IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: WASHINGTON MUTUAL, INC., et al.,[1] Debtors.	))))))))	Chapter 11 Case No. 08-12229 (MFW) (Jointly Administered)

[REVISED] POST-HEARING BRIEF OF THE OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS IN OPPOSITION TO CONFIRMATION OF THE DEBTORS' MODIFIED SIXTH AMENDED PLAN OF REORGANIZATION

[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.

1. The Official Committee of Equity Security Holders (the "Equity Committee") respectfully submits this Post-Hearing Brief in support of its objections to confirmation of the Modified Sixth Amended Joint Plan of Affiliated Debtors Washington Mutual Inc. ("WMI") and WMI Investment Corp. ("WMI Investment", and together with WMI, the "Debtors") filed on February 7, 2011, as modified on March 16, 2011 and March 25, 2011 (the "Plan") [Dkt. Nos. 6696, 6964, and 7038].

I. PRELIMINARY STATEMENT

2. The evidence admitted at the Plan Confirmation Hearing in July demonstrates that the Plan should not be confirmed. That evidence permitted a rare look behind the curtain at the details of how a bankruptcy plan came into existence. In this case, it was the product of a disturbing process that operated, with the knowledge and complicity of the Debtors, for the benefit of a favored few – four powerful hedge fund managers who played pivotal roles in orchestrating both the Global Settlement Agreement and the Plan, and who, with the Debtors' express permission via the terms of confidentiality agreements, were enabled to engage in trading while in possession of non-public information about the details of settlement negotiations over disputed claims worth many billions of dollars. Indeed, it is undisputed that all four of these creditors traded while in possession of details about the settlement negotiations that were unknown to the public. The only issue is whether that information was "material" – and it clearly was.

3. While giving lip service to the goal and the duty to advance the interests of all, the Debtors in fact abandoned the interests of WMI's shareholders, allowing these key creditors, who had amassed blocking positions in impaired classes of junior debt, to drive the settlement negotiations far enough to achieve the returns they sought on those securities, but not far enough

to achieve a recovery for equity. Striving for such a recovery in fact would have been antithetical to the interests of these creditors, and it is evident that the Debtors' only goal was to achieve a Plan that they would support, thereby assuring a speedy confirmation.

4. The next Section of this brief reviews the evidence relevant to these issues in detail.

II. SUMMARY OF THE EVIDENCE

5. In the following section, the Equity Committee summarizes the evidence admitted at the Plan Confirmation Hearing relevant to the allegations of insider trading, inequitable conduct, and the Debtors' bad faith in proposing the Plan. Additional evidence bearing on these issues and evidence relevant to the Equity Committee's other objections to plan confirmation will be discussed in the Argument section of this brief.[2]

A. BACKGROUND ABOUT THE FOUR SETTLEMENT NOTE HOLDERS

6. The allegations of insider trading focus on the conduct of four hedge-fund managers, sometimes referred to as the Settlement Note Holders ("SNHs") because they were all originally parties to the Global Settlement Agreement.

7. Aurelius Capital Management, LP ("Aurelius") is a company that manages three funds; its primary focus is to invest in "distressed debt", acquiring the bonds of bankrupt companies and then involving itself in the bankruptcy process in order to "make sure the rights of those particular bonds is respected," *i.e.*, to seek a profitable return on the investments. (Tr. 7/18 at 38, 124) The firm's senior partner, and the individual responsible for making Aurelius' investment decisions, is a former corporate and bankruptcy attorney named Mark Brodsky. (*Id.* at 38, 42.) Dan Gropper, who testified at the hearing, is a managing director of the firm and

[2] Exhibits admitted at the plan confirmation hearing are cited by exhibit number and transcript excerpts by the abbreviation "Tr.", followed by the date and page number.

typically becomes involved in the bankruptcy and restructuring process as the firm's representative, dealing with outside counsel and other interested parties. (*Id.* at 38-39.)

8. Owl Creek Asset Management, L.P. ("Owl Creek") is an investment fund manager whose strategy includes acquiring the securities of bankrupt companies. (7/19 Tr. at 118.) The firm's "lead principle" and portfolio manager is Jeff Altman. (*Id.* at 120.) Daniel Krueger, who testified at the hearing, is a managing director of the firm and one of three assistant portfolio managers; he was the portfolio manager responsible for Owl Creek's investment in WMI securities. (*Id.* at 115-16, 120, 149.)

9. Appaloosa Management LP ("Appaloosa") is a manager of four hedge funds. (Tr. 7/20 at 38.) Jim Bolin, who testified on behalf of Appaloosa at the hearing, is the senior partner and portfolio manager. (Tr. 7/20 at 38.) David Tepper controls the general partner of Appaloosa and he and Bolin were the persons responsible for making decisions relating to Appaloosa's investments in WMI securities. (Tr. 7/20 at 40.)

10. Centerbridge Partners, L.P. ("Centerbridge") also manages hedge funds. Jeff Aronson is the founder of the firm, and Vivek Melwani, who testified at the hearing, holds the title of senor managing director, though he did not become a partner of the firm until March 2011. (Tr. 7/20 at 212, 213, 214.) Before joining Centerbridge, he was a bankruptcy partner in the Fried Frank law firm, where he worked for 13 years. (*Id.* at 213.)

B. THE SNHs' UNDERSTANDING OF PROHIBITIONS ON INSIDER TRADING

11. All four of the SNHs had internal policies, drafted by or with the assistance of counsel, setting forth instructions for employees about compliance with prohibitions on insider trading and reflecting each company's view of its legal obligations. (EC 3 [Aurelius]; AOC 15 & 16 [Owl Creek];

12. Aurelius' internal policy (EC 3 at 3, *et seq*.) includes the following statements:

- "SEC Rules adopted in 2000 provide that any purchase or sale of a security while 'having awareness' of inside information is illegal without regard to whether the information was the motivating factor in making a trade."

- "Within an organization or affiliated group of organizations, courts may attribute one employee's knowledge of inside information to another employee or group that later trades in the affected security, even if there had been no actual communication of this knowledge."

- "Information is 'material' when there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. Generally, this is information whose disclosure could reasonably be expected to have an effect on the price of a company's securities. The general test is whether a reasonable investor would consider it important in deciding whether or not to buy or sell a security in the company. The information could be positive or negative."

- "Information remains non-public until a reasonable time elapses after it is disseminated."

13. Appaloosa's policy on insider trading (EC 19) includes these statements:

- "Information is material if there is a substantial likelihood that a reasonable investor would consider it important in making his or her investment decision."

- "The Company may enter into confidentiality agreements with issuers or their representatives relating to the evaluation of a potential transaction in an issuer's securities or debt. . . . Employees should be particularly sensitive to information they receive pursuant to a confidentiality agreement as such information is likely to be material non-public information."

14. The Centerbridge Compliance Manual (EC 103 at 11) includes these statements:

- "Information is material if it has potential 'market significance,' meaning that (i) it is reasonably certain to have a substantial effect on the price of a company's securities, (ii) there is a substantial likelihood that knowledge of the information would be considered important by the reasonable investor in making an investment decision regarding an issuer's security, or (iii) there is a substantial likelihood that the reasonable investor would consider disclosure of the information to significantly alter the 'total mix' of information publicly available relating to an issuer's securities. <u>As a common sense guide, information should be considered material if public disclosure of the information would likely affect the price of an issuer's securities</u>." (Emphasis added.)

- "Information should also be considered nonpublic even when it has been publicly disclosed until a reasonable period of time has elapsed following disclosure for the information to be 'digested' by the securities markets."

15. Owl Creek's April 2008 Compliance Manual (AOC 16, Appendix A at 71, *et seq.*), which was in effect until September 2009 (Tr. 7/19 at 122-23), includes the following statements on insider trading:

- "Information is material where there is a substantial likelihood that a reasonable investor would consider that information important in making his or her investment decisions. Generally, this includes any information the disclosure of which may have a substantial effect on the price of a company's securities."

16. Owl Creek's Compliance Manual in effect beginning in September 2009 contains identical language. (AOC 15, at 63.)

C. THE DEBTORS' BANKRUPTCY FILING AND THEIR DISPUTES WITH JPMC AND THE FDIC

17. On September 25, 2008, the Office of Thrift Supervision closed Washington Mutual Bank ("WMB") and appointed the FDIC as receiver for WMB. (EC 299 at 2) Immediately after its appointment, the FDIC sold substantially all the assets of WMB to JPMorgan Chase Bank, N.A. ("JPMC") pursuant to a Purchase and Assumption Agreement ("PAA") in exchange for JPMC's payment of $1.88 billion and assumption of WMB deposit liabilities. (*Id.*) That precipitated the Debtors' filing of this bankruptcy case on September 26, 2008 (the "Commencement Date").

18. At the Commencement Date, the four SNHs held virtually no WMI securities. However, all four began buying WMI debt soon after the bankruptcy began.[3]

19. In the wake of the September 2008 seizure and sale of WMB's assets, a multitude of disputes arose among the Debtors, JPMC, and the FDIC involving claims for billions of dollars. As described by the Debtors in their first Disclosure Statement for a joint plan of reorganization, dated March 26, 2010:

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[3] Aurelius, and Owl Creek did not begin investing in WMI securities until after the Commencement Date. (Tr. 7/18 at 41, 127; Tr. 7/19 at 126, 150; AOC 62). Although the trial record is not entirely clear, it appears that Appaloosa began trading in September 2008. (Tr. 7/20 at 40.) Centerbridge began investing in WMI securities during the month preceding the bankruptcy. (Tr. 7/20 at 214.)

> The most significant disputes between the Debtors, JPMC, the FDIC Receiver, and FDIC Corporate relate to (i) in excess of $4 billion of the Debtors' funds on deposit in accounts now held by JPMC (the "Disputed Accounts") and (ii) approximately $5.4 to $5.8 billion in tax refunds, including interest through a projected future date of receipt and net of tax payments estimated to be owed to certain taxing authorities (the "Tax Refunds") that the Debtors believe are owed to WMI, as the common parent of a consolidated or combined tax group . . . . JPMC asserts that it is entitled to certain portions of the Tax Refunds. In addition, the parties dispute, among other things, ownership of and responsibility for certain Trust Preferred Securities, certain employee benefit plans and trusts created to fund employee-related obligations, certain intellectual property and contractual rights, shares in Visa Inc., and the proceeds of certain litigation and insurance policies . . . .

(EC 299 at 2.)

20. In addition to the disputes summarized above, on February 16, 2009, certain holders of WMI common stock and debt securities issued by WMI and WMB (the "ANICO Plaintiffs") filed an action against JPMC in state court in Galveston County, Texas, alleging misconduct by JPMC in connection with the seizure of WMB and the PAA (the "ANICO Litigation"). (DX-265 at 53.) Eventually, the Debtors themselves conducted discovery of JPMC pursuant to Rule 2004 regarding so-called "Business Tort Claims" claims similar to those asserted in the ANICO Litigation. (*Id.* at 54.) These claims themselves were multi-billion dollar disputes.

21. Further, the Debtors also eventually asserted various claims against the FDIC and JPMC for recovery of some $6.5 billion in pre-petition capital contributions by WMI to WMB, asserting that they were preferences or fraudulent conveyances. (*Id.* at 51; DX 299 at 3-4.)

22. For their part, the FDIC and JPMC themselves asserted tens of billions of dollars worth of claims against the Debtors.

23. As discussed below, it soon became evident to most observers of this bankruptcy – including the four SNHs – that the outcome of the case, and the extent to which creditors (and shareholders) would recover on their claims, would turn on how the multi-billion dollar disputes

summarized above would be resolved. As Aurelius flatly stated in its Omnibus Response To Certain Objections To Confirmation of Modified Sixth Amended Joint Plan, filed July 11, 2011, "creditor recoveries in these cases are dependent almost entirely upon the resolution of those issues." (Docket # 8134 at 14.)

24. In the words of this Court from the January 7, 2011 Opinion accompanying the Court's Order denying confirmation of the Debtors' Sixth Amended Joint Plan: "Because of the complex and interrelated claims that the Debtors, JPMC and the FDIC have to virtually every asset in the Debtors' estates, it is hard to imagine what plan the Debtors could propose without the resolution of those claims first." (EC 265 at 65-66.) Of course, the disputes were ultimately resolved through a Global Settlement. As the Court noted in the January 7 Opinion, "[t]he Plan Supporters acknowledge that the Global Settlement is <u>the foundation</u> of the Debtors' Plan." (*Id.* at 12) (emphasis added). *See also* Tr. 7/18 at 128:4-7.

25. Hence, from an early date in this bankruptcy, it was evident to all interested creditors – and certainly the SNHs -- that the outcome of their holdings would depend almost entirely on the resolution of multi-billion claims among the Debtors, JPMC, and the FDIC either through litigation or through the negotiation of a settlement.

26. When Aurelius began investing in WMI securities, post-bankruptcy, it did so after identifying the Disputed Accounts, the Tax Refunds, and the preference and fraudulent conveyance claims as key "drivers of value" in this bankruptcy. (Tr. 7/18 at 42-44.) From its perspective, "the large driver of value in this case was the resolution of the debtor's claims with JPMorgan and/or the FDIC." (Tr. 7/18 at 125) In Mr. Gropper's words, "I would say that the settlement, and whatever the settlement was, was an ultimate determinant of the resolution, to use your word, of the securities that we owned in these cases. . . . [W]e made an investment in

the securities of these debtors, and the outcome of that investment, not bet, was determined on the resolution of or settlement of certain causes of action in these estates." (Tr. 7/18 at 127)

27. Owl Creek likewise identified the Disputed Accounts as a primary motivator in its initial investment decision and understood that the resolution of the Debtors' disputes with JPMC could "materially affect the bondholders' recovery in the bankruptcy"; Owl Creek believed early on that if the Disputed Accounts issues were resolved in the Debtors' favor, "the senior bonds would have a very good recovery." (Tr. 7/19 at 150, 151) Owl Creek understood that the resolution of the Debtors' disputes with JPMC could materially affect the bondholders' recoveries in the bankruptcy. (Tr. 7/19 150.)

28. The "investment thesis" of Centerbridge also turned on an assessment of the Disputed Accounts and the Tax Refunds (Tr. 7/20 at 215-16.) While there were many other issues to be resolved, such as disputes over ownership of the Rabbi Trusts and the Goodwill Litigation, Appaloosa's Mr. Bolin referred to the amounts at stake as "rounding errors": "These are items that are anywhere from fifty to a hundred, 150 million dollars and there's billions of dollars at stake in the tax refund." (Tr. 7/20 at 202-03.)

D. THE COMMENCEMENT DATE – MARCH 2009

29. As of the Commencement Date, and as described by the Debtors,

> WMI had outstanding principle unsecured indebtedness totaling approximately $6.45 billion, with $4.1 billion attributable to nine issuances of senior unsecured notes (the "Senior Notes"), $1.6 billion attributable to three issuances of senior subordinated unsecured notes (the "Subordinated Notes"), and $750 million attributable to junior subordinated unsecured debentures (the "Junior Subordinated Debentures") issued in connection with certain trust preferred equity redeemable securities [*also sometimes referred to in this brief, and in the hearing, as the "PIERS"*].

(EC 299 at 22) (italicized language added). As discussed below, post-bankruptcy, the four SNHs acquired significant "blocking" positions in all three of these tranches of unsecured debt. By orders dated December 17, 2009 and January 28, 2010, this Court approved stipulations allowing proofs of claims filed by the indenture trustees for these securities in substantially their full principle amount plus accrued interest. (Docket # 7081 at 40-43.)

