "to be confidential and should not be provided to or the contents shared with parties that have executed a 'Lite' confidentiality agreement." (EC 10.) This restriction included the Settlement Note Holders. (July 21 Tr. at 28:11-22.)

20. Centerbridge managing director Vivek Melwani and Appaloosa managing director Jim Bolin each claim that they were not informed of these negotiations at the time. (July Tr. at 25:17-26:12; July 20 Tr. at 56:1-24.) Aurelius managing director Dan Gropper admits that he was aware of these negotiations. (July 18 Tr. at 159:23-162:8.) Gropper nonetheless testified that he could not remember if he was informed of the Debtors' revised terms, and further claims he did not learn the substance of JPMC's response. (*Id.*) However, just one day after the Debtors' counsel forwarded the JPMC counterproposal to White & Case, Gropper called the Debtors' chief restructuring officer, Bill Kosturos, to complain that he had not been consulted prior to the Debtors' revised offer to JPMC. (EC 12; AU 22; July 18 Tr. at 73:4-25.) Gropper followed that call with an email to Kosturos on April 29, which was copied to Dan Krueger of Owl Creek, among others. (EC 12; AU 22.) Gropper stated that Aurelius and the other members of its ad hoc group (including Owl Creek) collectively owned a "blocking position" in several classes of debt in the Debtors' capital structure, expressed his displeasure with the Debtors' "course of action," and implied that the Debtors were not maximizing the value of the estate. (EC 12; AU 22; July 18 Tr. at 73:19-74:12.) Thus, while Gropper claims not to remember if he learned the terms of the settlement negotiations at that time, his displeasure with the Debtors, together with his suggestion that the Debtors were not maximizing the value of the estate, leaves

little doubt that his attorneys informed him of the terms of negotiations notwithstanding Rosen's admonition.[7]

21. On April 30, 2009, the Debtors filed their March monthly operating report. (EC 25; AU 24; DX 427.) In that report, the Debtors disclosed the amount of the First Tax Refund as "approximately $2.6 - $3.0 billion." (EC 25 at 9; AU 24 at 9; DX 427 at 9.) The Debtors did not disclose any information regarding their settlement negotiations with JPMC. (July 18 Tr. at 157:3-7; July 20 Tr. at 237:24-238:2.) Rather, while the Settlement Note Holders knew that JPMC had offered on March 18, 2009, to pay over the majority of the $4.08 billion in disputed deposits as part of a negotiated settlement, the public was aware only that JPMC had initiated a lawsuit against the Debtors on March 24, 2009, asserting that it was entitled to the entirety of the disputed deposit accounts. (July 18 Tr. at 157:8-12.)

22. Pursuant to the confidentiality agreements, the confidentiality period (the "First Confidentiality Period") ended on May 8, 2009. (July 18 Tr. at 79:14-16.) Centerbridge immediately began purchasing the Debtors' senior bonds, which were the very bonds that would recover at or near par in the event that the Debtors recovered the disputed deposits. (July 20 Tr. at 276:7-11.) In the month of May alone, Centerbridge purchased $31.735 million face amount in senior floating rate bonds, and increased its overall net position of senior bonds by more than $23 million face amount. (TPS-2; AOC 54; CB 36; July 21 Tr. at 49:12-15.) By contrast, between February 1 and March 6, 2009, Centerbridge sold $44.1 million face amount of senior floating rate bonds, and decreased its overall net position in senior bonds by $29.1 million. (AOC 54; CB 36; July 21 Tr. at 49:1-11.)

[7] The recollections of Melwani, Bolin and Gropper could not be tested further at the Hearing because Centerbridge, Appaloosa and Aurelius have not produced emails or privilege logs reflecting their respective communications with their counsel.

23. Aurelius also changed its trading position after the First Confidentiality Period ended. Aurelius had created an "ethical wall" during the First Confidentiality Period so that it could continue trading in the Debtors' securities even as Aurelius' managing director Dan Gropper participated in negotiations. (AU 17; July 18 Tr. at 54:17-19; *id.* at 55:20-56:2; *id.* at 139:7-17.) Under the terms of the confidentiality agreement, Gropper was not permitted to discuss the Debtors with others at Aurelius for at least the term of the agreement. (July 18 Tr. at 79:14-16.)

24. From the day after the Debtors' release of their monthly operating report on April 30, 2009, through the end of the First Confidential Period on May 8—during which time Gropper still was restricted from communicating with his colleagues at Aurelius regarding the Debtors—Aurelius purchased only $15 million face amount of senior bonds. (AU 8 at WaMu_Aurelius_00004; July 18 Tr. at 173:25-174:8.) By contrast, over the course of the eight trading days after Aurelius dismantled its ethical wall, Aurelius purchased $42 million face amount of fixed rate senior bonds—a nearly three-fold increase—and also purchased $12 million face amount of subordinated bonds. (TPS-7; AU 8 at WaMu_Aurelius_00004; July 18 Tr. at 174:10-175:20.)[8]

C. Centerbridge and Appaloosa Receive the Restricted April Term Sheets

25. As noted above, the Debtors and JPMC had exchanged additional term sheets in April 2009, which the Debtors' counsel Brian Rosen shared with Fried Frank and White & Case with the instruction that they not share information relating to the negotiations with the Settlement Note Holders. (*Supra* ¶ 19; EC 10; EC 11.) Despite Rosen's express admonition, on July 1, 2009, Fried Frank attorney Brian Pfeiffer forwarded to Centerbridge and Appaloosa a chart summarizing the April term sheets. (EC 215.) As of that date, the Debtors had never

[8] Aurelius also sold $18 million face amount of senior floating rate bonds. (TPS-7; AU 8 at WaMu_Aurelius_00004; July 18 Tr. at 174:10-175:20.)

disclosed the terms of these negotiations either to the public, or to the Settlement Note Holders. Nor is there any evidence even suggesting that the Debtors lifted the restrictions set forth in Rosen's email.

26. As Fried Frank's summaries showed, JPMC had made significant concessions, particularly with respect to the sharing of the tax refund. JPMC proposed the Debtors and JPMC split the First Tax Refund 85%/15%, and split any additional refunds evenly. (EC 215.) Centerbridge therefore knew that, under JPMC's April 2009 term sheet, the Debtors' senior subordinated bonds would receive an improved recovery. (July 21 Tr. at 36:21-37:16.) Commensurate with the importance of this information, Appaloosa restricted its trading in the Debtors' securities from July through September 2009. (July 20 Tr. at 42:11-13.) Centerbridge, by contrast, continued to trade. (July 20 Tr. at 242:24-243:2.) In fact, over the next three months, Centerbridge proceeded to purchase $84.432 million face amount in subordinated bonds, [REDACTED]. (July 21 Tr. at 39:19-40:9; TPS-1; CB 36; AOC 54.) Centerbridge also purchased, on a net basis, nearly $61 million face amount of senior bonds. (July 21 Tr. at 39:19-40:9; TPS-1; CB 36; AOC 54.)

D. Centerbridge and Appaloosa Engage in Direct Negotiations with JPMC

27. In July 2009, just as Centerbridge was in the midst of its buying campaign, Centerbridge and Appaloosa orally delivered a settlement proposal to JPMC. (July 20 Tr. at 241:22-242:10.) Centerbridge modeled this proposal, which, consistent with all previous term sheets, provided for a return of the $4.08 billion in deposits to the Debtors. (July 21 Tr. at 34:10-15.) With respect to taxes, the Centerbridge/Appaloosa proposal contemplated a 60%/40% split of the First Tax Refund in favor of the Debtors, and an even split of any additional tax refund received if Congress changed the tax laws to extend the net operating loss carryback period. (EC 115 at LW_WAMU_001373.)

28. JPMC responded in August. (EC 115; July 20 Tr. at 243:9-17.) JPMC's response highlighted substantial agreement on most terms. Indeed, JPMC's McCree noted that, "[w]hile it appears that we do have several substantial open areas, on the vast majority of items I believe we have an agreement and I remain hopeful that we can come to some accommodation on the remaining points." (EC 115.) JPMC again agreed to pay over the $4.08 billion in disputed deposits subject to resolution of the tax issues, just as it had in all previous term sheets. (EC 115 at LW_WAMU_001373.) JPMC proposed to split the First Tax Refund 75%/25%, increasing its offer to the Debtors by 10% over its April proposal, and further offered to split any additional refunds 90%/10% in favor of the Debtors. (*Id.*) As before, the parties remained in agreement on a significant number of other terms, including "Trust Securities," "Goodwill Litigation," "Rabbi Trusts," "Split Dollar Policies," "Agreed Boli/Coli Policies," "Two disputed Pac Life Policies," and "Visa B Shares." (*Id.* at LW_WAMU_001373-75.) JPMC's proposal was more favorable to the Debtors than any of JPMC's previous offers.[9]

29. According to Melwani, negotiations "failed" on September 2, 2009, as a result of a meeting between Centerbridge, Appaloosa and JPMC. (July 20 Tr. at 244:25-245:13.) Melwani admitted on cross-examination, however, that Centerbridge did not make any counterproposal to JPMC at that meeting and that he expected the negotiations with JPMC to continue. (July 21 Tr. at 45:24-46:24.) Armed with knowledge of JPMC's additional concessions in its August term sheet and the expectation of future negotiations, Centerbridge increased its position in senior subordinated bonds by $52.932 million in September. (CB 36; AOC 54; July 21 Tr. at 40:7-10.)

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[9] Melwani claimed that Centerbridge briefly restricted its trading after receiving JPMC's August 18 proposal, but admitted that Centerbridge did not follow the procedures set out in its own compliance manual for instituting such a restriction, and that there was no written memorandum or communication substantiating his assertion. (July 21 Tr. at 41:10-42:20.)

30. Likewise, from September through November 16, 2009, Aurelius bought $42.145 million face amount of senior subordinated bonds and 1,558,325 PIERS shares. (AU 8 at WaMu_Aurelius_00003-04.)[10]

E. Aurelius and Centerbridge Trade in the Debtors' Securities After the Second Confidentiality Period

31. On October 28, 2009, Jim Bolin of Appaloosa forwarded to Bill Kosturos the August 2009 term sheet proposed by JPMC. (EC 212.) Jim Bolin had previously described the terms to him in September. (July 21 Tr. at 167:22-168:8.) Kosturos was "encouraged" by the progress that Centerbridge and Appaloosa had made, particularly with respect to the split of tax refunds, which were "key to the proposal." (*Id.* at 168:5-169:17.)

32. On November 6, 2009, the President signed the Worker, Homeownership, and Business Assistance Act of 2009 ("Business Assistance Act"), which extended the net operating loss carryback period to five years, thereby increasing significantly the total value potentially available to the Debtors' estate.

33. On November 10, 2009, Matthew Roose at Fried Frank informed the Debtors' counsel that it was "imperative" that some or all of the Settlement Note Holders "step in and participate in the negotiations" with JPMC. (EC 36 at WGM_00001528; July 21 Tr. at 123:1-5;

[10] During this period, Aurelius and Owl Creek decamped from the White & Case group due to disputes within the group regarding differing negotiating positions between Aurelius and Owl Creek on the one hand, and the rest of the White & Case group on the other. (July 18 Tr. at 101:12-102:6; July 19 Tr. at 22:1-10.) These disputes were "heated" and involved "yelling." (July 19 Tr. at 182:10-15.) Shortly thereafter, both Aurelius and Owl Creek joined the Fried Frank group. (July 18 Tr. at 101:12-102:6; July 19 Tr. at 22:1-10.) Despite the fact that Aurelius and Owl Creek had just left a group riven by divergent perspectives on the negotiations, and had joined the Fried Frank group mere weeks before it was preparing to engage in another round of negotiations with the Debtors, Gropper testified that he did not receive a briefing from Fried Frank on the status of settlement negotiations, and was not informed of the negotiations among Centerbridge, Appaloosa and JPMC during the summer of 2009. (July 19 Tr. at 22:18-25; *id.* at 26:4-16.) Owl Creek's Dan Krueger testified likewise. (July 19 Tr. at 204:7-206:13.) In light of the circumstances, it does not seem credible that Gropper and Krueger made no inquiry regarding the status of settlement discussions at this time. But given the limited discovery record available, the veracity of these claims could not be tested fully at the Hearing.

id. at 166:14-167:3.)[11] On November 16, 2009, Aurelius and Centerbridge, together with the other Settlement Note Holders, each entered into a second confidentiality agreement with the Debtors. (AU 27; EC 117.) These agreements were substantially identical to the agreements signed on March 9, 2009—including with respect to their use restrictions—with the exception that the agreement provided for a 45-day term rather than a 60-day term (the "Second Confidentiality Period"). (AU 27 ¶ 13; EC 117 ¶ 13; July 18 Tr. at 104:1-14; July 21 Tr. at 122:18-25.)

34. On the day the agreements were signed, Aurelius, Centerbridge and the other Settlement Note Holders met with Brian Rosen and Bill Kosturos, who disclosed to them that the estimated amount of the additional tax refund created by the extension of the net operating loss carryback period (the "Second Tax Refund") was $2.6 billion. (July 18 Tr. at 105:11-20; *see also* July 21 Tr. at 127:19-128:6.) The attendees also discussed the strengths and merits of the causes of action the Debtors had against JPMC and the FDIC. (July 19 Tr. at 31:11-32:15.)

35. Kosturos conferred extensively with the Settlement Note Holders on the Debtors' next offer to JPMC. At this point, the key outstanding issue was the split of taxes. On the afternoon of November 20, 2009, Kosturos provided Centerbridge and Appaloosa a draft term sheet with proposed terms to JPMC. (EC 219; July 20 Tr. at 248:2-12.) Shortly thereafter, Kosturos forwarded to Melwani and Bolin an email he had received earlier in the day from Donald McCree of JPMC, which stated, "just to confirm we were ready to engage in substantive negotiations at a 30/70 split of taxes, all subject to final terms and approvals. Look forward to receiving your proposal as soon as you can provide it." (EC 118.) Gropper was apprised of this

[11] Gropper claims he was unaware of any settlement proposals between the Debtors and JPMC in the fall of 2009, (July 18 Tr. at 93:23-94:1), and that the Debtors "reached out" to the Settlement Note Holders to enter into a confidentiality agreement" in early November 2009. (July 19 Tr. at 30:9-12.) This assertion is belied both by Kosturos' testimony and the written record, which demonstrate that the Settlement Note Holders, through their counsel, demanded to participate.

email as well. (July 19 Tr. at 43:15-20.)[12] But even though JPMC had stated it would increase WMI's share of the tax refunds from 25% (the figure in its August 2009 term sheet) to 30%, the Debtors and Settlement Note Holders decided to counter with a 61%/39% split—an increase of only 1%. (AU 28; July 18 Tr. at 106:4-14; July 19 Tr. at 33:15-21.) Before sending the Debtors' proposal to JPMC, Kosturos checked with Melwani and Bolin, asking if either had "[a]ny comments before [I] send to Don Mc[C]ree." (EC 220; July 20 Tr. at 249:1-8.) The Debtors conferred with no other creditors of the estate.

36. Kosturos sent this proposal to McCree later on November 23, 2009. (EC 119.) Aside from the 61%/39% split of the First Tax Refund, the term sheet also provided that JPMC would pay over the balances in the disputed deposit accounts, subject to tax considerations, and that the parties would split the Second Tax Refund evenly, with the Debtors and JPMC responsible for equal portions of any settlement amount paid to WMB's bondholders from the Second Tax Refund. (*Id.* at WMI-TPS-S0110489.)

37. In response, JPMC emailed Kosturos on November 30, 2009, proposing that JPMC receive "100% of the tax refunds already received and future refunds, except for the 'additional NOLs,'" while the Debtors would receive "100% of the 'additional NOLs created by the new legislation.'" (EC 16 at WaMu_Aurelius_12331; EC 120 at LW_WAMU_001392.) JPMC proposed that the "[r]emaining assets [were] to be divided as previously discussed," with five delineated exceptions. (EC 16 at WaMu_Aurelius_12331; EC 120 at LW_WAMU_001392.) JPMC's offer was forwarded to Centerbridge and Aurelius. (EC 16 at WaMu_Aurelius_12330.) As Centerbridge and Aurelius knew at the time, the value of the so-called "additional NOLs" was $2.6 billion. (July 19 Tr. at 35:11-19; July 20 Tr. at 251:12-15.)

[12] Kosturos testified that he would not have shared this information but for the fact that Centerbridge and Appaloosa had entered into confidentiality agreements with the Debtors. (July 21 Tr. at 169:20-170:14.)

38. The Settlement Note Holders and the Debtors collectively drafted a response to JPMC's November 30, 2009, offer, which ultimately was embodied in a term sheet dated December 8, 2009. (July 19 Tr. at 40:24-42:21.) Like all other proposals exchanged, the December 8 proposal contemplated that JPMC would pay over the balances in the disputed accounts. (EC 305 at JPMCD_000000212.00002.) In addition, the Debtors agreed to split the First Tax Refund 30%/70%, just as McCree had proposed in his November 20 email to Kosturos. (EC 118; July 19 Tr. at 44:4-9.) Finally, the proposal drawn up by the Settlement Note Holders and the Debtors also included a provision to split evenly the Second Tax Refund, with any settlement with the WMB's bondholders to be split "through future tax refunds, with a cap of $500 million." (EC 305 at JPMCD_000000212.00002.)