30. Initially, Aurelius began investing in Senior Notes. Later it moved into Subordinated Notes, and then eventually into the Junior Subordinated Debentures. (Tr. 7/18 at 45.) As described below, Owl Creek, Appaloosa, and Centerbridge also eventually came to own substantial positions all three tranches.

31. On October 15, 2008, the U.S. Trustee for this District appointed an official committee of unsecured creditors (the "Creditors Committee"), whose members (three of the original five) consisted of the indenture trustees for the three tranches of unsecured debt described above – The Bank of New York Mellon Trust Co., Law Debenture Trust Company of New York, and Wells Fargo Bank, N.A. (EC 299 at 22-26, 29.)

32. Of course, members of the Creditors Committee were precluded from trading in WMI securities unless they erected an ethical wall for the entire duration of the bankruptcy case, preventing communication of confidential information by Committee representatives and their firms. The four SNHs, despite their significant holdings of unsecured debt, consciously chose not to join the Creditors Committee and subject themselves to trading restrictions. (Tr. 7/20 at 108-09.) Instead, they became members of ad hoc groups of bondholders.

33. By no later than January 2009, Aurelius and Owl Creek had joined a group of approximately 35 WMI bondholders coordinated by a seven-member steering committee (on which both Aurelius and Owl Creek sat) and represented collectively by the White & Case law firm (the "White & Case Group"). (Tr. 7/18 at 49; Tr. 7/19 at 160.) Most of the members of the White & Case group were owners of Senior Notes, though Aurelius and Owl Creek also owned the two more junior issues of securities. (Tr. 7/18 at 49.) In October 2008, Appaloosa and

Centerbridge formed a separate group (originally consisting of only themselves), jointly represented by the Fried Frank firm (the "Fried Frank Group"). (Tr. 7/20 at 107.)

34. These groups of bondholders began focusing on settlement of the claims among the Debtors, JPMC, and the FDIC almost immediately. By January 22, 2009, the White & Case Group had developed a settlement term sheet and shared it with the Fried Frank Group, soliciting their support. (EC 107; Tr. 7/20 at 114.) On January 29, 2009, a revised version of the term sheet was e-mailed to Debtors' counsel Brian Rosen. (EC 7; Tr. 7/19 at 159-60) Among other things, the term sheet proposed:

- The Disputed Accounts would be transferred to WMI
- The Trust Preferred Securities would be transferred to JPMC
- WMI would receive the first $2 billion in tax refunds; the next $1 billion of refunds would go to the FDIC as receiver for WMB; all refunds in excess of $3 billion would be split 50/50 between WMI and the FDIC as receiver

35. On February 23, 2009, the FDIC convened a meeting that included representatives of the Debtors (Mr. Kosturos and Debtors' counsel), JPMC, the Creditors Committee, and lawyers from White & Case and Fried Frank, "to see if the parties couldn't get together and start discussing issues between them." (Tr. 7/21 at 99.)

E. MARCH 2009 – MAY 2009

36. In March 2009, the Debtors then "reached out" to members of the White & Case Group – including Aurelius and Owl Creek -- as well as the two-member Fried Frank Group and invited them to participate in attempting to negotiate a settlement of the disputes with JPMC and potentially the FDIC. (Tr. 7/18 at 51, 128; Tr. 7/20 at 46.) In Mr. Kosturos' words, the Debtors welcomed the participation of the SNHs because he thought it was "very important to have your major constituency creditors who hold very large positions in the case participating in negotiations from time to time." (Tr. 7/21 101-102.)

37. All four of the SNHs signed confidentiality agreements dated March 9, 2009, as a condition to participating, as did three other members of the White & Case group. (Tr. 7/18 at 55; AU 16; EC 24; EC 111; EC 141) The confidentiality agreements specified that the SNHs (defined as "Participants") were to be provided confidential information "reasonably related to and necessary for the limited purpose of Participant's participation in negotiations among the Debtors, the [FDIC], JPMorgan Chase & Co . . . concerning the terms of a plan . . . ." (EC 2, at 1)

38. The confidentiality agreements gave the four SNHs a choice between (i) ceasing all trading in WMI securities during the confidentiality period or (ii) designating a representative who would become involved in settlement negotiations and creating an ethical wall between that person and others within the firm, who could continue to engage in trading. The agreements further provided that at the end of the confidentiality period (60 days later), the Debtors would make public disclosure of "a fair summary" of any material nonpublic information shared with the SNHs during that period. The purpose of this provision, from the SNHs' perspective, was to give them an unfettered ability to resume unrestricted trading at the conclusion of the confidentiality period, despite their possession of information learned during that period. (E.g., Tr. 7/20 at 265.)

39. Aurelius elected to continue trading during the March-May 2009 confidentiality period and instead "walled off" its designee (Mr. Gropper) who would be participating in the process. (Tr. 7/18 at 54, 55-56) Centerbridge, Appaloosa, and Owl Creek chose to restrict trading during the confidentiality period. (Tr. 7/21 at 231; Tr. 7/20 at 42; Tr. 7/19 at 128.)

40. At the time of the settlement meeting that was arranged to occur following execution of the confidentiality agreements, federal tax law permitted companies in WMI's position to carry back tax losses for a period of three years. However, legislation had been

introduced in Congress that, if enacted, would allow an additional two years of NOL carry-backs. (Tr. 7/18 at 68.) According to Mr. Gropper's testimony, it was evident by March 2009 that passage of the bill was a priority of the Obama Administration. (Tr. 7/18 at 98) However, he testified that the bill "died" over the summer of 2009 but that the prospects for passage began to gain momentum again beginning in September 2009, and was enacted into law in early November 2009. (Tr. 7/18 at 98, 101) In this brief, tax refunds that might result from the additional two-year carryback period are referred to as the "Extended Period Tax Refunds" and refunds resulting from the three-year NOL carry-backs allowed under then-current law are referred to as the "Existing Period Tax Refunds".

41. On March 10, 2009, almost immediately after executing the confidentiality agreements, the five members of the White & Case Group (including Aurelius and Owl Creek) and the two members of the Fried Frank Group (Appaloosa and Centerbridge), along with their respective counsel from White & Case and Fried Frank, attended a meeting in Manhattan at the offices of JPMC's counsel, Sullivan & Cromwell. (Tr. 7/18 at 64-65, 148; Tr. 7/20 at 46.) Representatives of JPMC and the FDIC were present in separate rooms, as were Mr. Kosturos and Debtors' counsel from Weil Gotshal, Mr. Rosen and Mr. Walsh. (Tr. 7/18 at 65; Tr. 7/21 at 101) It is undisputed that the occurrence of this meeting was not public knowledge.[4]

42. At the meeting, the Debtors' representatives laid out for the creditors an "opening proposal" for settling the disputes with JPMC and the FDIC. (EC 140; Tr. 7/18 at 65; Tr. 7/19 at 130-31.)[5] To assess these proposals, the creditors asked certain questions about the Debtors'

[4] Owl Creek's Mr. Krueger testified that other members of the White & Case Group who did not sign confidentiality agreements or participate in this process were aware that other members of the Group had agreed to sign confidentiality agreements and become restricted, but he agreed this would not meet his definition of "public knowledge." (Tr. 7/19 at 165-66.)

[5] At some point in advance of the meeting, the Debtors had sent Fried Frank a March 5 draft of the term sheet, and on March 9, the day before the meeting, the Fried Frank forwarded it to Appaloosa. (EC 26 and 26A; Tr. 7/20 at 172-73; Tr. 7/21 at 103.)

assets, and Mr. Kosturos told them (among other things) that the Debtors expected to receive Existing Period Tax Refunds in the range of $2.6 - $3 billion, which was "a very material input" for the SNHs. (*Id.* at 65.) Following that session with the Debtors, the creditors worked on their own proposal to JPMC because they were dissatisfied with the Debtors' proposal. (*Id.* at 66; Tr. 7/20 at 50.) They then met again with the Debtors' representatives and obtained the Debtors' agreement to present the proposal to JPMC (a proposal that Mr. Bolin termed "aggressive", Tr. 7/20 at 50), and attorneys from White & Case orally presented the proposal to JPMC while the Debtors silently sat by. (Tr. 7/18 at 66, 149-50; Tr. 7/21 at 105, 141-42.) JPMC advised that it was not prepared to respond at that time, and the meeting then ended. (*Id.* at 66-67.)

43. Subsequently, on March 13, Weil Gotshal reduced the oral proposal to writing and transmitted it not only to JPMC but also to the creditors who had attended the settlement meeting, including the SNHs. (AU 18; EC 28; EC 142; EC 143; Tr. 7/18 at 67, 151; Tr. 7/19 at 132-33.) This proposal was not made public. (Tr. 7/18 at 151.) In Mr. Bolin's words, "this term sheet was a formalization, I believe, of the WMI noteholders/Appaloosa/Centerbridge proposal that started discussions with JPMorgan." (Tr. 7/20 at 119.)

44. Under the proposal, JPMC would receive the Trust Preferred Securities ("TPS"), the Visa shares, and the WMI intellectual property and in return the Debtors would receive the Disputed Accounts and the Goodwill Litigation proceeds. With respect to the Tax Refunds, WMI would receive the first $500 million; Existing Period Tax Refunds (those which the Debtors told the creditors would amount to $2.6-$3 billion) would be split on a 60/40 basis in WMI's favor; and any Extended Period Tax Refunds would be split 80/20 in WMI's favor. (AU 18 at 2; Tr. 7/18 at 153-54.)

45. The proposal also allocated other disputed assets and included a split between WMI and JPMC of the Rabbi Trusts and the BOLI/COLI policies. (AU 18 at 4.) The Debtors

would release JPMC from virtually all other claims, including preference and fraudulent conveyance claims. (*Id.* at 3.)

46. On March 18, JPMC responded to the Debtors' settlement proposal in writing, in the form of a table that set out the elements of the Debtors' proposal and provided a point-by-point response. (AU 19; EC 8; EC 9; Tr. 7/18 at 68-69; Tr. 7/19 at 134.) The terms of JPMC's offer were not disclosed to the public. (Tr. 7/18 at 157; Tr. 7/21 at 148-49.) Although the SNHs attempt to minimize the significance of the response (Mr. Gropper going so far as to call it a "non-response response", Tr. 7/18 at 69, and Mr. Bolin terming it a "nose-thumbing" response, Tr. 7/20 at 51), it was in fact highly significant.

47. JPMC agreed that WMI would receive the $4.08 billion in Disputed Accounts, less approximately $250 million in tax refunds that had been received on September 30, 2008. JPMC further agreed to the Debtors' proposed allocation of the Rabbi Trusts and the BOLI/COLI policies. JPMC agreed to accept the Visa shares and the TPS, but also proposed that it retain all Goodwill Litigation proceeds other than approximately $15 million. JPMC further proposed that all of the Tax Refunds be allocated to itself. (AU 9)

48. The settlement counterproposal was sent to the Debtors and to the FDIC under cover of an e-mail from JPMC's counsel at Sullivan & Cromwell, Hydee Feldstein, which stated in part as follows:

> Please understand that we are approaching the analysis from the perspective of <u>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</u>. We believe it is important to work from this baseline rather than going top-down to achieve certain pre-determined recovery levels for particular constituencies if we are to resolve this in a reasonable manner.

(EC 8) In other words, JPMC's counterproposal could reasonably be understood as reflecting its own assessment of the merits of disputed claims and its expectation about how they would be resolved in the absence of a settlement. Among other things, the proposal made recipients of the e-mail aware of JPMC's view that the Debtors were legitimately entitled to claim the Disputed Accounts as their own and likely would prevail on that claim at the end of the day.

49. This counterproposal was received by the Debtors and they then forwarded it on to counsel for the two creditor groups, White & Case and Fried Frank. (EC 8) Those attorneys, in turn, forwarded them to the SNHs. (Tr. 7/18 at 69; Tr. 7/19 at 19-20; EC 29; EC 144; EC 145) Thus, the SNHs, unlike the public at large, were fully aware not only of JPMC's counterproposals but also of what they reflected about JPMC's own assessment about the merits of the disputes. No public disclosure was made of either the Debtors' original offer or JPMC's counter. (Tr. 7/21 at 237-38; Tr. 7/19 at 179.)

50. With respect to the Disputed Accounts, the SNHs have argued that they had already concluded the Debtors were likely to receive those accounts through litigation, and they point to a motion for approval of stipulation filed in this case in October 2008, pursuant to which, in Mr. Gropper's direct testimony, "JPMorgan was going to just give back the deposit to the debtors." (Tr. 7/18 at 69) However, Mr. Gropper failed to note in his direct testimony that the motion to approve the stipulation was withdrawn by the Debtors on January 26, 2009, and that the stipulation itself would have preserved all of JPMC's "claims, rights and remedies, including any right of set-off, recoupment or any lien that JPMorgan Chase might have had, all as if the deposits had not been transferred." (Tr. 7/18 at 134-35)

51. Moreover, on March 24, 2009, JPMC filed an adversary proceeding against the Debtors asserting that it was entitled to keep the $4 billion in Disputed Accounts. (Tr. 7/18 at 157; Tr. 7/21 at 110.) Even Mr. Gropper acknowledged that there is a difference between an investor who makes its own assessment about the merits of a disputed legal position based solely on public information and an investor who knows that one of the parties has made a settlement proposal in which it would relinquish its claim to the money. (Tr. 7/18 at 158.)

52. On April 16, 2009, the Debtors provided JPMC with a further offer. (EC 10; EC 11; Tr. 7/21 at 111.) It continued to provide that JPMC would pay over the $4.08 billion in Disputed Accounts, with a proviso for the payment of interest after April 16. It offered to split the Goodwill Litigation proceeds, with WMI receiving the proceeds of the American Savings litigation and JPMC receiving the first $55 million from the Anchor Litigation and splitting all additional proceeds 50/50. With respect to the Tax Refunds, the Debtors reduced their proposed split of the Existing Period Refunds from 60/40 to 50/50, while reiterating the proposal that any Extended Period Refunds be split 80/20 in WMI's favor.

53. On April 26, JPMC's Travis Epes provided a further written counteroffer to WMI's general counsel, Chad Smith, and the following day Sullivan & Cromwell also sent it to Weil Gotshal. (EC 10) That same day, Weil Gotshal forwarded it to counsel for the SNHs. (*Id.*)

54. In the counteroffer, JPMC again agreed to pay over the $4.08 billion in Disputed Accounts, with the exception of 85% of $248 million in tax refunds already received. JPMC also agreed to the Debtors' proposal on interest that would be paid on the Disputed Accounts. With respect to the Goodwill Litigation, JPMC did not change its previous offer. With respect to tax refunds, JPMC moved from its previous position that all refunds be allocated to itself. Instead, it proposed an 85/15 split of Existing Period Tax Refunds in its favor, and a 50/50 split of Extended Period Tax Refunds, with WMI to receive 100% of NOL carry-forwards. (EC 11)

55. This represented significant movement by JPMC. (Tr. 7/21 at 26.) Not surprisingly, Weil Gotshal advised the SNH counsel that they should not share the JPMC counterproposal or JPMC's accompanying e-mail with parties who had executed a "lite" confidentiality agreement, i.e., the agreements that the SNHs had executed. (EC 10; Tr. 7/21 at 28.) In other words, <u>the Debtors themselves had concluded that the counterproposal was</u>

material non-public information and wanted to avoid the contractual obligation to publicly disclose it that would have been triggered if the Debtors had provided it directly to the SNHs.