39. Gropper communicated the terms of this proposal to his colleague Eleanor Chan, who updated Aurelius' internal model of "[p]rojected recoveries" of the various "securities within the Washington Mutual capital structure." (July 19 Tr. 94:16-97:10.) This model was available to all Aurelius traders and analysts. (*Id.* at 96:3-7.)

40. The Debtors' general counsel, Chad Smith, forwarded that proposal to McCree and Travis Epes at JPMC on December 8, 2009. (EC 305; July 19 Tr. at 42:1-21.) Although Smith did not copy the Settlement Note Holders on the email, they nonetheless were consulted throughout the rest of December. In fact, just three days after Smith forwarded the proposal to McCree and Epes, Bill Kosturos informed McCree that he had "spoke[n] to my major creditors and they are unwilling at this point to give up the VISA shares and American Savings litigation. Their agreement to proceed with my previous offer was based on keeping these assets and they feel if they give them up WMI will not have the votes to confirm a Plan of Reorganization. I will continue to talk to them this weekend, but I'm not confident that I will be able to sway them from their positions." (EC 306.) Similarly, on December 17, 2009, Kosturos attempted to

arrange a call with Melwani and Bolin to "update [them on] where we are." (EC 122.) Melwani was unavailable, so his colleague Jed Hart agreed to discuss. (*Id.*; July 21 Tr. at 72:4-9.) Melwani was unaware what was said during this call. (July 21 Tr. at 72:4-25.)

41. At the request of the Settlement Note Holders, the Debtors agreed to end the confidentiality period on December 30, 2009 (one day early). (July 18 Tr. 111:16-112:6; July 19 Tr. at 50:7-18.) (AU 27 ¶ 13; EC 117 ¶ 13.) On December 30, 2009, the Debtors released their November 2009 monthly operating report. (EC 39.) Neither the December 8 term sheet, nor the November 23 or November 30 term sheets that preceded it, were publicly disclosed. (July 19 Tr. at 43:9-12.)[13] Under the heading "Taxes," the Debtors disclosed that, "[t]he current estimate for the total expected refunds, net of potential payments, is in the range of approximately $2.6 - $3.0 billion. JPMC, the purchaser of substantially all of WMB's assets, has asserted significant claims to the expected tax refunds." (EC 39 at 12.) The Debtors also disclosed that the estimated impact of the Second Tax Refund would "result in additional refunds of up to approximately $2.6 billion, as to which there are competing claims of ownership." (*Id.*) The Debtors did not disclose that JPMC had recently proposed that the Debtors receive the full amount of the Second Tax Refund, or that the Debtors had offered to split the refund with JPMC evenly. (EC 16 at WaMu_Aurelius_12331; EC 305.)

42. After requesting that the Debtors terminate the confidentiality agreements one day early, Aurelius purchased 590,000 PIERS shares on December 31, 2009, and continued to make additional purchases through January and February of 2010. (TPS-8; TPS-9; AU 8 at WaMu_Aurelius_00002-03; July 19 Tr. at 50:19-55:15.) Centerbridge purchased 202,528 PIERS shares immediately after the Debtors terminated the confidentiality agreement, followed

[13] Instead, the public knew only that the Debtors were continuing to pursue claims against JPMC. The Debtors filed a motion on December 14, 2009, in which they sought authority to conduct further discovery in connection with investigating claims against JPMC. (July 19 Tr. at 44:10-25.)

by 612,073 additional shares in January 2010. (July 21 Tr. at 73:25-74:2; TPS-3; CB 36; AOC 54.) These purchases stand in stark contrast to Centerbridge's transactions before the confidentiality period began: in the ten days between the enactment of the Business Assistance Act and the beginning of the November-December confidentiality period, Centerbridge purchased no PIERS shares. (July 21 Tr. at 74:5-12; TPS-3; AOC 54; CB 36.)

F. The Debtors, JPMC and the FDIC Reach a Final Agreement That Reflects Many of the Terms Agreed to in Prior Term Sheets

43. On January 10, 2010, WMI General Counsel Chad Smith circulated to Don McCree and Travis Epes at JPMC what he described as "a draft agreement to be used in connection with documenting the global settlement of matters *In re Washington Mutual, Inc.*," which Smith indicated "represents our most recent discussions from December." (EC 296 at WMI-TPS_500110988.00001.) The agreement, which Smith requested be kept confidential, provided for the disputed deposit accounts to be paid over to the Debtors; for the Trust Preferred Securities to be transferred to JPMC; for the Debtors to receive 30% of the First Tax Refund, with JPMC to receive the remainder; and for the Debtors to receive 100% of the Second Tax Refund. (*Id.* at WMI-TPS_500110988.000012.) The 70%/30% split of the First Tax Refund was based on McCree's November 20 email to Kosturos. (July 21 Tr. at 186:6-18.) Two days later, JPMC's counsel at Sullivan & Cromwell transmitted a counterproposal that left the Debtors' proposed terms substantially unchanged, except JPMC proposed that the Second Tax Refund be split evenly, with any settlement with the "WMB Bondholders" to be paid equally by the Debtors and JPMC "through future tax refunds" subject to an unspecified cap. (EC 304 at WGM_00034495.)

44. Gropper and Melwani each claim that they were unaware of the substance or status of these negotiations.[14] (July 19 Tr. at 55:25-56:12; July 20 Tr. at 259:14-20.) But, the Settlement Note Holders thought that negotiations were sufficiently advanced to instruct their attorneys to begin drafting a proposed plan of reorganization. (July 19 Tr. at 63:15-20; July 20 Tr. at 296:8-14.) On February 9, 2010, Brad Scheler at Fried Frank emailed to Brian Rosen and Bill Kosturos "a plan term sheet" for a "structure . . . to distribute value and proceeds [of WMI] to creditors." (EC 41 at WMI-TPS_500110994.0001; EC 125 at WMI-TPS_500110994.0001.) The plan term sheet included a proposal to provide JPMC with certain trust certificates to satisfy JPMC's claims to WMI's tax refunds. Under the Settlement Note Holders' proposal, JPMC would receive "C Certificates" in an amount equal to 70% of the First Tax Refund, and "D Certificates" in an amount equal to 50% of Second Tax Refund. (EC 41 at WMI-TPS_500110994.0006; EC 125 at WMI-TPS_500110994.0006.) These are the same ratios of recovery provided for both in the term sheet the Debtors and Settlement Note Holders drew up in December, (EC 305; July 219 Tr. at 66:21-67:11; July 20 Tr. at 300:11-16), and in JPMC's January 12 counter to the Debtors' January 10 term sheet, (EC 304 at WGM_00034495).

45. The Settlement Note Holders continued to be involved in the negotiations, either directly or through their counsel, throughout February and March 2010. At the request of the Settlement Note Holders' counsel, the Debtors' representatives held a meeting on February 25, 2010, with Settlement Note Holders and Fried Frank "to discuss the term sheet and next steps." (EC 274; July 19 Tr. at 69:18-70:8; July 21 Tr. at 192:5-194:3.) Fried Frank also repeatedly informed the Debtors of its clients' views on a number of subjects as negotiations continued in March 2010. On March 2, 2010, for instance, Fried Frank partner Brad Scheler informed Brian

[14] Again, these assertions cannot be fully tested given the limited document production made by the Settlement Note Holders, including their failure to produce emails or privilege logs reflecting communications with counsel.

Rosen that "[o]ur clients won't go for" certain draft settlement language proposed by JPMC. (EC 280.) Later that same day, Scheler again emailed Rosen to state that "[o]ur clients either want the tripartite deal or want to move forward on Thursday." (EC 281.)

46. On March 4, 2010, Brian Rosen announced to this Court that settlement negotiations had gained "momentum," and therefore asked the Court to abstain from ruling for one week on pending motions so that the parties could continue negotiations. [D.I. 2503 at 11:13-12:11.] Upon hearing this news, Scheler informed Rosen and Bill Kosturos soon afterwards that "[m]y clients and I think it would be ideal and for the best for us to get in a room with you two and your colleagues forthwith to work to coordinate and harmonize all efforts and to resolve any and all open points." (EC 282.) Scheler copied on his email Fried Frank's internal distribution lists of all four Settlement Note Holders, including Aurelius and Centerbridge, indicating that he had done so "so that my guys clear their schedules." (*Id.*)

47. On March 8, 2010, Aurelius sold 390,000 PIERS shares—its first sale of PIERS shares since before the Business Assistance Act was introduced in Congress in September 2009. (TPS 9; AU 8 at WaMu_Aurelius_00001, WaMu_Aurelius_00004.)