56. However, the evidence strongly suggests that the SNHs – or at least Aurelius – soon found out about the terms of the April 16 proposal that the Debtors made to JPMC, if not the terms of the JPMC counterproposal.

57. On Monday, April 27, Brian Rosen spoke by phone with Jerry Uzzi at White & Case, and Uzzi learned about the Debtors' April 16 offer (EC 12); as noted earlier, that same evening Uzzi received the details of the Debtors' offer and the JPMC counter by e-mail from Weil Gotshal. (EC 10) Aurelius' Dan Gropper then learned of these developments from Mr. Uzzi, and on the evening of Tuesday, April 26, he called Bill Kosturos to complain. (EC 12; Tr. 7/18 at 73, 165.) Gropper followed up that call with an e-mail to Kosturos, which he copied to Jeff Altman and Dan Krueger of Owl Creek and to another bondholder in the White & Case group, Elliott Management.[6] (EC 12) Mr. Gropper testified that he sent the e-mail on behalf of all three bondholders. (Tr. 7/18 at 73)

58. In the e-mail, Gropper pointedly noted that Aurelius, Owl Creek, and Elliott Management collectively held securities that represented "a blocking position"[7] in both the Subordinated Bonds and the Junior Subordinated Bonds – collectively owning 27.3% of the former and 27.0% of the latter – in addition to 16.3% of the Senior Notes and 5.7% of the PIERS. (EC 12)[8]

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[6] Mr. Gropper and Aurelius' senior partner Mark Brodsky had both worked at Elliott Management for about nine years prior to Brodsky's starting Aurelius in 2006. (Tr. 7/18 at 38.)

[7] Mr. Gropper explained that by "blocking position", he was referring to ownership of a sufficient percentage of a particular position to prevent approval of a plan submitted to a vote of creditors. (Tr. 7/18 at 164-65.)

[8] On April 7, Fried Frank had provided similar information to the Debtors on behalf of their clients Appaloosa and Centerbridge, showing that they then owned 14.57% of Senior Notes, and blocking positions of 45.64% of Subordinated Notes, and 41.68% of PIERS. (EC 216; Tr. 7/21 at 23-24.)

59. He then explained that he had become aware of the Debtors' further proposal to JPMC and stated: "We do not agree with that course of action and would have strongly objected to it if we had been consulted prior to the offer being made." (EC 12) He further stated: "I am sure that you are desirous of maximizing value for all the stakeholders, rather than just those who are simply looking for a quick deal that compromises significant value for the estate." (EC 12) Gropper testified that he was referring here to holders of senior bonds. (Tr. 7/18 at 75)

60. Finally, Gropper insisted on a meeting "as soon as possible" with Kosturos, representatives of the WMI Board, and Debtors' counsel from Weil Gotshal and Quinn Emmanuel. (EC 12)

61. The clear implication from the e-mail is that Aurelius, Owl Creek, and Elliott Management had learned the terms of the Debtors' proposal. Contrary to Gropper's testimony, his complaint was clearly about far more than "process" (the fact that the Debtors had gone back to JPMC without first consulting the creditors). The level of consternation reflected in the e-mail signifies knowledge of just how far the Debtors had moved their previous offer in JPMC's direction. Even Mr. Gropper conceded that he knew the Debtors had made economic concessions in JPMC's favor. (Tr. 7/18 at 167-68)

62. On April 30, Brian Rosen responded to Gropper's e-mail via a letter to White & Case. Among other things, Mr. Rosen made reference to "numerous conversations" the Debtors had had with Gropper and to "meetings and conference calls" between Quinn Emmanuel and White & Case "to ensure that a coordinated and agreed upon approach" was being taken in the existing litigation. (AU 23 at 1-2) In addition, Mr. Rosen expressed the Debtors' agreement to meet with Aurelius, Owl Creek, and Elliott on May 6 to discuss, among other things, "what additional leverage points could be exerted upon JPMC." (AU 23 at 2)

63. The meeting took place on May 6, attended by the three bondholders and their individual counsel as well as White & Case, plus Mr. Kosturos and counsel from Weil and Quinn. (Tr. 7/18 at 76-77) Any suggestion that the meeting did not include a discussion of the Debtors' April 16 offer and JPMC's April 26 counteroffer beggars belief. Although Mr. Gropper quibbled at the hearing, he did not deny this, instead claiming memory loss:

> Again, we had known that the debtors had made another proposal to JPMorgan. I don't actually recall whether we learned the terms of that proposal or not. We know that JPMorgan had responded to that proposal. I do know that we did not receive that response from JPMorgan.

(Tr. 7/18 at 77.)

64. Of course, the terms of the JPMC offer was the information that the Debtors had asked White & Case not to share with the SNHs, the reasonable inference being that the Debtors considered that information to be material and did not wish to disclose it publicly.

65. The confidentiality agreement expired on May 8. (Tr. 7/18 at 79) The position of the SNHs is that the only material non-public information they received during the confidentiality period was the Debtors' estimate of the Existing Period Tax Refunds they expected to receive, along with some less consequential financial information, and that all this had become public as of April 30 when the Debtors disclosed it in a Monthly Operating Report ("MOR") filed that day. (AU 24, at Note 5; Tr. 7/18 at 79-80)

66. The Debtors' disclosure about the anticipated amount of Existing Period Tax Refunds took the form of a note in the MOR, which included the statement that "JPMorgan, the purchaser of substantially all of WMB's assets, may seek to claim all or a portion of the expected tax refunds." (AU 24, Note 5.) In addition, the form of the disclosure even eluded the eyes of Aurelius' research analyst with responsibility for monitoring developments in the WMI bankruptcy; he did not notice the April 30 disclosure until it was brought to his attention by Mr. Gropper after the confidentiality period ended on May 8. (Tr. 7/18 at 94, 143)

67. It is undisputed, however, that the SNHs also possessed confidential, non-public information about the first round of settlement offers and counteroffers between the Debtors and JPMC – and that information was not publicly disclosed.

68. At the hearing, the SNH witnesses testified about procedures their firms had in place to ensure the ethical walls were honored during the confidentiality period. Mr. Gropper, for example, described elaborate procedures that Aurelius implemented to prevent other employees of the firm from overhearing conversations he might have on the phone. He even testified about the $150,000 that Aurelius spent to soundproof his office – despite the fact that this happened only after the March-April 2009 period in which he was behind an ethical wall. (Tr. 7/18 at 57-58, 139-40.)

69. None of this matters, because as soon as the confidentiality period ended, Mr. Gropper and the designees of the other three SNHs were completely free to share what they had learned with everyone else in their firms, including the persons responsible for making decisions to buy and sell WMI securities, and nothing in the confidentiality agreements prohibited them from immediately trading on the basis of the information they had learned. (Tr. 7/18 at 140; Tr. 7/21 at 152-53.)

70. Indeed, their understanding of the agreements (as well as the Debtors' understanding) was that the SNHs were not even required to maintain the confidentiality of information learned during the confidentiality period from the public at large. (Tr. 7/20 at 273; Tr. 7/21 at 151-52.) Moreover, as Aurelius has stated to the Court previously, "once there was no wall in place, Mr. Gropper's knowledge was imputed to Aurelius as a matter of law."[9] Indeed, Mr. Gropper volunteered the same point in his testimony. (Tr. 7/18 at 140)

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[9] Aurelius Capital Management, LP's Objection to Motion of the Official Committee of Equity Security Holders For An Order Compelling Production of Documents (Docket #8004) (June 28, 2011) at 16 n.7; see also id. at 30-31 n.11 ("Once there was no ethical wall in place, Aurelius was charged with any

71. After expiration of the confidentiality period on May 8, the SNHs were all engaged in active trading while in possession of the nonpublic information about settlement negotiations that they had obtained during the confidentiality period.

72. Between May 11 (the first trading day after May 8) and May 13, Aurelius bought \$11 million face amount of Subordinated Notes and \$10 million in Senior Notes, and on May 20, it bought an additional \$20 million in Senior Notes. (AU 8 at 4; Tr. 7/18 at 174-75.) Aurelius had also purchased \$15 million face amount of Senior Notes between April 30 – when the Debtors disclosed their estimate of Existing Period Tax Refunds – and May 8, when the confidentiality period expired. (AU 8 at 4.) But by May 8, the market prices of WMI securities fully reflected the impact of the Debtors' April 30 disclosure. (See Tr. 7/18 at 177.)

73. On May 12, Appaloosa bought \$2 million face amount of Subordinated Notes (Tr. 7/20 at 128). Between May 13 and May 19, Centerbridge bought more than \$32 million face amount of Senior Notes. (AOC 54 at 14; Tr. 7/20 at 275) For the month of May, net of sales, Centerbridge increased its holdings of Senior Notes by more than \$23 million face amount. (CB 36) On May 18 and 19, Owl Creek bought PIERS. (EC 131; Tr. 7/19 at 168-69.)

74. These trades occurred, not in the week following the Debtors' April 30 public disclosure of the Existing Period Tax Refund amount, but after the expiration of the confidentiality period on May 8, by which point the market would have already absorbed the news about the tax refund amount. (Tr. 7/21 at 48.)

F. JULY 2009 – OCTOBER 2009

75. In early July 2009, Appaloosa and Centerbridge decided to initiate a resumption of settlement negotiations with JPMC, without involvement by the Debtors, in an effort "to find

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knowledge that Mr. Gropper had, regardless of what he told to whom. The only relevant question is *what information the Debtors gave to Aurelius in the negotiations*.") (emphasis in original).

a common ground, that ultimately could become the basis for what could be a settlement agreement." (Tr. 7/20 at 55.)

76. On July 1, as part of an effort to prepare a new settlement proposal to JPMC, Fried Frank sent to both Appaloosa and Centerbridge a chart setting forth the terms of the Debtor's April 16 proposal to JPMC and JPMC's April 26 response (though it's identified in the table as JPMC's "4/27" term sheet). (EC 215; Tr. 7/20 at 281-82.) <u>This is the same JPMC proposal that Weil had provided SNH counsel in April with a request that it not be shared with their clients, presumably because of its materiality</u>. Nothing in the record, including any testimony by the Debtors, Appaloosa, or Centerbridge, indicates that the Debtors had changed their minds about the significance of the information or authorized this disclosure to the two SNHs. (<u>See</u> Tr. 7/21 at 30)

77. Beginning in July, Appaloosa suspended its trading in WMI securities until September 2 (Tr. 7/20 at 130), undoubtedly recognizing the significance of he information it had received from Fried Frank and the importance of the negotiations on which it was about to embark. Mr. Bolin self-servingly explained that Appaloosa did this in order to "avoid the exposure of having trades executed during that period recharacterized against" Appaloosa. (Tr. 7/20 at 130.) However, Centerbridge did <u>not</u> suspend trading. (Tr. 7/20 at 279-80; Tr. 7/21 at 37.)

78. As shown in AOC 54, the summary of Centerbridge's trading activity, it continued to actively buy and sell WMI securities, engaging in 40 separate transactions from July 15 through August 18. During July and August, net of sales, Centerbridge increased its holdings of Senior Subordinated Notes by $31.5 million and its ownership of Senior Notes by almost $61 million, face amount. (CB 36; Tr. 7/20 at 276-77). Although Mr. Melwani testified that Centerbridge suspended its trading on August 19 after receiving a settlement proposal from

JPMC, it resumed again on September 8. (AOC 54 at 16.) In September, Centerbridge increased its net ownership of Subordinated Notes by almost $53 million. (CB 36) In just the two-month period of August and September, Centerbridge made net acquisitions amounting to more than $100 million face amount. (Tr. 7/20 at 277.)

79. On July 29, 2009, representatives of Appaloosa and Centerbridge met directly with Don McCree and Travis Epes (an in-house attorney) of JPMC. (Tr. 7/20 at 57.) At that meeting, Appaloosa and Centerbridge orally presented terms for a settlement, which included a 60/40 split of the Existing Period Tax Refunds in JPMC's favor and a 50/50 split of the Extended Period Tax Refunds. (Tr. 7/20 at 57, 58; Tr. 7/21 at 32-33; EC 14.) JPMC did not respond immediately, but did so by e-mail on August 18. (EC 115) In the e-mail transmittal, McCree stated:

> While it appears that we do have several substantial open areas, on the vast majority of items I believe we have agreement and I remain hopeful that we can come to some accommodation on the remaining points. To the extent you believe it would be productive to enlist a professional mediator to help bridge those gaps, we are willing to consider that as a way to move forward. . . .
>
> . . . As you suggested at our last meeting, we also believe it is important for us to begin discussions with all of the parties in your group. We also need to discuss an approach for bringing in the broader constituencies, including the debtors and creditors' committee.

(EC 115)

80. A comparison of the two proposals as set out in the JPMC table accompanying McCree's e-mail indeed shows a substantial narrowing of differences as compared to the exchange of proposals between the Debtors and JPMC in April.

- JPMC agreed to pay over all of the $4.08 billion in Disputed Accounts to WMI, less JPMC's share of tax refund amounts received (75% of approximately $248 million)

- JPMC proposed a 75/25 split in its favor of the Existing Period Tax Refunds, as compared to the 60/40 split proposed by Appaloosa and Centerbridge

- JPMC proposed a 90/10 split in WMI's favor of any Extended Period Tax Refunds, as compared to the Appaloosa/Centerbridge proposal for a 50/50 split
- JPMC agreed to the proposal that WMI receive all of the American Savings goodwill litigation and that JPMC receive the Anchor Savings goodwill litigation
- JPMC agreed that WMI would receive the Visa shares
- JPMC agreed to the proposals regarding the division of the Rabbi Trusts, the Split Dollar Policies, the BOLI/COLI policies, and the Pac Life policies

(EC 115; Tr. 7/20 at 136-37.)

81. Appaloosa and Centerbridge viewed the JPMC offer as one that they could counter. (Tr. 7/20 at 58.) Mr. Bolin further testified that if JPMC was of the opinion that agreement had been reached on the vast majority of items, a reasonable investor might have wanted to know that. (Tr. 7/20 at 133.) He also acknowledged that "[i]f a settlement was close, a reasonable investor might've wanted to know that, yes." (Tr. 7/20 at 136.)

82. As a result of Appaloosa and Centerbridge's assessment of the JPMC offer as one that was conducive to further negotiations, they met again with JPMC on September 2 and made a further counteroffer on the points that had not yet been agreed to. (Tr. 7/20 at 58.) According to Mr. Bolin's testimony, McCree did not want to continue discussions at that time, preferring "to let the litigation go a couple of more rounds." (Tr. 7/20 at 58-59.) Even at that time, it would be incredible to assert that the negotiations were dead. As Mr. Melwani admitted, "People like to build consensus. So at some point, we probably did think there'd be a negotiation again." (Tr. 7/21 at 46; *id.* at 86-87.) In fact, resumption of the negotiations was not long in coming.

83. In mid-September, Appaloosa and Centerbridge and their counsel met with Mr. Kosturos and informed him of the offer they had made to JPMC and of JPMC's counteroffer. (Tr. 7/21 at 118-19.)