48. On March 12, 2010, Brian Rosen announced in Court "a three-way understanding" among the Debtors, JPMC and the FDIC "with respect to all matters." (AOC 58 at 18:16-17.) Rosen then went on to disclose the "salient provisions" of that understanding. (*Id.* at 18:24.) Rosen stated that JPMC would pay over the "deposit accounts" subject to the parties' agreement on the tax refunds; that JPMC would receive the Trust Preferred Shares; that the parties would split the First Tax Refund 30% to the Debtors and 70% to JPMC; and that the parties would split the Second Tax Refund 40.4% to the Debtors, and 59.6% to the FDIC. (*Id.* at 19:2-20:7.)

49. On March 26, 2010, the Debtors filed a Disclosure Statement for the Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code, which included a description of the proposed settlement. (EC 299 at 9; D.I. 2623.) After further negotiations with the FDIC, the Debtors announced a revised settlement agreement on May 16, 2010. (EC 300.) Under this revised agreement, the Debtors received (among other things), the amounts in the disputed accounts, 20% of the First Tax Refund and 68.5% of the Second Tax Refund. (*Id.* at 9-10.) The Debtors estimated that they would receive, in total, between $2.39 billion and $2.6 billion in total as the result of tax refunds. (*Id.* at 10.) Many of the terms of this final agreement, including ownership of the disputed deposits and Trust Preferred Shares, were indistinguishable from the terms included in the first term sheets exchanged between the parties.

50.

ARGUMENT

I. AURELIUS AND CENTERBRIDGE TRADED THE DEBTORS' SECURITIES WHILE IN POSSESSION OF NON-PUBLIC INFORMATION

51. Aurelius and Centerbridge unquestionably traded the Debtors' debt securities while in possession of non-public information concerning settlement negotiations and the parties' settlement positions. The Settlement Note Holders (including Aurelius and Centerbridge) insisted on, and received, access to settlement negotiations among the Debtors, JPMC and others. (*Supra* ¶¶ 12, 33.) From their privileged positions, Aurelius and Centerbridge learned the terms of the Debtors' negotiations with JPMC, including the contents of term sheets the parties exchanged during both the First Confidentiality Period and the Second Confidentiality Period. (*Supra* ¶¶ 14-24; 31-42.) In addition, Centerbridge was aware of the April 2009 term

sheets exchanged by the Debtors and JPMC, as well as the terms of its own July 2009 settlement proposal to JPMC, and JPMC's August 2009 response. (*Supra* ¶¶ 25-30.) More importantly, the funds were aware of the progression of the discussions, and the concessions made by JPMC over time. None of this information was publicly available. (*Supra* ¶¶ 16, 25, 41.)

52. Both Aurelius and Centerbridge traded while in possession of this non-public information. (*Supra* ¶¶ 22, 23, 26, 29-30, 42, 47.)

II. THE NON-PUBLIC INFORMATION IN AURELIUS' AND CENTERBRIDGE'S POSSESSION WAS MATERIAL

53. The non-public information provided to Aurelius, Centerbridge and the other Settlement Note Holders during settlement negotiations was material.

54. In the context of the federal securities laws, information is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).[15]

55. Negotiations need not have reached a final agreement to become material. Indeed, in *Basic*, the Supreme Court explicitly declined to exclude "preliminary merger discussions" from the definition of material "merely because agreement-in-principle as to price and structure has not yet been reached by the parties or their representatives." *Basic*, 485 U.S. at 236.[16] The Court instead held that determination of whether information concerning speculative or contingent events (such as settlement negotiations) is material "will depend at any given time

[15] The Court need not find that information in Aurelius' and Centerbridge's possession was material under the federal securities laws to conclude that they acted inequitably. Nevertheless, the federal securities laws provide a useful guide for the Court.

[16] Both Aurelius and Centerbridge acknowledge in their respective compliance manuals that proposed transactions are potentially material. (EC 103 at LW_WAMU_019032; AU 17 at WaMu_Aurelius_00010; July 21 Tr. at 76:12-77:10.)

upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Id.* at 238 (citing *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 849 (1968)). The Court also recognized that preliminary merger negotiations can be material even if the probability of a final agreement is low:

> Since a merger in which it is bought out is the most important event that can occur in a small corporation's life, to wit, its death, we think that inside information, as regards a merger of this sort, can become material at an earlier stage than would be the case as regards lesser transactions-and this even though the mortality rate of mergers in such formative stages is doubtless high.

Basic, 485 U.S. at 238 (quoting *SEC v. Geon Industries, Inc.*, 531 F.2d 39, 47-48 (2d Cir. 1976) (Friendly, J.)).

56. Thus, negotiations, including settlement negotiations, can be material even in the absence of a final agreement. *See, e.g.*, *Dunning v. Bush*, 637 F. Supp. 2d 625 (S.D. Iowa 2009) ("The court finds that the defendants knew the current status of the ongoing Superior-Lehigh settlement negotiations prior to the time Peter Dunning signed the Stock Purchase Agreement, and that such information was material and should have been disclosed."); *SEC v. Shapiro*, 494 F. 2d 1301, 1306-07 (2d Cir. 1974) (holding that negotiations were material in light of projected very substantial increase in earnings per share, although merger still less than probable); *Dungan v. Colt Indus., Inc.*, 532 F. Supp. 832, 837 (N.D. Ill. 1982) (fact that defendants were seriously exploring the sale of their company was material).

57. Materiality, moreover, can be inferred from a party's trading decisions. *See Basic*, 485 U.S. at 240 n.18 (recognizing that "trading (and profit making) by insiders can serve as an indication of materiality"). Indeed, as the Third Circuit has held, "[t]he best proof of the materiality of that information is that . . . experienced investors, found it to be sufficiently

material . . . to purchase [the] stock." *Rothberg v. Rosenbloom*, 771 F.2d 818, 821 (3d Cir. 1985). *Accord Shapiro,* 494 F.2d at 1307.[17]

A. The Information Aurelius and Centerbridge Received During the First Confidentiality Period Was Material

58. The information regarding settlement negotiations that Aurelius and Centerbridge received during the First Confidentiality Period was material. Based on their privileged access to settlement negotiations, Aurelius and Centerbridge both knew that the Debtors had proposed that JPMC pay over to the Debtors the $4.08 billion in disputed deposits, and that JPMC had agreed, subject to an agreement on certain tax issues. (EC 9 at WGM_00033671; EC 29; EC 30; EC 144; EC 145.) Aurelius and Centerbridge also knew that the parties agreed on a significant number of other terms, all of which would have substantial implications for the value of the Debtors' estate, and hence for the value of the Debtors' securities. (EC 9; EC 29; EC 30; EC 144; EC 145.)

59. Gropper and Melwani do not dispute that Aurelius and Centerbridge received this information. Instead, they contend that these negotiations were not material because the parties remained far apart on a final agreement. (July 18 Tr. at 84:1-17; July 20 Tr. at 238:8-239:9.) The Supreme Court disposed of this same argument in *Basic*, however, where it rejected the petitioner's contention that negotiations become material only once the parties have reached an "agreement-in-principle." *Basic*, 485 U.S. at 236. Instead, as set forth in greater detail above, the materiality of negotiations must be determined by balancing the probability of an agreement and the "anticipated magnitude" should such an agreement be reached. (*Supra* ¶ 55.)

[17] In light of the Settlement Note Holders' refusal to produce their internal investment models and communications concerning their investment decisions, the Court did not permit them to introduce evidence relating to the purported reasons for their respective trades. (July 18 Tr. at 86:12-91:12; *id.* at 95:-96:5; July 20 Tr. at 224:21-226:16.) As such, the inferences set forth below regarding Aurelius' and Centerbridge's trading are unrebutted.

60. Here, the anticipated magnitude of an ultimate agreement on the deposit issue alone would be incredibly significant to the estate in general, but also to senior bond holders in particular. An agreement with JPMC just on the disputed deposits potentially would bring approximately $4 billion of value into the Debtors' estate—a tremendous amount of money to any entity, especially one in bankruptcy. Moreover, as Melwani conceded at trial, this massive influx of cash would pay off the Debtors' senior bonds at (or close to) par. (July 20 Tr. at 276:7-11.) Given that those bonds were trading at levels substantially below par during this time period, (*see, e.g.*, AOC 54 at 14), a potential settlement of the disputed deposits would result in a sizeable recovery to senior bonds over the then-current market prices.

61. In addition, the probability of an agreement between the parties was significantly higher than Gropper and Melwani suggest. Gropper and Melwani stress that the parties had not resolved how to split various tax refund amounts. But each ignores the fact that, as of the very first exchange of term sheets, the parties already were in substantial agreement on a large number of terms, including ownership of the disputed deposits (as noted above, a $4 billion item) and the Trust Preferred Shares (another $4 billion item). (EC 9 at WGM_00033671-74.) Moreover, JPMC had agreed to a number of other terms in the Debtors' proposal, including the Debtors' proposals regarding "Rabbi Trusts," "Split Dollar Policies," "Two disputed Pac Life Policies," "Visa B Shares," and "Contracts and Licenses." *Id.* As even Gropper conceded during his testimony, these other items were "significant from a dollar perspective." (July 18 Tr. at 68:13-14.)[18] As both Gropper and Melwani therefore knew, the parties already had achieved significant common ground, even if they had not yet reached a final agreement.

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[18] Melwani also asserts that an agreement was not imminent because the FDIC was not a party to the initial negotiations. (July 20 Tr. at 238:8-239:9.) Even aside from the fact that an agreement does not have to be imminent to be material, it was by no means clear that the FDIC was entitled to the Debtors' assets. (July 18 Tr. at 120:17-19.) Therefore, the absence of the FDIC in negotiations would not suggest that the Debtors and JPMC could not reach an agreement.

62. In any event, Gropper's and Melwani's assertions are belied by the "best proof" available: Aurelius' and Centerbridge's own trading activity after the close of the First Confidentiality Period. *Rothberg*, 771 F.2d at 821. As noted above, the First Confidentiality Period expired on May 8. Commensurate with their knowledge that JPMC had been prepared to pay over the majority of the disputed deposit accounts to the Debtors, which would pay out senior bond holders at or near par, both funds immediately began purchasing massive quantities of senior bonds. Between May 11 and the end of the month, Centerbridge purchased $31.735 million face amount in senior floating rate bonds, and increased its overall net position of senior bonds by more than $23 million face amount. (TPS-2; AOC 54; CB 36; July 21 Tr. at 49:12-15.) These purchases, which are significant in their own right, take on added significance when compared to Centerbridge's trading before learning of the terms of the March negotiations: between February 1 and the beginning of the First Confidentiality Period on March 9, 2009, Centerbridge *sold* $44.1 million face amount of senior floating rate bonds, and *decreased* its overall net position in senior bonds by $29.1 million. (AOC 54; CB 36; July 21 Tr. at 49:1-11.) Centerbridge thus completely changed its investing strategy after learning of the Debtors' and JPMC's negotiating positions.

63. Aurelius also dramatically changed its trading patterns after Gropper's ethical wall restrictions were lifted. From May 1 through May 8, 2009—the time period between the Debtors' monthly operating report and the date on which Gropper could once again discuss the Debtors with his colleagues—Aurelius purchased just $15 million face amount of fixed rate senior bonds. (TPS 7; AU 8 at WaMu_Aurelius_00004; July 18 Tr. at 173:25-174:8.) In the first eight trading days after the ethical wall restrictions had been lifted, by contrast, Aurelius purchased $42 million face amount in fixed rate senior bonds—almost tripling its purchases as compared to the May 1 through May 8 period. (TPS-7; AU 8 at WaMu_Aurelius_00004; July

18 Tr. at 174:10-175:20.) In addition, Aurelius purchased $12 million face amount in subordinated bonds immediately after Gropper's restrictions were lifted, whereas it made not a single purchase of such bonds between May 1 and May 8. (TPS-7; AU 8 at WaMu_Aurelius_00004; July 18 Tr. at 174:10-175:20.)[19]

B. The Information Centerbridge Received in July 2009 Was Material

64. Centerbridge also received material non-public information in July 2009, in the form of Fried Frank's summary of the Debtors' and JPMC's April term sheets. (EC 215.) Only two parties received the summary: Centerbridge and Appaloosa. Appaloosa, upon receiving these term sheets and meeting with JPMC to explore a potential settlement, restricted itself from trading in the Debtors' securities. (July 20 Tr. at 42:11-13.) Centerbridge, which received the same information and attended the same meetings, did not. (*Id.* at 242:24-243:2.)

65. Appaloosa restricted its trading with good reason: Fried Frank's summary of the April term sheets informed both Centerbridge and Appaloosa that a deal with JPMC was even more probable than it had been in March, and that the terms of the negotiations had become more favorable to the Debtors. Based on Fried Frank's summary, Centerbridge knew that the parties once again had substantially agreed that JPMC would pay over the $4.08 billion in disputed deposits. (EC 215 at AMLP0015036.) Centerbridge now also knew (even as the public did not), that JPMC had made further concessions to the Debtors by dropping its demand for receipt of all tax refunds due to the Debtors, and instead had proposed that the parties split the First Tax Refund 85%/15% in favor of JPMC, with any additional refunds resulting from an extension of the net operating loss carryback period to be split evenly. (*Id.* at AMLP0015037-38.) Based on the Debtors' estimate that the First Tax Refund would total between $2.6 billion to $3 billion, this concession amounted to between $390 million and $450 million to the Debtors just on the

[19] Aurelius also sold $18 million face amount of floating rate bonds. (TPS-7; AU 8 at WaMu_Aurelius_00004; July 18 Tr. at 174:10-175:20.)

First Tax Refund, with potentially millions, if not billions, of dollars more if Congress extended the net operating loss carryback period through future legislation (as it eventually did).

66. Once again, Centerbridge's own trading patterns demonstrate the materiality of the non-public information Centerbridge and Appaloosa received from Fried Frank. The April term sheet summaries reinforced the fact that the parties were in substantial agreement on the ultimate ownership of the $4.08 billion in disputed deposits, which Melwani and Centerbridge knew would result in a complete (or near complete) recovery for the Debtors' senior bonds. (July 20 Tr. at 276:7-11.) Consistent with this information, Centerbridge purchased, on a net basis, nearly $61 million face amount of senior bonds between July and September 2009 at prices that were still below par. (July 21 Tr. at 39:19-40:9; TPS-1; CB 36; AOC 54.) [redacted]

[redacted]

(July 21 Tr. at 39:19-40:9; TPS-1; CB 36; AOC 54.) Moreover, as Melwani conceded at trial, Centerbridge knew that, under JPMC's April proposal, the Debtors' senior subordinated bonds would receive an improved recovery. (July 21 Tr. at 36:21-37:16.) Over this same three-month time period, Centerbridge proceeded to purchase $84.432 million face amount in subordinated bonds—[redacted]. (July 21 Tr. at 39:19-40:9; TPS-1; CB 36; AOC 54.) Centerbridge's trading activity thus supports a finding of materiality.[20]

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[20] Melwani claimed that Centerbridge's purchases during this time period were motivated by its need to bring a newly launched fund, Centerbridge Special Credit, up to parity with its existing funds. (July 20 Tr. at 239:18-241:2.) In light of Centerbridge's refusal to produce documents underlying its trading decisions, the Court held that Melwani could not testify as to the purported reasons for Centerbridge's trades in the Debtors' securities. (July 20 Tr. at 224:21-226:16.) In any event, Melwani's purported rationale was disproved on cross-examination, when he conceded that Centerbridge did not purchase the Debtors' debt securities in proportion to its existing holdings, but rather made an independent assessment as to which classes of the Debtors' securities to purchase. (*Id.* at 278:3-279:12.)

C. JPMC's August 2009 Term Sheet Was Material

67. The terms of JPMC's August 2009 offer to Centerbridge and Appaloosa were material as well. (EC 115.) As before, JPMC once again agreed to pay over the $4.08 billion in disputed deposits subject to resolution of the tax issues, just as it had in all previous term sheets. (EC 115 at LW_WAMU_001373.) More importantly, JPMC made another significant concession on the split of tax refunds, proposing to split the First Tax Refund 75%/25%. (*Id.*) This was a 10% increase over its previous offer to the Debtors, which, based on the estimated total value of the First Tax Refund, amounted to an additional $260 million to $300 million in value for the estate. JPMC further offered to split any additional refunds 90%/10% in favor of the Debtors. (*Id.*) JPMC's proposal was more favorable to the Debtors than any of JPMC's previous offers. Based on this information Centerbridge received further confirmation that an agreement with JPMC was becoming even more probable, and the potential deal was becoming more valuable to the Debtors' estate. Centerbridge thus proceeded to increase its position in senior subordinated bonds even further by adding an additional $52.932 million face amount to its position in September 2009. (CB 36; AOC 54; July 21 Tr. at 40:7-10.)

D. The Information Aurelius and Centerbridge Received During the Second Confidentiality Period Was Material

68. The non-public information that Aurelius and Centerbridge, together with the other Settlement Note Holders, received during the Second Confidentiality Period was also material.