84. In October of 2009, both Owl Creek and Aurelius left the White & Case Group of bondholders and joined the Fried Frank Group (Appaloosa and Centerbridge). Owl Creek left the White & Case Group in the middle of the month, and Aurelius was asked to leave at the end of the month. (Tr. 7/18 at 101)[10] By November 1, 2009, all four SNHs were being jointly represented by Fried Frank. (Tr. 7/18 at 102) At that point, the Fried Frank Group of four SNHs collectively owned about three-quarters of WMI's outstanding Subordinated Notes and PIERS. (Tr. 7/18 at 102)

85. On October 27, after Owl Creek had joined the Fried Frank Group but before Aurelius had done so, employees of the three hedge funds then represented by Fried Frank attended a meeting requested by the Debtors for the purpose of organizing an approach to JPMC to restart settlement negotiations. (Tr. 7/20 at 61-62, 139-40) At this meeting, which pre-dated execution of confidentiality agreements, Appaloosa's Jim Bolin informed the group about the settlement discussions that Appaloosa and Centerbridge had conducted with JPMC over the summer. (Tr. 7/20 at 140-41, 175-76.) At that time, the three SNHs also learned of an October 18 settlement proposal that they believed had been made to JPMC (and shared with the WMI creditors' committee) by bondholders of WMB. (Tr. 7/20 at 62-63.)

86. Following this meeting, Appaloosa's Jim Bolin sent Bill Kosturos the term-sheet comparison that JPMC had provided on August 18, which included the two SNHs' July 19 proposal and JPMC's response. (Tr. 7/20 at 64, 139.)

87. There is a dispute about whether Aurelius and Owl Creek learned about the details of the July-August 2009 negotiations between JPMC and the other two members of the

[10] The White & Case Group consisted primarily of owners of senior bonds and "the holders of senior debt representing the vast majority of that group decided that it was inconsistent to have within it members who were advocating on behalf of the subordinated debt and [PIERS]." (Tr. 7/18 at 101) In Mr. Gropper's words, "[t]here were people who owned senior bonds within the group, and they basically said, we have the deposit, it pays us off like we're done . . . ." (Tr. 7/18 at 178.)

Fried Frank Group after they joined that group. Mr. Bolin claimed memory loss about whether he had discussed with Owl Creek and Aurelius the substance of the July-August term sheets, though he couldn't think of any reason why he wouldn't have shared the information with them. (Tr. 7/20 at 178-79.)

88. Mr. Gropper testified that he did not learn about the terms of the July-August offer and counteroffer at any time during 2009. (Tr. 7/19 at 25-26.) He so testified despite the fact that all four SNHs were then being represented by the same counsel and despite the fact that all four SNHs subsequently worked together with each other and with the Debtors to formulate a further settlement proposal to JPMC in November – a process in which it would have been useful, if not critical, to know the last offers and counteroffers that had been exchanged.

G. NOVEMBER 2009 – DECEMBER 2009

89. On November 6, Congress had finally passed the much-anticipated law that permitted corporate taxpayers to extend permitted NOL carrybacks for an additional two years. (Tr. 7/19 at 30; Tr. 7/21 at 74.) Prompted at least in part by this development (Tr. 7/19 at 135-36), the Debtors again "reached out" to the SNHs, explaining that JPMC wanted to sit down and negotiate; the Debtors invited the SNHs to sign confidentiality agreements and participate. (Tr. 7/19 at 30.) At the time of the November confidentiality agreements, the SNHs collectively owned "around 60%" of the Subordinated Notes and about the same percentage of PIERS. (Tr. 7/21 at 160.)

90. All four SNHs executed new confidentiality agreements on November 16, 2009. (Tr. 7/18 at 105; AU 27; EC 37; EC 117; EC 148) They were substantially similar to the agreements signed in March 2009, but with a different termination provision, which provided for expiration on December 31, 2009, rather than after 60 days. (*Id.* ¶7) As in the case of the March

agreements, the November ones gave each SNH the choice of either erecting an ethical wall and continuing to trade or to cease trading for the duration of the period. (Tr. 7/18 at 104)

91. Contrary to what it had done in March, Aurelius elected to cease trading, as Mr. Gropper testified, in order "to bring to bear on the negotiations all of the analytical horsepower that existed inside the firm, so all, Mr. Brodsky and Ms. Chan, and myself participated in those discussions." (Tr. 7/18 at 104-05) In addition, Aurelius had amassed a much more significant position in WMI securities, representing a much larger percentage of Aurelius' invested capital. (Tr. 7/19 at 28-29.) The clear implication is that Aurelius attached material importance to the new round of settlement negotiations that was about to commence. As Mr. Gropper testified, "[W]e understood that JPMorgan wanted to engage again, so it was our presumption that that may, in fact, lead to a resolution, yes." (Tr. 7/19 at 30.)

92. Appaloosa's Mr. Bolin characterized the new round of negotiations with JPMC beginning in November as "possibly" material. (Tr. 7/20 at 141.)

93. On the day the new confidentiality agreements were signed – November 16 -- the four SNHs attended a meeting at Weil Gotshal with Mr. Kosturos and Mr. Rosen. (Tr. 7/18 at 105)[11] At that meeting, the Debtors' representatives told the SNHs that WMI expected to received $2.6 billion in additional tax refunds as a result of the passage of the bill that extended the NOL carryback period by an additional two years. (Tr. 7/18 at 105) This came as "a big surprise" to the SNH representatives. (Tr. 7/18 at 105) In the case of Aurelius, for example, their own internal analysis had estimated the Extended Period Tax Refund at more than one billion dollars <u>less</u> than the figure disclosed by the Debtors; the Debtors' estimate was clearly "a very, very material input." (Tr. 7/18 at 105)

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[11] Mr. Bolin testified that, also on November 16, he and David Tepper from Appaloosa, Mr. Melwani and Jed Hart from Centerbridge, and Mr. Rosen from Weil met in person with Don McCree and Travis Epes from JPMC at Weil's offices. (Tr. 7/20 at 67-68, 141.) It isn't clear whether this meeting preceded or followed the meeting discussed in the text.

94. At the meeting, the Debtors handed out a draft term sheet for a proposal to JPMC, with blanks for the ratio of proposed tax refund splits. (EC 150; Tr. 7/19 at 140.41.) In addition, there was discussion about the strength and merit of various causes of action, about tax issues, and about utilization of tax assets, (Tr. 7/19 at 31-32.) The meeting then ended, to enable the SNHs to "process that information" they had learned, on the understanding that the group would come back together at a later time to formulate a settlement proposal to JPMC. (Tr. 7/18 at 105-06.)

95. In the meantime, on November 20, JPMC's Don McCree e-mailed Bill Kosturos stating as follows: "Bill – 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) As compared to JPMC's August response to Appaloosa and Centerbridge (a 25/75 split), this reflected a willingness to move further toward compromise.

96. That same day, Kosturos forwarded McCree's e-mail to Appaloosa and Centerbridge (EC 118), and advised Aurelius and Owl Creek of JPMC's communication as well. (Tr. 7/19 at 43; Tr. 7/20 at 288-89.) Mr. Bolin testified that this information "may have been" material. (Tr. 7/20 at 144-45.)

97. In addition, Kosturos sent Appaloosa and Centerbridge a draft settlement proposal to JPMC that included a 39/61 split of Existing Period Tax Refunds in JPMC's favor and a 50/50 split of Extended Period Tax Refunds. (EC 219) With respect to the Goodwill Litigation, it proposed that 100% of American Savings proceeds be allocated to WMI and that 100% of Anchor Savings proceeds go to JPMC. It provided that WMI would retain the Visa shares. (*Id.*)

98. On November 23, the SNHs attended another meeting with the Debtors at Weil for the purpose of formulating a further settlement proposal to JPMC; at that meeting, they

received a draft of a further settlement offer that the Debtors proposed to give JPMC. (Tr. 7/18 at 106) It was identical to the one that Kosturos had sent Appaloosa and Centerbridge on November 20, except (i) it required JPMC to negotiate a settlement with REIT TPS holders directly; (ii) it provided for a settlement with WMB Bondholders to be split by WMI and JPMC pro-rata based on the overall tax refund split, payable out of Extended Period Tax Refunds; and (iii) it provided that WMI and JPMC would share pro-rata, from the Extended Period Tax Refunds, in the expense of acquiring "certain additional releases beneficial to WMI and JPMC"; under the November 20 draft, that cost was to be shared equally. (AU 28)

99. The SNHs agreed that the Debtors' proposal was reasonable (Tr. 7/18 at 107), though the version transmitted to JPMC reflected certain changes from what was distributed at the November 23 meeting: (i) any settlement with WMB Bondholders was to be funded 50/50 by WMI and JPMC, and (ii) the expense of acquiring "additional releases" was also to be shared equally. (EC 119) With those changes, Kosturos sent the term sheet to JPMC's Don McCree later on November 23 – after first running it by Appaloosa and Centerbridge (EC 220) -- and distributed it to the SNHs as well. (EC119)

100. How JPMC would respond to the November 23 proposal was predictable, given that on the largest remaining open issue – the treatment of tax refunds – the proposal agreed upon by the Debtors and the SNHs represented movement of only 1% in the split of Existing Period Tax Refunds as compared to the offer proposed by Appaloosa and Centerbridge in August: from 60/40 to 61/39.

101. On November 30, 2009, JPMC responded. With respect to the tax refunds, JPMC proposed that 100% of the Existing Period Tax Refunds go to JPMC and that 100% of the Extended Period Refunds go to WMI. On the less consequential open items, JPMC proposed

that the Visa shares and American Savings goodwill litigation proceeds be conveyed to itself. (EC 120)

102. On November 30, Mr. Kosturos forwarded the offer to Appaloosa and Centerbridge (who then forwarded it to Aurelius and Owl Creek) and characterized it as JPMC "resetting the bookends." (AU 29, EC 120; Tr. 7/18 at 108)

103. At the hearing, the SNH witnesses attempted to use JPMC's November 30 proposal as evidence that the parties were far apart, because, to use Mr. Gropper's words, it "completely changed the risk profile":

> Now, this completely changed the risk profile of any proposal, because in this proposal, you were talking about getting NOLs that were from a bill that had been passed three weeks earlier, where the federal government had never paid a dollar in tax refunds under this bill ever.
>
> Where approval of this tax refund was going to be required by the Joint Congressional Committee on Taxation, and we didn't know whether or not Congress was going to have a problem with approving a multi-billion dollar tax refund that was going to go to bonds that were primarily held by private investment funds.
>
> And lastly, there was a provision in the bill as passed by Congress that did not allow TARP recipients to benefit from the passage of that bill. So if it were deemed that JPMorgan actually owned the tax refund, it would be a zero to WMI. So this represented a dramatic, dramatic shift in the risk allocation in the proposal.

(Tr. 7/18 at 109-10)

104. These arguments lack credibility, to put it mildly. Mr. Gropper's own testimony elsewhere at the hearing demonstrates that whatever risk may have been attached to realization of the Extended Period Tax Refunds, those refunds were considered extremely valuable. Indeed, he testified that passage of the law was "a significantly positive event affecting Washington Mutual's securities," and he characterized the Debtors' $2.6 billion valuation of those refunds, when disclosed to the SNHs on November 20, as "a very, very material input." (Tr. 7/19 at 37; Tr. 7/18 at 105) He and the other SNHs later asked the Debtors to publicly disclose the $2.6

billion valuation and terminate the confidentiality agreements a day early, on December 30 instead of December 31 so that the market could react to this significant information and reflect it in market prices. (Tr. 7/18 at 111; Tr. 7/19 at 50, 52-53) The Debtors agreed to do so, and disclosed the $2.6 billion estimate in an MOR filed on December 30, 2009. (AU 32, note 5; Tr. 7/18 at 112)[12]

105. When Centerbridge's Mr. Melwani was asked whether in December 2009 there was "a material risk in your mind about whether WMI would be able to secure than 2.6 billion dollar additional carryback amount," he answered (more candidly than Mr. Gropper): "To the best of my recollection, probably not." (Tr. 7/21 at 70.) Owl Creek's Mr. Krueger testified that when the extension of the NOL carryback period was enacted in November, "everybody who knew anything about this company knew that that would bring in some large amount of money into the estate." (Tr. 7/19 at 135.)

106. With respect to the TARP issue – which would become an issue only if it were determined that JPMC owned the tax asset -- Mr. Gropper testified that in Aurelius' view, based on its own analysis at least as far back as March 2009, "it's pretty clear that in our view JPMorgan didn't, in fact, buy the tax asset." (Tr. 7/18 at 70)

107. Finally, the SNHs' and the Debtors' own behavior proves that rather than viewing JPMC's offer as an apocalyptic setback in the settlement process, they saw it as simply another negotiating move (Mr. Bolin termed it an example of JPMC "playing a little bit cute again," Tr. 7/20 at 68, and Mr. Melwani testified that bankruptcy negotiations "are all about posturing," Tr. 7/21 at 67) – and one to which they responded promptly.

[12] As discussed later, Aurelius and Centerbridge engaged in significant trading activity on the last day of the calendar year, made possible by the Debtors' agreement to terminate the confidentiality agreement a day early.

108. The evidence of this did not come out in the direct testimony of the SNH witnesses. For example, although Mr. Gropper testified that "[u]ltimately, the settlement noteholders agreed with the debtors to make another proposal" (Tr. 7/18 at 110), he did not describe it in his direct testimony, he said he didn't recall whether the proposal was delivered to JPMC, and he testified that by the December 30 end of the confidentiality period, "it was clear to all of us, frankly, that the negotiations were over and the parties were very far apart." (Tr. 7/18 at 111) When asked by his counsel whether there were any further settlement negotiations during the balance of the confidentiality period after receipt of JPMC's November 30, "resetting-the-bookends" offer, his answer was, "No." (Tr. 7/a8 at 111)

109. On direct, Mr. Bolin testified that he didn't recall whether any further proposals were given to JPMC after November 30 and said "[b]y the second week in December, it was apparent that negotiations had again ended." (Tr. 7/20 at 70.) Mr. Melwani stated on direct that after receiving the November 30 JPMC proposal, "we viewed the settlement as having failed" and that no one shared with him any subsequent term sheets prepared by any party after November 30 until the end of the confidentiality period on December 30. (Tr. 7/20 at 251-52.)

110. On direct, Mr. Krueger claimed he was not even aware of JPMC's November 30 response, much less any subsequent offer by the Debtors. (Tr. 7/19 at 141-42.)[13]

111. In fact, contrary to the impression studiously created by all this direct testimony, the negotiations progressed significantly further in December, and the SNHs knew it.

112. Mr. Kosturos continued to talk with JPMC's Don McCree about getting the settlement process back on track (Tr. 7/21 at 120), and on December 8, WMI's general counsel Chad Smith e-mailed JPMC's Don McCree a new proposal, offering to split the Existing Period

[13] On cross-examination, he persisted in his memory loss though he conceded that he must have received the e-mail addressed to him that disclosed JPMC's November 30 counteroffer. (EC 16; Tr. 7/19 at 184-85.)

Tax Refund on a 70/30 basis in JPMC's favor, with a 50/50 split of the Extended Period Tax Refunds. (EC 305; Tr. 7/19 at 41-42.) The December 8 term sheet also proposed that WMI and JPMC split the cost of settling the claims of WMB Bondholders 50/50 through future tax refunds, subject to a $500 million cap; that the Goodwill Litigation be split by WMI taking the American Savings piece and JPMC taking the Anchor Savings piece; and that WMI keep the Visa shares. (EC 305) Of course, this new offer was not public knowledge, <u>though it was known to the SNHs, as Mr. Gropper finally acknowledged on cross-examination</u>. (Tr. 7/19 at 42, 43, 94-95.)

113. In other words, as Mr. Gropper conceded on cross, within one week after JPMC's "resetting the bookends" proposal, the Debtors (with the SNHs' knowledge and approval) went right back to JPMC with a proposal for a 70/30 split of the Existing Period Refunds, <u>which is the split that Mr. Kosturos had told the SNHs that he thought JPMC would find acceptable</u>. (Tr. 7/19 at 44.) Mr. Kosturos also admitted that even after receiving JPMC's "resetting the bookends" proposal on November 30, he did not believe the negotiations were dead. (Tr. 7/21 at 181-82.)