69. Gropper and Melwani claimed during their testimony that the November 23 and 30 term sheets were immaterial because the parties' positions had grown farther apart at this time. (July 19 Tr. at 36:17-37:1; July 20 Tr. 249:19-251:23.) According to both Gropper and Melwani, this was the case because JPMC proposed for the first time on November 30 that JPMC would receive the full amount of the First Tax Refund while the Debtors would receive

the full amount of the Second Tax Refund, which both testified was somehow riskier than the First Tax Refund. (July 19 Tr. at 35:24-36:16; July 21 Tr. at 68:4-18.) But Gropper's and Melwani's claims cannot be squared with the record. By the time of JPMC's November 30 proposal, the Business Assistance Act had been enacted into law, and both Aurelius and Centerbridge knew that the resulting Second Tax Refund amounted to an estimated $2.6 billion. JPMC's proposal thus offered a greater amount of tax refund dollars than JPMC had offered to the Debtors in any previous proposal. Further, Gropper's and Melwani's purported concerns regarding the supposed risks of the Second Tax Refund are belied by their own enthusiasm for it before Congress had enacted the law that made the refund possible. Indeed, Gropper testified that Aurelius purchased the Debtors' securities prior to November 2009 based on the *potential* passage of a law extending the net operating loss carryback period. (July 19 at 37:2-18.) It defies reason that the *actual* passage of the Business Assistance Act increased the risk that the Debtors could recover the Second Tax Refund, particularly when Gropper conceded that he knew all of the potential risks surrounding the extension of the net operating loss carryback period prior to passage of the bill. (July 19 Tr. at 29:2-40:17.)

70. More importantly, however, both Gropper and Melwani ignore the fact that negotiations did not end on November 30. Rather, after receiving JPMC's term sheet, the Settlement Note Holders and the Debtors' representatives formulated a counterproposal in which they *accepted* JPMC's previous offer to split the First Tax Refund 70%/30% in favor of JPMC. (July 19 Tr. at 40:24-42:21; *id.* at 44:4-9.) By December 2009, Aurelius and Centerbridge thus knew, among other things, that (i) the Debtors and JPMC had agreed that JPMC would pay over nearly the full amount of the disputed deposits and JPMC would receive the Trust Preferred Shares; (ii) the Debtors' had now agreed to JPMC's demand on the split of the First Tax Refund; and (iii) there existed an additional $2.6 billion in additional tax refunds that remained to be

divided in some form. While certain terms (including the apportionment of the Second Tax Refund) remained open, the parties were closer to a final agreement than they had been at any point before, and at terms that would imply a greater recovery to the Debtors' estate than had been available previously. Thus, by the close of the Second Confidentiality Period, the probability of a final deal had improved, and the magnitude of that deal both to the estate and to Aurelius and Centerbridge had increased.

71. Once again, Aurelius' and Centerbridge's own trading decisions demonstrate the materiality of the information they received. After prevailing upon the Debtors to end the Second Confidentiality Period one day earlier than called for under the confidentiality agreements, both Aurelius and Centerbridge mounted aggressive buying campaigns of the Debtors' PIERS securities. Aurelius purchased 590,000 PIERS shares on December 31, 2009, and continued to make additional purchases through January and February of 2010. (TPS-8; TPS-9; AU 8 at WaMu_Aurelius_00002-03; July 19 Tr. at 50:19-55:15.) Centerbridge, for its part, was equally aggressive. It purchased 202,528 PIERS shares immediately after the Debtors terminated the confidentiality agreement, followed by 612,073 additional shares in January 2010. (July 21 Tr. at 73:25-74:2; TPS-3; CB 36; AOC 54.) By contrast, Centerbridge did not purchase a single PIERS share in the ten days between the passage of the Business Assistance Act authorizing the extended NOL carryback period and the beginning of the Second Confidentiality Period. (July 21 Tr. at 74:5-12; TPS-3; AOC 54; CB 36.) Suffice it to say, these are hardly the trading patterns of investors that saw no hope of a settlement on favorable terms.

III. AURELIUS AND CENTERBRIDGE HAVE VIOLATED THE FEDERAL SECURITIES LAWS

72. This Court is not required to find that Aurelius and Centerbridge have violated the federal securities laws in order to conclude that they have acted inequitably. *See e.g.*, *Citicorp Venture Capital, Ltd. v. Comm. Of Creditors Holding Unsecured Claims*, 160 F.3d 982, 987 (3d

Cir. 1998) (holding insider trading inequitable without finding violation of federal securities laws). Nevertheless, reference to the insider trading laws establishes the gravity of the misconduct.

73. Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), prohibits "any manipulative or deceptive device or contrivance" used "in connection with the purchase or sale of any security." Rule 10b5-1, 17 C.F.R. § 240.10b5-1, promulgated thereunder, prohibits "the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information."

74. There are two theories of insider trading liability under Section 10(b): the "classical theory" and the "misappropriation theory." *U.S. v. O'Hagan*, 521 U.S. 642, 651-52 (1997). Under the classical theory, a corporate insider violates Section 10(b) and Rule 10b-5 by trading in the securities of his own corporation on the basis of material non-public information about the corporation in breach of a fiduciary duty to disclose the information or abstain from trading. Insider status, and the concomitant duty to disclose or abstain from trading, extends to so-called "temporary insiders," who are outsiders that "have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes." *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983). In addition, a non-insider "tippee" that receives information from a corporate insider assumes a fiduciary duty not to trade on material nonpublic information "when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know there has been a breach." *SEC v. Cuban*, 620 F.3d 551, 554 (5th Cir. 2010).

75. Under the misappropriation theory, by contrast, a corporate "outsider" violates Section 10(b) and Rule 10b-5 "when he misappropriates confidential information for securities trading purposes, in breach of a fiduciary duty owed to the source of the information," rather than to the persons with whom he trades. *O'Hagan*, 521 U.S. at 652. The "misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information." *Id.* The misappropriation theory is "'designed to protec[t] the integrity of the securities markets against abuses by 'outsiders' to a corporation who have access to confidential information that will affect th[e] corporation's security price when revealed, but who owe no fiduciary or other duty to that corporation's shareholders.'" *Id.* at 653 (citation omitted) (alterations in original).

A. Aurelius, Centerbridge and the Classical Theory

76. Under the classical theory, a person engages in insider trading when he or she (i) trades in the securities of a corporation (ii) on the basis of (iii) material non-public information, (iv) in violation of a duty either to disclose the information or abstain from trading. *See O'Hagan*, 521 U.S. at 651-52 (citations omitted). In addition, a defendant must act with scienter, which is defined as "a mental state embracing intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). As demonstrated above, both Aurelius and Centerbridge traded in the Debtors' debt securities while in possession of material non-public information. (*Supra* § I & II.) Moreover, Aurelius' and Centerbridge's trading patterns, (*supra* § II), provide ample evidence of scienter. *See, e.g.*, *SEC v. Pardue*, No. CIV.A. 02-8048, 2005 WL 736884, at *6 (E.D. Pa. Apr. 1, 2005) (scienter found based on suspicious timing of trades); *SEC v. Shared Med. Sys. Corp.*, No. CIV.A 91-6546, 1994 WL 201858, at *1 (E.D. Pa. May 23,

1994) (same).[21] The only questions that remain are whether Aurelius and Centerbridge owed a duty to disclose or abstain from trading, and whether they traded "on the basis of" the information in their possession. Each of these elements is met easily here.

77. Aurelius and Centerbridge owed fiduciary duties both as temporary insiders under the classical theory of insider trading, and as non-statutory insiders under the bankruptcy laws. The Supreme Court has defined temporary insiders as those who "have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes." *Dirks*, 463 U.S. at 655 n.14. Aurelius and Centerbridge are quintessential temporary insiders under *Dirks*. Each requested (if not demanded) to be included in confidential settlement negotiations with JPMC and others, and to receive confidential information so that they could participate in the process. (July 21 Tr. at 101:17-21; EC 36 at WGM_00001528; July 21 Tr. at 123:1-5; *id.* at 166:14-167:3.) The Debtors agreed to these demands to serve a purely corporate purpose, *i.e.* to facilitate the negotiation of a settlement with JPMC. (July 21 Tr. at 101:19-102:3; *id.* at 156:2-157:2.) As a condition of participating, the Debtors insisted that Aurelius, Centerbridge and the other Settlement Note Holders sign confidentiality agreements in which each agreed "to use Confidential Information only for the purpose of participating in the Cases and further agrees not to use Confidential Information in any manner inconsistent with this Agreement." (EC 2 ¶ 1; EC 111 ¶ 1.) As Dan

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[21] *See also Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n. 30 (1983) (stating that "proof of scienter required in [securities] fraud cases is often a matter of inference from circumstantial evidence. If anything, the difficulty of proving the defendant's state of mind supports a lower standard of proof [than by a preponderance of the evidence]"). Gropper and Melwani also claimed to have relied on the Debtors' determinations that all material, non-public information had been disclosed at the close of each confidentiality period. (*See, e.g.*, July 18 Tr. at 81:16-25; *id.* at 113:10-24; July 20 Tr. at 233:8-12; 252:16-23.) Of course, the limited discovery into the state of mind of the Settlement Note Holders makes it impossible to test the veracity of these claims. But in any event, the Debtors' conclusions did not absolve Aurelius and Centerbridge of their independent duties to ensure compliance with the federal securities laws. *See, e.g.*, *SEC v. Enters. Solutions, Inc.*, 142 F. Supp. 2d 561, 675 (S.D.N.Y. 2001). This is particularly true where, as here, the Debtors owed no fiduciary or other duty to the Settlement Note Holders.

Gropper (who signed the confidentiality agreement on Aurelius' behalf) acknowledged, "Confidential Information" could be used only for the purpose of participating in the bankruptcy case. (July 18 Tr. at 138:20-139:6.) Aurelius and Centerbridge thus became temporary insiders as a result of their access to the Debtors' confidential information for corporate purposes, and therefore breached their duties by failing to disclose the information or abstain from trading.[22]

78. These same facts also made Aurelius and Centerbridge non-statutory insiders of the Debtors under the bankruptcy laws. It is well settled that a party who has "sought and received inside information" from a debtor "is an insider and fiduciary" to the debtor and other creditors as a result. *In re Allegheny Int'l, Inc.*, 118 B.R. 282, 299 (W.D. Pa. 1990); *see also In re Krehl*, 86 F.3d 737 (7th Cir. 1996).[23] Here, as noted above, *supra* ¶ 77, Aurelius and Centerbridge "sought and received inside information" from the Debtors. *Allegheny*, 118 B.R. at 299. Indeed, as in *Allegheny*, these funds received "a great volume of information that was not available to other creditors, shareholders, and the general public." *Id.* at 298. As such, each acquired fiduciary duties to the Debtors as a non-statutory insider, and consequently breached those duties by trading in the Debtors' securities based on the material, non-public information the Debtors provided to them.

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[22] Kosturos claims that he did not believe that the confidentiality agreements restricted the Settlement Note Holders from trading based on the information they received during the confidentiality periods after those agreements expired by their terms. (July 21 Tr. at 152:25-153:7.) As Kosturos admitted, however, he is not a lawyer, and was not speaking for the Debtors. (*Id.* at 151:1-11.) In contrast to Kosturos' personal opinion, the terms of the confidentiality agreements explicitly provide that "Confidential Information" could be used "only for the purpose of participating in the Cases and further agrees not to use Confidential Information in any manner inconsistent with this Agreement." (EC 2 ¶ 1; EC 111 ¶ 1.) The use of "Confidential Information" by Aurelius and Centerbridge to formulate their trading decisions does not fit within this description. Irrespective of Kosturos' admittedly personal, non-legal view, the terms of the confidentiality agreements thus reflects that the Debtors expected Aurelius and Centerbridge to maintain the confidentiality of the settlement negotiation information they received.

[23] It is not necessary that the creditor have actual control over the Debtor. *Allegheny*, 118 B.R. at 298; *see also In re Krehl*, 86 F.3d 737 ("Access to inside information can be sufficient to confer insider status even where there is no legal right or ability to exercise control over a corporate entity.").

79. In addition, both Aurelius and Centerbridge traded "on the basis" of material, non-public information. An entity trades "on the basis" of material non-public information if the person "was aware of the material nonpublic information" when it purchased or sold securities. 17 C.F.R. § 240.10b5-1(b). Courts applying this rule have held that a defendant presumptively trades "on the basis" of material nonpublic information whenever it trades in knowing possession of that information. *See, e.g.*, *U.S. v. Heron*, 323 Fed. App'x 150, 156-57 (3d Cir. 2009) (holding "that a reasonable jury could [find] that [the defendant] traded on the basis of material, non-public information that he clearly possessed"); *see also U.S. v. Teicher*, 987 F.2d 112, 120 (2d Cir. 1993). As both Aurelius' and Centerbridge's internal compliance manuals acknowledge, the material non-public information need not be the sole or even the motivating factor for the trading. (EC 103 at LW_WAMU_019004-05; AU 17 at WaMu_Aurelius_00009.)

80. Here, the Debtors provided (either directly or through counsel) confidential settlement information to Aurelius and Centerbridge during both the First Confidentiality Period and Second Confidentiality Period. Aurelius and Centerbridge knew they had this information, which, as Gropper and Melwani concede, was not made public. (*Supra* ¶¶ 16, 41.) Nevertheless, Aurelius and Centerbridge proceeded to trade the Debtors' securities after each of the two confidentiality periods. Aurelius and Centerbridge thus traded "on the basis" of this information.

B. Centerbridge and the Misappropriation Theory

81. Under the misappropriation theory, a person engages in insider trading where "(1) . . . the defendant possessed material, nonpublic information; (2) which he had a duty to keep confidential; and (3) . . . the defendant breached his duty by acting on or revealing the information in question." *SEC v. Lyon*, 605 F. Supp. 2d 531, 541 (S.D.N.Y. 2009). Where the misappropriator is a tippee, liability attaches where, as here, "the tippee traded on the

misappropriated information when [it] knew or should have known it was misappropriated." *SEC v. Willis*, 777 F. Supp. 1165, 1174 (S.D.N.Y. 1991). Under this theory, a tippee is liable even if the tipper does not receive a benefit from conveying the information. *See, e.g.*, *SEC v. Musella*, 748 F. Supp 1028, 1038 n.4 (S.D.N.Y. 1989) ("The misappropriation theory of liability does not require a showing of a benefit to the tipper . . . ."); *Lyon*, 605 2d at 548; *Willis*, 777 F. Supp. at 1169; *see also U.S. v. Libera*, 989 F.2d 596, 600 (2d Cir. 1993).

82. The Debtors shared with Fried Frank material, non-public information regarding the Debtors' April 2009 negotiations with JPMC. (*Supra* § II.B.) The Debtors did so subject to the express condition that this information be kept confidential. (EC 10.) Fried Frank and its attorneys therefore were obligated to maintain the confidentiality of that information, and could disclose it to Centerbridge and Appaloosa only if (i) those clients were subject to confidentiality agreements of their own with the Debtors, and (ii) the Debtors approved. (DX 408 ¶ 1.) On July 1, 2009, Fried Frank shared summaries of the April negotiations with both Centerbridge and Appaloosa. (EC 215.) As of this time, neither Centerbridge nor Appaloosa was subject to a confidentiality agreement with the Debtors, and the Debtors had never lifted their confidentiality restrictions. By sharing the Debtors' confidential information with Centerbridge and Appaloosa, Fried Frank breached its duty of confidentiality to the Debtors.

83. Centerbridge knew or should have known that this information was restricted. Although Centerbridge successfully resisted discovery as to its state of mind, the current record is more than sufficient to conclude that Centerbridge knew or should have known that this information was restricted and subject to Fried Frank's confidentiality obligations to Debtor. *SEC v. Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984), is instructive in this regard. In *Musella*, the court held that the defendant, Daniel Covello, knew or should have known that his brother had shared with him confidential information that his brother in turn had obtained from a law firm

employee in breach of that employee's duty of confidentiality to his employer. *Id.* at 442. The court had no direct evidence of Covello's knowledge of the source of the information he received. *Id.* Nonetheless, the court rejected Covello's claim that "'he had no reason to know that the information came improperly from an insider,'" because, the court concluded, he was a "sophisticated . . . market professional" who would have inquired in the "underlying circumstances of the tip received." *Id.* Here, too, Centerbridge is a "sophisticated" investor and "market professional" that is unlikely to accept blindly information provided to it by others, including its own attorneys.

84. Indeed, notwithstanding the limited discovery permitted in this case, the evidence of Centerbridge's knowledge is even stronger than the evidence available in *Musella*. In *Musella*, the Court had no direct evidence of Daniel Covello's state of mind. Here, Melwani admitted he knew that, outside of a period in which Centerbridge was bound by a confidentiality agreement, Fried Frank was not permitted to provide Centerbridge with non-public information without the Debtors' permission. (July 21 Tr. at 228:13-21.) And given that Centerbridge claims it first learned of the April negotiations on July 1, 2009, Centerbridge also necessarily knew that neither Fried Frank nor the Debtors had shared with them any information regarding these negotiations at the time those negotiations actually took place. Based upon these two facts alone, Centerbridge must have known that the Debtors therefore considered this information to be confidential, and had instructed Fried Frank not to share it with Centerbridge or the other Settlement Note Holders. Centerbridge therefore knew, or was reckless in not knowing, that these restrictions remained in place when Fried Frank forwarded the summary in July. As in

Musella, any claimed ignorance by Melwani or Centerbridge simply is not credible. 578 F. Supp. at 442.[24]

IV. AURELIUS' AND CENTERBRIDGE'S MISCONDUCT WARRANTS THE MOST SEVERE SANCTION POSSIBLE

A. The Settlement Noteholders' Undue Influence Over The Plan Process Precludes The Required Finding of Good Faith

85. The Court may confirm the Plan only if it "has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). The good faith standard requires that the Plan be "proposed with honesty, good intentions and a basis for expecting that a reorganization can be effected with results consistent with the objectives and purposes of the Bankruptcy Code." *In re Coram Healthcare Corp.*, 271 B.R. 228, 234 (Bankr. D. Del. 2001) (Walrath, J.) (citations and quotation marks omitted). In evaluating whether the "good faith" requirement has been satisfied, the Plan (and bankruptcy) process must not only be fair, but must also appear fair to non-insiders and the public. *See In re Ira Haupt & Co.*, 361 F.2d 164, 168 (2d Cir. 1966) (Friendly, J.) ("The conduct of bankruptcy proceedings not only should be right but must seem right.").