114. The SNHs' involvement in the settlement process during December didn't end with the Debtors' transmission of their December 8 proposal to JPMC. On December 11, Kosturos e-mailed JPMC's Don McCree and stated as follows:

> <u>I spoke to my major creditors</u> and they are unwilling at this point to give up the VISA shares and the American Savings litigation. Their agreement to proceed with my previous offer was based on keeping those assets and they feel that if they give them up WMI will not have the votes to confirm a Plan of Reorganization. <u>I will continue to talk to them this weekend</u>, but I'm not confident that I will be able to sway them from their positions.

(EC 306) At a minimum, this e-mail suggests that Kosturos and McCree had discussed the SNH/Debtors' proposal of December 8, that JPMC had pushed back on the ownership of Visa shares and Goodwill litigation, but that the Debtors' proposed split of the Tax Refunds had not been controversial – and that Kosturos had relayed his discussions with McCree to the SNHs.

115. To say the least, this e-mail is inconvenient for the Debtors and the SNHs, because it demonstrates that settlement discussions among them and JPMC continued even after the transmission of the December 8 proposal. Indeed, it is so inconvenient that Mr. Kosturos was moved to testified that his references in the e-mail to discussions with major creditors "might not be true", suggesting that perhaps he simply lied about them to JPMC as a negotiating ploy – though he stopped short of stating unequivocally that he had done so. (Tr. 7/21 at 182-83, 184.)

116. When shown a subsequent December 17 e-mail (EC 122) that he sent Messrs. Bolin and Melwani of Appaloosa and Centerbridge, attempting to schedule a call for the purpose of updating them, Mr. Kosturos acknowledged that the update "certainly could have been" about JPMC negotiations. (Tr. 7/21 at 186-187.)

117. As noted, this significant progression in the settlement negotiations was unknown to the public. What the public knew was that on December 14, 2009, the Debtors had publicly filed a motion in this Court seeking authority to conduct further discovery from the FDIC and other third parties under Rule 2004 as part of their investigation of Business Tort Claims against JPMC. (7/19 Tr. at 44.) As the Court will recall, the Debtors represented to the Court that they needed additional discovery as estate fiduciaries to determine the validity and ownership of potentially significant claims against JPMC relating to the seizure and sale of WMB. The Debtors continued to publicly assert that position as late as the hearing on their Rule 2005 motion on January 28, 2010. (Tr. 7/19 at 44.)

118. When the confidentiality period was terminated as of December 30, all of the SNHs resumed trading – while in possession of non-public information about the progress of the settlement negotiations described above.

119. On the very next day, the last day of the calendar year and the last day of Aurelius' fiscal year, it sold roughly $15 million in Senior Notes at 97.25% of face value and about $34 million of Subordinated Notes at 93% of face value (both sales at very close to par). By the end of the first week in January, Aurelius had sold another $20 million of Senior Notes at either 100% or 101% of face value. (AU 8; Tr. 7/19 at 51-52) Also on December 31, Aurelius bought 590,000 shares of PIERS. (AU 8; Tr. 7/19 at 53)

120. On December 31, Centerbridge increased its investments in WMI securities, buying $34 million face amount of Subordinated Notes and over 200,000 PIERS at $21.50 per unit. (AOC 54 at 18; Tr. 7/20 at 303.) In January, Centerbridge sold more than $127 million in Senior Notes at almost par, while increasing its net investment in Subordinated Notes by almost $17 million face amount and its net investment in PIERS by more than 600,000 shares at a price above $20. (CB 36; AOC 54 at 18; Tr. 7/21 at 74-75.)

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121. In January, Appaloosa also engaged in trading, selling almost $50 million face amount of both Senior Notes and Subordinated Notes, in addition to 300,000 shares of preferred. (AOC 62 at 3-4) Owl Creek also engaged in trading during January, selling WMI securities. (EC 131)

122. Mr. Gropper testified on direct that after December 30, Aurelius was "compulsive" in making sure it received no material non-public information; "we went out of our way to make sure that nothing got tripped up and we didn't inadvertently or intentionally get any material nonpublic information." (Tr. 7/18 at 118) He testified that a research report had come

out in January disclosing that the Debtors and JPMC were engaged in settlement negotiations, but he said: "We certainly did not know the content of those negotiations." (*Id.* at 119) According to his direct testimony, Mr. Gropper knew nothing about the substance of any negotiations until after the terms of the Global Settlement were announced on March 12. (*Id.* at 119-20) He further testified on direct that the terms announced on March 12 "bore no resemblance to the proposal that JPMorgan had made in late November" – simply ignoring the further negotiations that had occurred in December. (Tr. 7/18 at 121)

123. However, the involvement of the SNHs in the settlement process didn't end on December 30, 2009. As described above, at the end of the confidentiality period they knew – at the least – that the Debtors had made a new settlement offer that matched what JPMC had itself suggested in September with respect to the issue of tax refunds – which was the only significant remaining open issue. Based on Mr. Kosturos' December 11 e-mail to McCree and his December 17 e-mail to Appaloosa and Centerbridge, it is likely that the SNHs also knew that biggest dollar items in dispute – the multi-billion dollar ones – had essentially been resolved or were very close to resolution.

124. They also knew, based on the Debtors' disclosure of the amount of refunds expected from the Extended Tax Refund Period, what the proposed settlement would likely generate for the estates from the largest items, even leaving aside all other assets that would come to the estates under the previously agreed portions of the proposed settlement: The $4.08 billion in Disputed Accounts; plus 30% of the estimated $2.6-$3 billion in Existing Period Refunds ($780 million - $900 million); plus 50% of the estimated $2.6 billion in Extended Period Tax Refunds ($1.3 billion).

125. They further knew, after December 30, that settlement negotiations between the Debtors and JPMC were continuing because they were being informed of that by their joint counsel at Fried Frank. (Tr. 7/19 at 57)

126. Fried Frank was involved in the settlement negotiations on behalf of the SNHs, and the SNHs knew that. (Tr. 7/19 at 57-58) Fried Frank knew the views of the SNHs about what would be an acceptable settlement, as reflected in the December 8 proposal, and they were acting for the SNHs in the negotiations. (Tr. 7/19 at 58, 60-61) As Mr. Gropper testified with respect to the continuing settlement negotiations between December 2009 and the announcement of a settlement in March 2010:

> Fried Frank was involved in those negotiations and Fried Frank knew the groups' collective views of what would be an acceptable settlement. So they were effectively acting for us in those negotiations.

(Tr. 7/19 at 58-59) (emphasis added). Mr. Bolin testified similarly: "Generally, they [Fried Frank] knew what we would accept." (Tr. 7/20 at 84.)

127. The SNHs have denied that Fried Frank informed them about the substance of what was happening in the negotiations. However, the SNHs knew that Fried Frank wasn't telling them to restrict their trading in order to receive important information about the settlement process – the kind of communication they would have expected to receive if the process had broken down or if the Debtors were about to make significant concessions to JPMC, inconsistent with what Fried Frank knew the SNHs would accept. Further, they knew that the Debtors were not pursuing aggressive litigation against JPMC. (Tr. 7/19 at 61)

128. On January 10, 2010, based on the significant progress made during the settlement negotiations in December, WMI sent JPMC a 39-page draft settlement agreement plus 65 pages of attached exhibits. (EC 296; Tr. 7/21 at 186-87.) As WMI's Chad Smith stated in his cover e-mail to JPMC, "[t]he attached represents our most recent discussions from December

and covers issues (e.g. releases) that will need to be addressed in connection with the debtor's bankruptcy plan." (*Id.*) Mr. Kosturos testified that by this time, JPMC had agreed to a 70/30 split on the Existing Period Tax Refunds. (Tr. 7/21 at 186.)

129. The very next day, Mr. Smith, Mr. Kosturos, and their counsel from Weil met in person with representatives of the four SNHs and their attorneys from Fried Frank. (EC 124) It is unclear whether, by this meeting, the Debtors had learned more about how JPMC was likely to respond to the December 8 offer than Kosturos had learned during the second half of December. However, what is clear is that this meeting involved discussions between the SNHs and the Debtors about a plan structure that could be used in the event of a settlement with JPMC, as well as ways of potentially utilizing WMI's NOL carry-forwards. (Tr. 7/19 at 62-63.)

130. On the next day, January 12, JPMC e-mailed the Debtors a further settlement proposal. (EC 304) It accepted the Debtors' December 8 proposal on the division of tax refunds (70/30 in JPMC's favor on the Existing Period Tax Refunds and a 50/50 split on the Extended Period Tax Refunds). It accepted the proposal that payments needed to settle with WMB Bondholders be split 50/50, but subject to further discussions on a dollar cap. It accepted the Debtors' proposal for splitting the Goodwill Litigation. (*Id.*) On the same day, Mr. Kosturos met with the SNHs. (Tr. 7/21 at 189.)

131. With respect to what the public knew at roughly this time, the Court conducted a hearing on January 18, 2010, at which the Debtors argued for additional authority to seek discovery via Rule 2004 as part of their continuing investigation of Business Tort Claims against JPMC. In addition, the Debtors had filed a motion on January 11 to disband the Equity Committee (Dkt # 2132) (referring to in the Plan hearing), in which the Debtors asserted:

> The Debtors are not operating entities. As such, their solvency prospects rise and fall on the outcome of the litigations with JPMorgan and the FDIC, and the successful prosecution of any additional claims that may be asserted once the 2004 Motion fact investigation is concluded.

(Dkt # 2135 at 15.) The Debtors further stated in the motion that "[b]y all measures, the Debtors are insolvent – a conclusion supported by all known facts and submissions to date in these chapter 11 cases. Indeed, this conclusion is confirmed by the public markets. The Debtors' junior subordinated debentures are trading, as of January 8, 2010, at approximately 50 cents on the dollar – a steep discount to par value."

132. In the Debtors' reply brief filed in support of the same motion on January 25, 2010 (and also quoted during the Plan hearing because of a disclosure about the existence of settlement negotiations with JPMC and the FDIC), the Debtors publicly stated:

> [I]t is beyond peradventure that the Debtors have commenced and, by their procedural successes, have prosecuted each of the litigations in good faith. Indeed, that the Debtors have asserted over $20 billion of possible claims against JPMorgan and the FDIC is illustrative of the fact that the Debtors are discharging their fiduciary duties to these estates and seeking to maximize the estates' assets for the benefit of ***all*** stakeholders – creditors and equity holders alike.

Dkt # 2223 at 2 (emphasis in original).[14]

133. By February 9, Fried Frank had developed and transmitted to the Debtors a draft term sheet describing "the principal terms and conditions of a proposed chapter 11 plan" for WMI. (EC 41, 2nd page) In a cover e-mail, Fried Frank explained that they and their SNH clients were continuing "to review and revise the draft." (EC 41, 1st page; <u>see</u> Tr. 7/19 at 65, 66-67; Tr. 7/20 at 82-83) Significantly, the term sheet expressly reflected and provided a mechanism for implementing the 70/30 split of the Existing Period Tax Refund and the 50/50 split of the Extended Period Tax Refund. (EC 41, 3rd and 7th pages.) It expressly stated that

[14] Similar statements were made by Debtors' counsel at the January 28 hearing on the motion: "I would like to point out that it is the Debtors' goal, the Debtors' responsibility, and the Debtors' obligation to look after the interests of all stakeholders. Creditors and shareholders alike. And the Debtors, in that regard, have served, and will continue to serve, as the custodian for the whole. . . . The Debtors and the professionals have adhered to a simple mantra throughout this case. Which is to do whatever is necessary to maximize the assets of the Debtors' estates, and to minimize the liabilities that may be allowed against creditors." Transcript of Hearing, Jan. 18, 2010, at 11:18-12:6.

WMI's common stock would be canceled and that common shareholders would receive no distribution under the proposed Plan. (*Id.*, 7th page)

134. Understandably, the SNHs attempted to minimize the significance of this document and the volumes it speaks about how likely they viewed a settlement as materializing and about its likely terms. For example, in his direct testimony, Mr. Gropper called the work on the plan structure "noodling" – something that would save time "in the event a deal was cut with JPMorgan," as if that were some kind of remote contingency. (Tr. 7/18 at 117) On cross-examination, however, he testified that in the January-March 2010 time frame, the SNHs' counsel at Fried Frank were "dialoguing with Weil throughout that time about that construct." (Tr. 7/19 at 78)

135. In the case of the February 9 draft term sheet for a Plan, the SNHs and their counsel followed up by asking the Debtors for a meeting "to discuss the term sheet and next steps." (EC 274)

136. That meeting was scheduled to occur on February 25, and Fried Frank sent Weil a proposed agenda in advance, which included an update on discussions among the Debtors, JPMC, the FDIC, and the WMB Bondholders, a discussion about a proposed Plan of Reorganization and "Waterfall Issues", and a litigation update. (EC 126)

137. At the February 25 meeting, which was attended by the four SNHs and their Fried Frank counsel (Tr. 7/20 at 180), there was discussion of the Plan, the waterfall issues, and the litigation update. (Tr. 7/19 at 70) However, it appears that the then-current status of negotiations with JPMC and the FDIC were not discussed because the information would have constituted material non-public information.

138. Specifically, Mr. Bolin testified that JPMC's counsel was also present at the meeting (or at least part of it), and that when it became known that the SNHs were not restricted

in their trading and did not wish to receive material non-public information, JPMC's counsel "indicated that if that was the case, he was not going to talk to us," and so the SNH representatives were asked to leave and their counsel continued with the meeting in their absence. (Tr. 7/20 at 73.)[15]

139. From this, Appaloosa concluded "that discussions between JPMorgan and the FDIC and the debtor may have gotten some traction," and for that reason, Appaloosa suspended its trading in WMI securities because it felt it would be "imprudent" to continue trading based on its view that the settlement negotiations had gotten "traction", and it restricted trading from then until just prior to March 4, 2010. (Tr. 7/20 at 43-44, 73-74, 91.)