86. The evidence adduced at trial demonstrates a Plan process tainted by the undue influence of the Settlement Note Holders. Putting aside evidence of illegal insider trading activities, the negotiations that resulted in the Plan now before the Court were dominated by four aggressive hedge funds that purchased access and influence. Those hedge funds then used that access and influence to engineer a settlement designed: (i) to pay themselves in full (or greater) at the expense of other estate constituents; and (ii) to leave themselves in control post-confirmation of the collection and distribution of potentially significant additional estate value

[24] Centerbridge's trading in the Debtors securities after receiving JPMC's August 2009 term sheet also would implicate the misappropriation theory insofar as JPMC provided that term sheet on the condition that Centerbridge maintain its confidentiality. (EC 115.) By trading while in knowing possession of that term sheet, Centerbridge thus misappropriated JPMC's confidential information.

(*e.g.*, utilization of tax attributes, prosecution of remaining estate claims and causes of action, *etc.*) outside the purview of this Court. While the Debtors went to great lengths at trial to create the illusion of their control over the Plan process, the evidence (including evidence of the Settlement Note Holders negotiating directly with JPMC and/or berating the Debtors' professionals for engaging in settlement discussions without the Settlement Noteholders' input and approval) belies any such conclusion.

87. For the reasons set forth above and in the post-trial submission of the Equity Committee, the Trust Preferred Holders respectfully submit that the Settlement Note Holders' overzealous gaming of the bankruptcy and Plan processes precludes this Court's required finding that the Plan was proposed in good faith. To do otherwise in this high-profile matter, closely followed by laypeople and bankruptcy professionals alike, would not only be a miscarriage of justice, but would signal to the public that the bankruptcy process may be permissibly warped to serve the whims of powerful financial institutions such as the Settlement Note Holders. This the Court should not do.

B. In the Alternative, Equitable Disallowance Is Appropriate To Remedy Aurelius' and Centerbridge's Inequitable Conduct

88. This Court has the power to equitably disallow claims to remedy inequitable conduct. *See Pepper v. Linton*, 308 U.S. 295, 311 (1939) (affirming equitable disallowance of claims). As the Supreme Court recognized in *Pepper*, a bankruptcy court is a court of equity, and may exercise its equitable powers "to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done." *Id.* at 305. Accordingly, a "bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate." *Id.* at 308.

89. In light of the Supreme Court's decision in *Pepper*, "[i]t is well settled that bankruptcy courts possess a broad range of equitable powers, including the authority to disallow or subordinate the claims of any creditor who attempts to take unfair advantage of the debtor or other creditors." *Pan Am. Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438, 498 (S.D.N.Y. 1994) (citing *Pepper*, 308 U.S. at 307-08; *see also, e.g.*, *Citicorp Venture Capital, Ltd. v. Comm. Of Creditors Holding Unsecured Claims*, 160 F.3d 982, 991 n.7 (3d Cir. 1998) (noting that *Pepper* suggests that equitable disallowance is a viable remedy but finding it "unnecessary here to resolve the issue"); *In re Adelphia Commc's Corp.*, 365 B.R. 24, 70-73, (Bankr. S.D.N.Y. 2007), *aff'd in relevant part*, 390 B.R. 64, 74-76 (S.D.N.Y. 2008) (denying motion to dismiss and holding that equitable disallowance is a viable remedy); *In re Outdoor Sports Headquarters, Inc.*, 168 B.R. 177, 181-82 (Bankr. S.D. Ohio 1994) (equitable disallowance available to remedy inequitable conduct by one creditor against other creditors).

90. The Trust Preferred Holders respectfully submit that the record establishes that Aurelius' and Centerbridge's inequitable conduct warrants equitable disallowance of their claims.

C. In the Alternative, the Court Should Apply the Federal Judgment Rate to the Post-Petition Interest Claims of All Holders of the Debtors' Senior Bonds, Subordinated Bonds and PIERS

91. For the reasons stated in The TPS Consortium's Post-Trial Brief in Further Opposition to the Debtors' Modified Sixth Amended Joint Plan (which is incorporated herein by reference), the appropriate post-petition interest rate is the federal judgment rate (determined as of the date the Court enters the confirmation order), without regards to equitable considerations, including, *inter alia*, the wrongful conduct of the Settlement Noteholders. (*See* TPS Consortium Post-Trial Brief.) To the extent, however, that the Court disagrees that the federal judgment rate is the appropriate rate of post-petition interest in all events, the Trust Preferred Holders

respectfully submit that the Court should apply the federal judgment rate (as of the date of confirmation) here in light of Aurelius' and Centerbridge's inequitable conduct. *See In re Coram Healthcare Corp.*, 315 B.R. 321, 347 (Bankr. D. Del. 2004) (applying federal judgment rate as rate of post-petition interest in light of note holder's inequitable conduct); *see also* Opinion Denying Confirmation of the *Sixth Amended Joint Plan of Affiliated Debtors Pursuant To Chapter 11 of the Bankruptcy Code* (the "Opinion") [D.I. 6528], at 93-94.

92. The Trust Preferred Holders further submit that the Court should apply the federal judgment rate to the claims of *all* holders of each class of WMI debt securities held by Aurelius and Centerbridge (*i.e.* the senior bonds, senior subordinated bonds and PIERS shares), because Aurelius' and Centerbridge's inequitable conduct unfairly benefited not only themselves, but all holders of these securities. In *Coram*, this Court recognized that the inequitable actions of one noteholder justified applying the federal judgment rate to the claims of other noteholders who benefited equally from the wrongdoing. *Coram*, 315 B.R. at 347. The same is true here. Aurelius and Centerbridge, together with the other Settlement Note Holders, took advantage of their privileged positions as large holders of WMI debt to influence the global settlement agreement with JPMC and the FDIC, as well as the Plan. The results of that undue influence favored the interests of the holders of senior bonds, senior subordinated bonds and PIERS shares. More specifically, the Plan provides for substantial, if not complete (or greater), recoveries for these classes of securities, while leaving all others out of the money. As in *Coram*, this conduct advantages not only the Settlement Note Holders, but all other holders of senior bonds, subordinated bonds and PIERS as well. To allow these parties to benefit as a result of

wrongdoing, even if by another, would not be "fair and equitable" where others, including the Trust Preferred Holders, would be harmed as a result.[25]

D. At a Minimum, The Court Should Grant the Equity Committee's Motion for Standing to Pursue an Adversary Proceeding Against Aurelius and Centerbridge

93. As the Court acknowledged during the Hearing, it did not have the benefit of a complete factual record due to the fact that the Settlement Note Holders successfully resisted discovery on several issues, including the purported rationales for their trading. (July 18 Tr. at 88:22-91:12.) Discovery was limited in other ways as well. For instance, neither Aurelius nor Centerbridge produced a privilege log, without which it cannot be determined when, and on what subjects, they conferred with counsel. The present record is more than sufficient for this Court to conclude that Aurelius and Centerbridge have committed significant wrongdoing in connection with these proceedings. Nevertheless, the Trust Preferred Holders respectfully submit that, at a minimum, the Court should grant the Equity Committee's motion for standing to pursue an adversary proceeding against Aurelius and Centerbridge so that these issues can be explored on a full record. Moreover, in the event that the Court approves the Plan, the Trust Preferred Holders further respectfully submit that the Court sequester the Plan proceeds otherwise due to Aurelius and Centerbridge until such time as the adversary proceeding is finally resolved.

CONCLUSION

WHEREFORE, for all the foregoing reasons, the Trust Preferred Holders respectfully request that this Court: (1) sustain the Trust Preferred Holders' objections; (2) deny confirmation of the Plan; and (3) provide the Trust Preferred Holders such other and further relief as is just and proper.

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[25] At a minimum, the Court should apply the federal judgment rate to the post-petition interest claims of the Settlement Note Holders insofar as those four funds "have consistently acted as a group in this case in advancing their interests" through settlement and plan negotiations. *In re Coram*, 315 B.R. at 347.

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Respectfully submitted,

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