140. However, none of the other three SNHs restricted their trading as a result of what happened at that meeting.

141. Further drafts of a settlement agreement were being negotiated by the Debtors and JPMC during late February. (See, e.g., EC 297) Also in late February, Appaloosa's Mr. Bolin, Fried Frank, and the Debtors were planning for a March 1 meeting to discuss the FDIC. (EC 277)

142. And indeed, on March 1, the Debtors met with JPMC at JPMC's headquarters – and the meeting was also attended by Mr. Bolin. (EC 279; Tr. 7/20 at 96.) He testified that he "had a good sense negotiations were picking up." (Tr. 7/20 at 97.) According to Mr. Kosturos, the Debtors had arranged the meeting at Fried Frank's request so that Mr. Bolin and Mr. Scheler could "register their thoughts on the negotiations." (Tr. 7/21 at 197.) Among the issues discussed that day (as reflected in a follow-up e-mail from JPMC's counsel the next day) was

[15] In his direct testimony, Mr. Bolin did not specify the date of the meeting when this occurred, other than to testify that it was in February. However, on cross-examination, he testified that it happened at the meeting on February 25 and that all four SNHs were present. (Tr. 7/20 at 87, 180.)

how to handle a scenario in which the FDIC attempted to exert control over the Disputed Accounts. (EC 280, 2nd page)

143. On March 2, JPMC suggested proposed language for the settlement agreement to cover this scenario by allowing WMI to withdraw if the FDIC attempted to exercise control over more than $3.7 billion in the Disputed Accounts; the proposal also contemplated cancellation of the March 4 hearing then scheduled to occur in this Court on the Debtor's motion for summary judgment respecting ownership of the Disputed Accounts. (*Id.*; EC 281)

144. Weil sent this on to Fried Frank (Brad Scheler), who in turn responded that "[o]ur clients won't go for this." (EC 280) Mr Scheler further wrote: "This makes clear that JPM wants most to avoid an adverse summary judgment decision. <u>Our clients either want the tripartite deal or want to move forward on Thursday</u>." The e-mail gives rise to the clear inference that Mr. Scheler had been speaking with the SNHs about the issues raised by JPMC's March 2 proposed language for dealing with a situation in which the FDIC did not sign on to the settlement.[16]

145. On March 4, 2010, Mr. Rosen announced in open court that the Debtors and JPMC were near an agreement on a global settlement (Tr. 7/20 at 74-75), and the terms of that settlement were read into the record at a hearing on March 12 (AOC 58). On March 26, the written Global Settlement Agreement was filed with the Court as part of the first Disclosure Statement for a proposed Plan of reorganization. (EC 299) At that time, it had been approved by all parties to the Agreement other than the FDIC, and the SNHs were all parties to the Agreement. The GSA, as it then existed provided for the following:

- JPMC would turn over to the Debtors more than $4 billion in the Disputed Accounts

[16] Mr. Gropper did not recall discussing this issue with Mr. Scheler, but he had no other explanation for Mr. Scheler's reference to what the SNHs wanted, and he admitted that he had phone conversations with Fried Frank during January, February, and March 2010. (Tr. 7/19 at 73-74)

- The Existing Period Tax Refunds would be split 70/30 in JPMC's favor;
- The Extended Period Tax Refunds would be split 40.4% to WMI and 59.6% to the FDIC in its capacity as receiver for WMB
- JPMC would receive the Trust Preferred Securities, the previously agreed split of the Rabbi Trusts and the BOLI/COLI policies, the Anchor Savings portion of the Goodwill Litigation
- JPMC would pay WMI $50 million for the Visa shares

(EC 299 at 9-12 (summary of GSA))

146. The proposed Plan included broad releases in favor of the SNHs. (EC 299, Ex. A, at ¶¶1.149, 42.5, 42.6.) In addition, the proposed Plan provided for payment of the legal fees of Fried Frank and White & Case "without the need for any of these professionals to file an application for allowance thereof with the Bankruptcy Court." (EC 299 at 103)

147. On March 23, 2010, the SNHs received three crucial pieces of information that were not revealed to the public until the May 17, 2010 Amended Disclosure Statement. First, Debtors sent them a "waterfall" estimating that the Debtors would have $5.2 billion in cash available to pay creditors. (EC 42, 43) Mr. Goulding testified that he thought that the March 23, 2010 waterfall contained an "approximation for cash at the effective date" and, sure enough, the $5.2 billion "cash" figure shown on the May 17, 2010 waterfall differed by only $2 <u>million</u> from the cash approximation on the March 23, 2010 waterfall. (Tr. 7/14 at 56; Tr. 7/20 at 153:20-25; EC 42; EC 43; EC 300 [Ex. C "Liquidation Analysis" at 3]). This pivotal information regarding the cash available for distribution was not made public anywhere until the May 17, 2010 Amended Disclosure Statement. (<u>See</u> EC 299 (3/26/10 Disclosure Statement leaving Liquidation Analysis blank)

148. Second, the March 23, 2010 waterfall informed the SNHs that the Debtors estimated that the GUCs would be worth $400 million, which differed only slightly from the $375 million estimate in the May 17, 2010 Amended Disclosure Statement. (EC 43; EC 300

[Ex. C "Liquidation Analysis" at 3].) Again, this critical information regarding the size of the GUCs – which recover pari passu with senior noteholders – was not revealed to the public until the May 17, 2010 Amended Disclosure Statement. EC 299 (3/26/10 Disclosure Statement with no estimate of size of GUCs); EC 300 [Ex. C "Liquidation Analysis" at 3].) Third, the SNHs received a valuation of reorganized WMI near the end of March, but this too was not disclosed to the public until the May 17, 2010 Amended Disclosure Statement. (Tr. 7/20 at 154:23-155:2; EC 299; EC 300 [Ex. C "Liquidation Analysis" at 3].)

149. Putting these three pieces of pivotal nonpublic information together with what was publicly disclosed in the March 2010 Disclosure Statement regarding WMI's share of the tax returns (estimated at over $1.9 billion) (EC 299 at 9), the SNHs alone could derive the total value of the money available to the non-GUC creditors under the Plan. No one else was in a position to do this until May 17, 2010.[17]

150. As Mr. Bolin testified, the relevant information disclosed in the March 26, 2010 Disclosure Statement related only to the relative priority of the classes shown in the matrix. But crucially, the matrix did not contain any information about the size of the assets available for distribution – it only showed who would get paid in what order. Indeed, the only information available in the March Disclosure Statement regarding the size of the estate's assets was a vague statement in the preamble that the Plan "contemplate[s] that funds in excess of approximately $7 billion will be available for distribution" – a far cry from the precise information known to the

[17] As noted, the Debtors filed the first Disclosure Statement on March 26, 2010. (EC 299; admitted at Tr. 7/20 at 158) However, it did not include estimated recovery percentages for the various classes of claims (id. at 15 et seq.) and the final page of the DS – the Exhibit C "Liquidation Analysis" was blank. It also did not contain any valuation of the reorganized WMI. The First Amended Disclosure Statement filed on May 16, 2010 did include recovery percentages, a liquidation analysis in Exhibit C, and a valuation analysis in Exhibit D. (EC 300 at 18 et seq. & Exs. C, D; admitted at Tr. 7/20 at 158). See Tr. 7/20 at 206.

SNHs showing that the estate had more than \$7.3 billion[18] in March 2010 – only \$400 million of which needed to be distributed to GUCs -- and, accounting for the gains in tax refunds conceded by the FDIC in May, over \$7.7 billion by the May 2010 disclosure statement.

151. While in possession of the waterfall matrix provided on March 22, Appaloosa engaged in WMI securities trades on March 29 and March 30; Centerbridge engaged in trading on multiple dates from March 29 through May 15; Aurelius was trading on multiple dates from April 7 through May 7; and Owl Creek was trading on multiple dates from March 29 through April 21. (Tr. 7/20 at 156; AOC 54; AU 8; EC 131.)

152. Following the filing of the Global Settlement Agreement (the "GSA") in the Disclosure Statement on March 26, the parties to the Agreement ran into trouble getting final approval from the FDIC, which had not been delivered as of March 26. (See EC 299 at 7; EC 300 at 7.) This led to further negotiation and changes to the GSA and the proposed Plan. As before, the SNHs and their counsel were intimately involved in that process, as reflected in the e-mails admitted into evidence as EC 289, EC 284, EC 309, and EC 308.

153. On four occasions, Fried Frank transmitted to the SNHs "draft documentation which included the settlement agreement, the plan and disclosure statement," and the SNHs provided comments on the documents. (Tr. 7/19 at 77-78) On those occasions, there was testimony that the SNHs suspended trading in order to review the documents and then resumed trading after the documents were filed with the Court. (Tr. 7/19 at 77-78; Tr. 7/20 at 77.)

154. A revised Disclosure Statement was filed on May 16, 2010, which included a revised GSA that had been approved by the FDIC in addition to the other identified signatories. (EC 300) It changed the split of tax refunds during the Existing Tax Refund Period to 80/20 in

[18] This is derived by simply adding what was publicly disclosed regarding the size of the tax refunds (midpoint estimate of \$1.965 billion), plus what the SNHss knew the size of the cash to be (\$5.2 billion), plus what the SNHs knew the estimated value of WMMRC to be (\$140 million).

favor of JPMC and the split for the Extended Period Tax Refunds to 68.5/31.5 in favor of the FDIC as receiver, subject to a cap of $850 million. (EC 300 at 10.) The revised GSA also reduced the amount of JPMC's payment for the Visa shares to $25 million. (EC 300 at 11.) The SNHs remained signing parties to the GSA and continued to receive broad releases and reimbursement of their professional fees.

155. One of the Plan issues on which the SNHs pushed hard was the provision for payment of post-petition interest at contract rates rather than the federal judgment rate. (Tr. 7/19 at 86-88)

156. The SNHs were also involved in the negotiation of subsequent versions of the Debtors' proposed Plan, including at least the version filed on October 6, 2010. (Tr. 7/19 at 78-79) Under the current Plan, the SNHs will become shareholders of Reorganized WMI because they own PIERS. (Tr. 7/19 at 79, 112-13.)

157. Steve Zelin from Blackstone was a witness called by the Debtors at the hearing on the subject of Blackstone's valuation of Reorganized WMI. He explained that in arriving at the valuation, Blackstone had capped the amount of capital they assumed would be invested in Reorganized WMI as a result of concerns about whether the IRS would challenge the reorganized company's use of NOL carry-forwards. When he was asked to identify the facts and circumstances that he had considered based on his discussions with counsel about the indicia of intent to avoid taxation by creditors acquiring stock in the Reorganized WMI, he identified three considerations, which he called the "three primary factors." (Tr. 7/13 at 282-84) The last of these factors he described as follows:

> We looked at the fact that the share – the soon to be shareholders were <u>active participants in the negotiation of the plan and structured the plan</u> as also another important factor.

(*Id.* at 283-84.)

I. ADDITIONAL FACTS

158. Aurelius had an internal software model that it used to estimate the recoveries it would obtain from this bankruptcy under certain assumptions. (Tr. 7/19 at 92.) It was available to traders and analysts within Aurelius. (*Id.*) Eleanor Chan was the Aurelius manager who was primarily responsible for inputting data into the model. (*Id.* at 93.) Mr. Gropper communicated with her about the JPMC settlement discussions. (Tr. 7/19 at 94.) In addition, because Aurelius did not establish an ethical wall at the time of the November-December negotiations, Ms. Chan was already aware not only of JPMC's offer at that time but also the Debtors' response, and she input that information into the model. (Tr. 7/19 at 94-95.)

159. Though Mr. Gropper insisted that information about settlement proposals was not the basis on which Aurelius made investment decisions, he conceded that the same model used to project recoveries on Aurelius' WMI investments was used to model recoveries based on the settlement proposals – and that it was available to traders and analysts at Aurelius. (Tr. 7/19 at 96-97.)

160. Appaloosa also had a software model that projected recoveries under the various settlement proposals by running the proceeds through a claims waterfall. (Tr. 7/20 at 181-82)

J. WHAT THE EVIDENCE SHOWS

161. Either directly and unequivocally or through reasonable inference, the evidence summarized above demonstrates the following:

162. For each of the four SNHs, investing in the securities of bankrupt or "troubled" companies is either a significant part of their overall investment strategy for the funds they manage, or virtually the sole focus of that strategy. Two of them were not investors in WMI prior to the bankruptcy, and the other two only started investing shortly before the bankruptcy.

They became significant investors after the Commencement Date because they saw a ripe opportunity for significant profit in a relatively short space of time.

163. They knew that the Debtors would never reorganize as a viable operating entity. In substance, this was to be a liquidating bankruptcy, and the Debtors' largest assets – multi-billion dollar assets -- consisted of legal claims against JPMC. The resolution of those claims, and the claims that JPMC and the FDIC were defensively asserting against the Debtors, would determine the outcome of post-bankruptcy investment in WMI securities. Of chief importance were the disputes over ownership of more than $4 billion in former WMB deposit accounts held by JPMC as the bank's purchaser and of billions of dollars in tax refunds that would be due after the use and carry-back of massive NOLs. Those disputes would be resolved in one of two ways – through litigation or by settlement.

164. Knowing this, each of the SNHs began using the significant investment capital at their disposal to acquire large positions in almost every layer of WMI debt. Eventually, they recognized each other as investors pursuing similar strategies and began to make common cause. Either individually or collectively, they eventually acquired "blocking positions" in all of the more junior issues of impaired WMI debt. This ability to prevent voting approval of a plan of reorganization gave them the power to exercise influence over the Debtors and over the future course of the bankruptcy.

165. They then used their positions in WMI's capital structure and the influence that gave them to promote a settlement process and to guide its progress, working toward a negotiated resolution of the disputed claims among the Debtors, JPMC, and the FDIC that would give them the returns they sought on their WMI investments.

166. Significantly, each of the SNHs chose to prosecute their interests, not through membership on the Creditors Committee, which would have required them to restrict trading or

establish and enforce an ethical wall over the life of the case, but by acting through ad hoc creditor groups, and by November 2009, through a single group consisting solely of themselves and represented by Fried Frank.

167. For the party asking for money in any settlement negotiation, more is better than less – up to a point. The more you ask for, the harder it is to reach an agreement, and the longer it will take to reach one. In this case, the maximum recovery for noteholders was set by the face principle amount of the debt they owned and the contractual interest payable on the principle. From the standpoint of the SNHs, seeking more than that would accomplish nothing, and allowing the Debtors to seek more than that (whether through negotiation or litigation) would jeopardize success in achieving an agreement with JPMC, and certainly would delay the point at which an agreement could be reached.

168. And so, not surprisingly, achieving recoveries sufficient to put equity in the money was not only of no interest to the SNHs, seeking such recoveries would be positively detrimental to their own self-interest in reaching a timely deal. To avoid that course, the SNHs needed the cooperation of the Debtors – and they got it.

169. All creditors knew that if WMI could recover the money in the Disputed Accounts, that would be enough to pay off the Senior Notes. At that point, owners of the senior debt would be satisfied and would have no interest in pushing for more. As owners of junior debt, however, the SNHs needed more, and it was obvious that the payoff for them would turn on the division of the disputed Tax Refunds. Other significant claims were also in dispute, and in absolute terms they involved assets worth significant amounts of money, but in the context of this bankruptcy, they were "rounding errors" in comparison to the value at stake in the disputed Tax Refunds. In turn, the type of tax refund division the SNHs could live with would depend

significantly on whether Congress passed legislation extending the NOL carry-back period for corporate tax-payers.

170. The process of laying the groundwork for settlement began no later than January 2009, when the White & Case and Fried Frank Groups developed an early term sheet for a global settlement and participated in groundwork-laying discussions with the Debtors, JPMC, and the FDIC. During the confidentiality period that began on March 9 and ended on May 8, 2009, the SNHs not only got a seat at the table, they helped prepare the term sheet that bondholder counsel – not the Debtors – delivered to JPMC, and they were privy to JPMC's response – which signified a willingness to pay over to the Debtors virtually all the money in the Disputed Accounts. In addition, the evidence strongly suggests that the SNHs learned of the further offer made by the Debtors to JPMC in April.

171. Significantly, the Debtors permitted the SNHs to participate, and indeed drive the direction of, this first round of negotiations pursuant to a confidentiality agreement that imposed no constraints on the SNHs' ability to trade – and to trade on the basis of any information learned during the confidentiality period – as soon as the agreement terminated 60 days later. Worse still, the Debtors accepted provisions purporting to give the SNHs "cover" for their trading activity by imposing on the Debtors an obligation to determine what information was material, and then to publicly disclose it. It was entirely foreseeable to both the Debtors and the SNHs that whatever they learned about the back and forth of negotiations during the confidentiality period, that information would not be publicly disclosed. To have done so would have been tantamount to conducting settlement negotiations in public, which JPMC certainly would not have agreed to do; it seems extremely unlikely the Debtors would have agreed to do that either.

172. In other words, the Debtors were utterly complicit in the SNHs scheme to play the kind of role in settlement negotiations that a Creditors Committee would normally be expected to

play, but without any of the continuing constraints on their trading freedom that Creditors Committee membership would have entailed. There is no colorable argument that this arrangement benefitted the estates, much less was consistent with the Debtors' fiduciary obligations to all interested parties.

173. It is undisputed that beginning soon after the confidentiality period ended, all four SNHs traded in WMI securities while in possession of non-public, confidential information, i.e., that settlement negotiations pivotal to the estate had begun, that JPMC had made an offer which included return of the Disputed Accounts, that this offer reflected JPMC's own assessment of the merits of the competing claims to those accounts, and that the settlement dialogue with JPMC would likely continue. Regardless of the SNHs own internal assessment about the merits of the competing legal positions, there was a significant difference between having their own opinion about how a court might rule someday and knowing that JPMC itself expected to lose and was willing to include a $4 billion payment in its very first settlement offer.

174. While it is true that no settlement is really "final" until an enforceable agreement has been reached, and that in theory JPMC could have retracted the $4 billion offer as negotiations proceeded, to say that this information was not the kind that a reasonable investor would have considered important in making decisions to buy or sell WMI securities – to deny that it was information which, if publicly disclosed, might have had a substantial effect on the price of WMI securities -- is completely at odds with reality. That is not the way markets in the securities of bankrupt companies such as this one work. They are inherently speculative, based not on hard asset values or earnings forecasts but on predictions about the outcome of legal claims and negotiations. Not only might this information have affected the price of WMI securities if disclosed (in a press release, for example), it most certainly would have – especially

because as far as the public knew, JPMC was strenuously fighting in court to retain the Disputed Accounts through the adversary proceeding it filed in March.

175. No one honestly believed that settlement negotiations were "dead" at the end of the first confidentiality period, and indeed they resumed, initiated by Appaloosa and Centerbridge. Those negotiations produced a further offer by JPMC in August that represented significant compromise movement on the division of the tax refunds, at just the time when prospects for passage of the carry-back extension bill began to improve.

176. By this point, not only had Appaloosa and Centerbridge learned of the significant changes in JPMC's negotiating posture reflected in that offer, they had also received from Fried Frank the second round of offers exchanged by the Debtors and JPMC in April – which the Debtors had expressly asked SNH counsel not to share with their clients, the clear inference being that even the Debtors thought it represented <u>material</u> non-public information. While Appaloosa and Centerbridge had voluntarily restricted their trading during the time when they learned of JPMC's August offer, Centerbridge did <u>not</u> restrict its trading when it received the April offers from Fried Frank on July 1, and Centerbridge resumed trading again on September 8 in full awareness not only of those offers but also of the significant movement reflected in JPMC's August offer.

177. In November, the Debtors again became complicit in the SNHs effort to drive toward a settlement while preserving their freedom to trade. The Debtors became aware of what Appaloosa and Centerbridge had been doing with JPMC, saw that as a positive sign, and reconvened settlement negotiations under cover of another confidentiality agreement that only imposed trading restrictions for a brief time, gave the SNHs complete freedom to maneuver in the markets when it ended, and again provided "cover" by imposing on the Debtors an obligation to disclose "material" information.

178. It is more than reasonable to infer that at least after the confidentiality agreements were signed on November 16, all four SNHs became privy to the July-August exchange of offers among JPMC, Appaloosa, and Centerbridge. They collaborated with the Debtorsin formulating yet another offer to JPMC, having learned the magnitude of the expected Extended Period Tax Refund, and they were also told by Mr. Kosturos about the extremely significant information imparted to him by JPMC and confirmed in Don McCree's November 20 e-mail – that JPMC would be willing to divide the Existing Period Tax Refunds on a 70/30 basis.

179. Though the SNHs and the Debtor attempted to convince the Court that JPMC's "resetting the bookends" response killed the negotiations and justified treating the information they had learned about JPMC's settlement posture as "immaterial", the evidence demonstrates that no one really believed that at the time. In fact, with the knowledge of the SNHs, the Debtors promptly made a further offer that embraced the very 70/30 split that JPMC had indicated it would find acceptable on the Existing Period Tax Refunds and a 50/50 split on the Extended Period Refunds (which was more favorable to JPMC that the 90/10 split in WMI's favor that JPMC had proposed in August).

180. Yes, the division of certain other assets – though very few of them – remained undetermined by the end of December. Yes, the parties had still not yet agreed on how to handle the cost of the WMB Bondholder Claims. But a final deal was certainly very close, certainly close enough that the SNHs had a good idea about the likely recovery for junior issues of WMI debt. So far as the public knew in November and December 2009, the Debtors and JPMC were locked in courtroom warfare, with discovery proceeding on the Debtors' Rule 2004 examination and with a new round of 2004 discovery being sought. To suggest that reasonable investors would not have wanted to know what the SNHs knew by December 30 and considered it important – to suggest that a press release disclosing the latest round of negotiations and

communications in November and December would not have affected market prices – is again preposterous.

181. All four SNHs began trading on either December 31 or in January while in possession of this material, non-public information, and they did so with the knowledge and the blessing of the Debtors. Indeed, the Debtors agreed to early termination of the confidentiality agreements so that the SNHs would have the freedom to execute year-ending trades on December 31, less than 24 hours after the Debtors' disclosure of the amount of Extended Period Tax Refunds they expected.

182. The Debtors' reference in their January 2010 briefing on the motion to disband the Equity Committee that there were settlement negotiations with JPMC in progress hardly qualified as an adequate public disclosure of what the SNHs knew. Those statements said nothing about the details of the parties' then-current settlement positions or how close they were to agreement.

183. Indeed, the parties were close enough to a deal that in January, the Debtors sent JPMC the first draft of a detailed settlement agreement, and in February the SNHs sent the Debtors a term sheet for a reorganization plan, which made express reference to the 70/30 ratio embodied in the agreed tax refund split.

184. Further confirmation about the proximity of a final agreement occurred on February 25, when the SNHs were excused from a meeting with the Debtors and JPMC because they were not then restricted. Appaloosa immediately restricted its trading based on that occurrence; however, none of the other SNHs did.

185. The four SNHs all insist that they were not directly involved in settlement negotiations between December 30 and March 4, when the Debtors publicly announced that a global settlement was near. That does not mean they knew only what the public knew. To the

contrary, they still knew what they had learned as of December 30, -- that the parties were already very close to a final agreement -- and they knew that nothing had happened to derail the progress toward final completion. How did they know that? At a minimum, they knew because their counsel at Fried Frank – who was well aware of the SNHs' objectives -- was directly involved in the process and had not asked them to "get restricted" in order to receive non-public information about what was happening in the negotiations – something they certainly would have expected if the negotiations had taken a turn for the worse. To paraphrase the famous line from the "Silver Blaze" Sherlock Holmes story, it was a case of the dog not barking. No news was good news.

186. A global settlement was reached in March, though it had to be put back together in slightly revised form in May to obtain the FDIC's final approval. During that time, the Debtors involved the SNHs in the revision process, since they were parties to the agreement, and the Debtors also involved the SNHs in the development of the proposed Plan, not only in March, April, and May but at subsequent times as changes to the Plan became necessary, continuing all the way through the Sixth Amended Plan last fall. And all the way through the drafting of that Plan, the Debtors consented to having the estates pay the SNHs' legal fees, without the need for any application to this Court, and consented to Plan provisions that would shelter them with broad releases.

187. This is not a picture of a Debtor who assiduously discharged its responsibilities as fiduciaries for all interested parties, shareholders as well as creditors. It is a sorry story of a bankruptcy run in secret, with the knowledge and complicity of the Debtors, for the benefit of a favored few, who played decisive roles in orchestrating both the GSA and the Plan, who stand to profit handsomely for their efforts, and who now ask this Court to hold that at no time did they owe any responsibility or legal duty to anyone but themselves.

188. Ironically, it is a story that never would have seen the light of day but for the arousal of this Court's suspicions – well-founded, as it turns out – at the December 2010 confirmation hearing. Moreover, it is undoubtedly not the full story, given the restrictions on discovery that the Court was persuaded to impose on the Equity Committee, the relative brevity of time within which the discovery was compressed, and the SNHs' failure to produce privilege logs that might have given the Equity Committee an opportunity to test the validity of their decisions to withhold contemporaneous documents from production. Yet the story, as incomplete as it may be, is disturbing, and it demands corrective action by this Court.

189. The SNHs and the Debtors are jointly attempting to persuade the Court that what happened in this bankruptcy – one that stems from the largest bank failure in U.S. history -- is "business as usual" and should be approved. We have no way of knowing whether events similar to those revealed here have happened, and are happening, in other cases. However, if they are, then approving what occurred here would be the wrong message for the judiciary to send. Regardless, the decisions the Court must make are confined to the facts of this case, whether they are unique or not, and based in the facts shown in the record before the Court, the relief requested by the Equity Committee herein should be granted.

III. ARGUMENT

A. The Plan Is Not Being Offered In Good Faith

1. Debtors Must Demonstrate That The Good Faith Requirement Is Satisfied.

190. As a condition of plan confirmation, section 1129(a)(3) of the Bankruptcy Code requires that the plan must have been proposed "in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). Although the Bankruptcy Code does not define good faith, courts have considered "whether such plan will fairly achieve a result consistent with the objectives and purposes of the Bankruptcy Code" in making the good faith determination under section 1129.

In re AbitibiBowater Inc., 2010 WL 4823839, at *4 (Bankr. D. Del. Nov. 22, 2010). More specifically, good faith requires:

> that the proposed plan foster a result consistent with the Code's objectives, (2) that the plan has been proposed with honesty and good intentions and with a basis for expecting that reorganization can be effected, or (3) that there was fundamental fairness in dealing with the creditors.

In re Lernout & Hauspie Speech Prods., N.V., 301 B.R. 651, 657 (Bankr. D. Del. 2003) (internal citations omitted), *aff'd*, 308 B.R. 672 (D. Del. 2004); *see also In re Coram Healthcare Corp.*, 271 B.R. 228, 234 (Bankr. D. Del. 2001) ("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." (internal quotation marks omitted)). The proponent of the plan bears the burden of establishing that the plan is proposed in good faith. *In re Unbreakable Nation Co.*, 437 B.R. 189, 198 (Bankr. E.D. Pa. 2010).

2. Challenge To The Good Faith Of This Plan Is Not An Effort To Re-litigate The GSA.

191. Despite the Debtors' suggestions to the contrary, the good faith objection is not a ruse being used by the Equity Committee to relitigate the Court's finding that the Global Settlement Agreement is fair and reasonable. (*See* Debtors' Supplemental Response to Equity Committee's Objection [Docket #8188] at 5, 27). To make clear, the Equity Committee submits that the Modified Plan cannot be confirmed because the *Modified Plan* – not the Global Settlement – is not being offered in good faith under section 1129(a)(3).

192. The arguments advanced by certain plan supporters that the fairness and reasonableness of the Global Settlement Agreement is law of the case and cannot be reconsidered are irrelevant to the good faith determination at issue here. (*See, e.g.*, Creditors Committee's Response [Docket #8140] at 5-6; AOC Response [Docket #8196] at 5-6). The

Court's "fair and reasonable" finding with respect to the GSA does not preclude the Court from subsequently determining whether the Modified Plan is being offered in good faith. The plan proponents' contention that the good faith issue is somehow foreclosed because of the findings with respect to the GSA must be rejected.

3. Good Faith Of The Modified Sixth Amended Plan Is An Open Issue.

193. The Debtors further argue that the Court's previous finding that the Sixth Amended Plan was proposed in good faith should be applied here because the only substantive changes to the Modified Plan (as compared to the Sixth Amended Plan) were to amend certain deficiencies identified in the Opinion. (Debtors' Confirmation Br. [Docket #8185] at 52). In the Opinion denying confirmation of the Sixth Amended Plan, the Court's only finding with respect to good faith is as follows:

> Mr. Thoma and an individual shareholder, Mr. Schnabel, each contend that the Plan has not been proposed in good faith because the Debtors did not allow the Equity Committee to participate in the plan negotiations and did not protect the shareholders' interests. The Court finds no evidence of lack of good faith, however. Simply because the Debtors were not able to achieve a greater recovery in the Global Settlement, does not mean that they did not meet their fiduciary duty to all constituents. More than mere innuendo and speculation is needed to establish a lack of good faith.

Opinion at 106.

194. It is unclear whether the Court's finding of "no evidence of lack of good faith" related to the Global Settlement Agreement or to the proposed plan. If to the Global Settlement Agreement, the Court can consider whether the Modified Plan is proposed in good faith under Section 1129(a)(3) as explained above. However, even if the prior finding related to the proposed plan – in which case the good faith finding would be law of the case at least with respect to that plan – the Court can nevertheless make a good faith determination with respect to the Modified Plan under the extraordinary circumstances exception to the law of the case doctrine.

195. In the event the Court's prior good faith determination related to the proposed plan and is therefore law of the case, the Court is not precluded from (and indeed should) reconsider its prior ruling. The law of the case doctrine does not limit the Court's *power* to revisit an issue. *See In re Broadstripe, LLC*, 435 B.R. 245, 255 (Bankr. D. Del. 2010) ("Law of the case directs a court's discretion, it does not limit the tribunal's power."). "[T]he law of the case doctrine merely directs the court's discretion not to rehear matters ad nauseam." *Id.*

196. Newly presented evidence justifies reexamination of an issue that has already been decided. Here, the Equity Committee's good faith objection based on allegations of misconduct by the SNHs involves evidence that has not been heard previously (and certainly not heard "ad nauseam"). The insider trading allegations were barely touched upon at the prior confirmation hearing in December, as the Court has already recognized by granting the Equity Committee's motion to take additional Rule 2004 discovery on this topic. Evidence proffered by Mr. Thoma relevant to the insider trading allegations was not admitted because it was hearsay. (Opinion at 69). This issue has not been litigated, and the Court is not foreclosed from considering it in conjunction with confirmation of the current plan.

197. Even if this issue had been previously addressed, the extraordinary circumstances exception to the doctrine applies and permits the Court to revisit its good faith finding. "Even where the law of the case doctrine applies, it does not bar reconsideration of an issue in certain 'extraordinary circumstances,' including where there has been a change in the law or where reconsideration is necessary to prevent clear error or injustice." *See Broadstripe*, 435 B.R. at n.37 (quoting *In re Joy Global, Inc.*, 381 B.R. 603, 612 (D. Del. 2007)), "[R]evisition of a prior ruling should be limited to extraordinary circumstances such as where: 1) the decision is clearly erroneous and its enforcement would work a manifest injustice; 2) intervening controlling authority makes reconsideration appropriate; or 3) substantially different evidence was adduced

at a subsequent trial." *In re Stone & Webster, Inc.*, 359 B.R. 102, 112 (Bankr. D. Del. 2007). The present facts fall squarely within the third factor – substantially different evidence was adduced at the subsequent confirmation hearing. *Id.* The facts about the insider trading and other inequitable conduct were discovered during the Equity Committee's recent investigation of the SNHs, discovery that occurred (with the Court's blessing) after the previous hearing. As a result, the Court did not, and could not, consider this evidence in its prior Opinion.

198. Consideration of whether the Modified Plan is proposed in good faith would not require the Court to explore the same facts and circumstances from the prior confirmation hearing in December. Nothing that has been decided is being re-litigated. The plan proponents attempt to avoid having to establish good faith on the basis that the issue has already been decided is incorrect and the Court should undertake that analysis with respect to the evidence submitted at the July hearing.

4. The Modified Plan Is Not Being Offered In Good Faith Because The Debtors Unduly Favored Powerful Creditors And Disregarded The Interests Of Equity.

199. The recoveries in this case have always been a function of how multi-billion dollar claims among the Debtors, JPMC, and the FDIC would be resolved. As described and demonstrated in detail in the Summary of Evidence, the Debtors' nearly exclusive focus since at least early 2009 has been achieving a settlement that would satisfy a small number of powerful creditors. Although representatives of senior noteholders were included in the first confidential negotiating session in March 2009, it quickly became evident – based on JPMC's first term sheet offer – that achieving a settlement sufficient to pay them in full would not be the real challenge. The challenge would lie in obtaining a settlement sufficient to satisfy junior classes of impaired debt, in which the SNHs either singly or collectively held blocking positions.

200. Beginning with the very first offer made on behalf of the estates in March – which was formulated by the SNHs and delivered by White & Case to JPMC with the Debtors sitting quietly alongside – the Debtors deferred significantly to the SNHs throughout the settlement process. When the Debtors actually conveyed a counteroffer to JPMC in April 2009, the SNHs pointedly reminded the Debtors that they had the ability to block plan confirmation and needed to be consulted before any further offers were made. From then through the end of 2009, there is no evidence that the Debtors made another move on the settlement front without including the SNHs, and indeed following their lead.

201. The SNHs were not members of the Creditors Committee. They made quite clear to the Debtors that they intended to continue trading for the benefit of their funds at the end of specified confidentiality periods, regardless of what they learned within those periods – insisting that the Debtors disclose any material information that might develop. To this day they insist that they owe no duties to anyone but themselves. And yet, despite all that, the Debtors allowed them to exercise powerful influence over the future of these estates, though the Debtors surely knew or should have known that the interests of the SNHs were antithetical to the interests of anyone below them in the waterfall – most especially equity. Seeking recoveries in excess of what the SNHs had targeted as returns on the debt owned by their funds could only have made achieving a deal more difficult and more time-consuming.

202. In retrospect, and in light of the evidence that has surfaced since the December 2010 plan confirmation hearing, it is now apparent that the Debtors' efforts to investigate and potentially litigate Business Tort Claims against JPMC were simply window-dressing, perhaps intended to keep just enough heat on JPMC to help push the SNH-directed settlement process to consummation sooner rather than later, but not more than that. We now know that while the Debtors were in this Court in January 2010 arguing for additional investigative authority under

Rule 2004, they had already transmitted to JPMC a detailed draft settlement agreement, having reached agreements in principle on the resolution of virtually all major issues – the Disputed Accounts, the Tax Refunds, the ownership of the TPS and the Goodwill Litigation, and so on. This Court did not know about those agreements, nor did the public, but the SNHs did.

203. No one involved in the process was looking out for the interests of shareholders or genuinely attempting to maximize the value of the estates for the benefit of all parties. To the contrary, by January 2010, equity was viewed by the Debtors as a nuisance at best and at worst as a threat to accomplishing the deal that they and the SNHs were on the verge of achieving. And so, while representing to this Court in January 2010 that they were guardians of the interests of all, the Debtors sought to disband the Equity Committee – with full knowledge that the deal they were close to achieving would provide nothing to equity.

204. The Debtors' transparent hostility to shareholders has been revealed over and over again in this case, while their allegiance to the interests of the SNHs has just as clearly been demonstrated repeatedly – to the point of persisting, until this Court finally ruled otherwise, in seeking payment of their attorneys fees and legally unsupportable releases in their favor as components of the Plan.

205. The gross imbalance in the Debtors' treatment of the SNHs and of equity could hardly be more clear, or more unjustifiable. In a nutshell, the Plan is the product of a deeply flawed process, and the Debtors have failed to carry their burden of proving that it has been submitted in good faith.

5. The Debtors Cannot Demonstrate Good Faith Because They Ignored Potentially Valuable Claims Against Directors And Officers.

206. The current Plan has not been offered in good faith because the Debtors have failed to use reasonable efforts to maximize the value of the Estates by pursuing claims against WMI's directors and officers. These claims potentially represent hundreds of millions of dollars

of value to the Estate. The Debtors not only neglected to initiate an investigation into the claims until recently, they may have allowed statutes of limitations to run on many of them. In particular, the Debtors failed to pursue or adequately toll claims against current members of the board who also served pre-petition. On its face, this failure presents an apparent conflict of interest between the interests of these board members, who continue to supervise and direct the actions of the Debtors' professionals, and the interests of the Estates and their claimants. Choosing the interests of the board members over the interests of the claimants demonstrates that the good faith requirements of a "result consistent with the code's objectives" or "fundamental fairness in dealing with creditors" were not met here. *See, e.g., In re Malkus, Inc.*, 2004 WL 3202212 at *3-4 (Bankr. M.D. Fla. 2004) (finding that the good faith requirement had not been met because the debtor's principal had engaged in actions tainted with conflict of interest, including the "failure, in his capacity as the Debtor's president, to investigate potential preference claims against either himself or affiliates."); *In re Pierce County Housing Authority*, 414 B.R. 702, 721 (Bankr. W.D. Wa. 2009) (finding a lack of good faith and denying confirmation of a plan when the debtor failed to preserve litigation claims against the Debtor's former counsel and others.).

207. At the Plan confirmation hearing, Mr. Kosturos acknowledged that the Estates hold potential claims against WMI's present and former directors and officers, including both preference claims and claims for breaches of duties owed to the company. (Tr. 7/21 at 204:4-24.) In other bankruptcies involving failed corporations, such claims have provided a source of recovery for the estate. *See, e.g., Smith v. Arthur Anderson*, 421 F.3d 989, 994 (9th Cir. 2005); *In re World Health Alternatives*, 385 B.R. 576, 598 (Bankr. D. Del. 2008) In addition to recovery of preference payments and damages caused by breaches of fiduciary duties, Washington State law provides for recovery of the full amount of any dividend paid when the

company was insolvent from any director who voted for the dividend. *See* Wash. Rev. Code § 23B.08.310. The liability of a director for unlawful distributions cannot be exculpated in the corporation's bylaws or articles. *Id.* § 23B.08.320.

208. Mr. Kosturos acknowledged that WMI has insurance policies at least potentially covering these claims with a limit of $250 million per year. (Tr. 7/21 at 205:4-9) Although a number of other litigants have sought recovery against the policy for the year 2007/2008, Mr. Kosturos did not know whether or not WMI has ever asserted its own 2007/2008 claim. (*Id.* at 205:23-206:1) Mr. Kosturos testified that he believed the Estates had asserted a claim against the 2008/2009 policy, but he had absolutely no idea when this claim was made. (*Id.* at 206:2-14.)

209. The Debtors only retained counsel to investigate these claims within weeks of the Plan confirmation hearing, nearly three years after the bankruptcy petition was filed. (Tr. 7/18 at 208:3-11; *see also* Debtors' Application to Retain Klee, Tuchin, Bogdanoff & Stern as Special Litigation Counsel [Docket No. 8111]). For some claims, this may be too late. The automatic tolling of the statute-of-limitations imposed by the Bankruptcy Code lasts for two years from the petition date. 11 U.S.C. § 108. Any claims that were viable at the Commencement Date but that are subject to a two year statute of limitations may now be time barred.

210. Mr. Kosturos acknowledged that the Debtors failed to enter into tolling agreements with eight of the nine current members of the board of directors (all nine of whom served pre-petition), until *one day before he testified on this topic at the Plan confirmation hearing*. (Tr. 7/21 at 208:12-209:4) Mr. Kosturos did not know if these eleventh-hour tolling agreements purport to be retroactive or if the directors who signed them agreed to waive any statute of limitations defenses. (*Id.* at 209:5-11) Although the Debtors placed in evidence copies of the two tolling agreements they entered into in the summer of 2010, one with former CEO

Kerry Killinger and one with board member Allan Fishman, they did not offer any of the newly-minted tolling agreements or make them available for review. Thus, the impact of these tolling agreements on any potential claims remains a mystery.

211. In his testimony, Mr. Kosturos attempted to foist responsibility for the failure to obtain tolling agreements on the Equity Committee by claiming that the Equity Committee was involved in the process of obtaining tolling agreements during the summer of 2010, prior to the expiration of the Bankruptcy Code's tolling provision. (Tr.7/21 at 209:18-210:3) At the time, the Equity Committee repeatedly informed the Debtors that it was the Debtors' responsibility to identify and preserve claims, and the Equity Committee could not and would not assume this responsibility on the Debtors' behalf. The Equity Committee's role in the tolling agreement process at that time consisted primarily of providing a signature to the tolling agreements negotiated by the Debtors. Even if it had been proper for the Equity Committee to assume a greater level of responsibility for determining which claims should be tolled, the Equity Committee had not conducted any investigation and lacked information necessary to make informed decisions. At that time, for example, the Equity Committee had no information about who was on the board, what committees the board had, or what decisions the board had made in the period preceding bankruptcy. The Equity Committee also did not have access to WMI's D&O insurance policies.

212. The failure to pursue these claims may have cost the Estates hundreds of millions of dollars, potentially enough money to place preferred equity holders in the money. As with the releases for pre-petition conduct promised to current board members in the failed Sixth Plan, the Debtors' inaction on these claims has advanced the personal interests of its current board of directors (who undoubtedly would prefer not to be named as defendants) over the interests of the Estates as a whole.

6. The Debtors Have Not Acted In Good Faith Because The Claimed "Reorganization" Of WMI Is A Sham.

213. As set forth in the Equity Committee's pre-hearing objection, the Modified Plan does not provide for a genuine reorganization of Washington Mutual or its massive financial services operations. *See* Equity Committee Objection at 13-14. The reorganized debtor that would emerge from this reorganization bears no meaningful resemblance to the pre-petition business and the Debtors own valuation models indicate that this entity will have no ongoing business and will be held solely for the passive income it generates.

214. The reality is that the Modified Plan is a thinly disguised liquidation, intended to distribute the assets of the Estates to creditors. The Debtors have structured this bankruptcy as a Chapter 11 reorganization in order to maintain control over the distributions to favored creditors and to control litigation claims (and releases of claims) against insiders. This abuse of Chapter 11 is not consistent with the Code's underlying purposes and provides additional evidence that the Modified Plan has not been offered in good faith.

B. <u>Settlement Note Holder Claims Should Be Disallowed.</u>

1. Equitable Disallowance Is A Viable Remedy.

215. In *Pepper v. Litton*, 308 U.S. 295 (1939), the Supreme Court explicitly found that where an insider is guilty of a "violation of rules of fair play and good conscience," that may be a "sufficient consideration" to invoke equity to disallow the insider's claims. *Id.* at 311. In reaching that conclusion, the Court noted that a fiduciary "cannot serve himself first and his cestuis second," and in particular, "cannot utilize his inside information and his strategic position for his own preferment." *Id.* The Court went on to hold:

> [The creditor] cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that

> it may not be exercised for the aggrandisement, preference, or advantage of the fiduciary to the exclusion or detriment of the cestuis. Where there is a violation of those principles, equity will undo the wrong or intervene to prevent its consummation.

Id.

216. More recently, the Third Circuit has held that where an insider uses inside information to purchase a debtor's claims at a discount without prior disclosure, "[a]t a minimum, the remedy [] should deprive [][the insider-fiduciary] of its profit on the purchases of the notes" and that further remedy may be appropriate to compensate the debtor's estate for additional administrative costs and delay caused by the inequitable conduct. *See Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims*, 160 F.3d 982, 991 (3d Cir. 1998); *Comm. of Unsecured Creditors v. Citicorp Venture Capital, Ltd.* ("*In re Papercraft, Corp.*"), 253 B.R. 385 (Bankr. W.D.Pa. 2000) (on remand, further reducing insider's claim to account for additional administrative expenses, professional fees, lost interest, and other costs). Indeed, *Citicorp* expressly declined to "endorse" the district court's conclusion that it was "without authority to fashion a disallowance remedy." *Citicorp*, 160 F.3d at 991 n.7.

217. Notwithstanding that precedent, the SNHs argue that equitable disallowance "does not exist as a remedy" under the Bankruptcy Code. In particular, the SNHs argue that under *Travelers Casualty & Surety Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007), a court may not equitably disallow a claim because inequitable conduct is not one of section 502(b)'s nine enumerated grounds for disallowing claims. (AOC Response [Docket No. 8196], at 26-27; Aurelius Response [Docket No. 8191], at 37-38.) They also argue that the legislative history of section 510, relating to equitable subordination, supports their argument because language about the court's power to disallow claims was dropped before the final version of the Code was enacted. (AOC Response [Docket No. 8196], at 28.)

218. These arguments were considered and rejected by both the bankruptcy court and district court in the recent Adelphia bankruptcy litigation. First, contrary to the SNHs' arguments here, the absence of language addressing disallowance is not a clear rejection of the remedy. Indeed, the district court in *Adelphia* noted that, in deciding to drop the language from the final enactment, "Congress could have decided to do away with equitable disallowance, or it could have thought specific reference to it was superfluous." *Adelphia Commc'ns Corp. v. Bank of Am., N.A.*, 390 B.R. 64, 76 (S.D.N.Y. 2008).

219. Second, in considering the viability of equitable disallowance, the bankruptcy court in *Adelphia* noted that the legislative history of section 510 of the Bankruptcy Code specifically acknowledges the existence of disallowance as an appropriate remedy:

> This section is intended to codify case law, such as *Pepper v. Litton* . . . , and is not intended to limit the court's power in any way. . . . *Nor does this subsection preclude a bankruptcy court from completely disallowing a claim in appropriate circumstances*.

Adelphia, 365 B.R. 24, 71 (Bankr. S.D.N.Y. 2007) (quoting legislative history).[19] The court noted that this legislative history is persuasive in light of the absence of clear direction in the Bankruptcy Code itself. *Id.*

220. Third, the district court in *Adelphia* correctly noted that *Travelers* did not purport to overturn *Pepper v. Litton*'s clear holding that equitable disallowance is available under the appropriate circumstances as a remedy for inequitable conduct. *Adelphia*, 390 B.R. at 76 ("Nor does the Supreme Court's reading of 11 U.S.C. § 502(b) in [*Travelers*] suggest the abandonment of *Pepper v. Litton*."). Rather, *Travelers* more narrowly held that the so-called *Fobian* rule, a

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[19] The SNHs argue that *Adelphia* is wrongly decided merely because the bankruptcy court looked to the legislative history of the statute. This is an odd argument from parties who themselves used legislative history to make their argument to the contrary. *See* AOC Response [Docket No. 8196], at 28. Nevertheless, their argument is wrong. The court in *Adelphia* reasonably looked to other non-statutory sources given that the statute is silent on the issue of whether equitable disallowance is a viable remedy. The SNHs' argument that the statute is clear on its face is misleading, given that the Code simply does not address equitable disallowance either way.

judge-made rule in the Ninth Circuit relating to attorney's fees, was not a viable ground for disallowance under section 502(b). *Travelers*, 549 U.S. at 451-52. There was no allegation of inequitable conduct in *Travelers*, nor any appeal to the bankruptcy court's equitable powers.

221. Finally, as the district court held in *Adelphia*, "*Pepper v. Litton*, fairly read, certainly endorses the practice (in appropriate circumstances) of the equitable disallowance of claims, not on the basis of any statutory language, but as within the equitable powers of a bankruptcy court." *Adelphia*, 390 B.R. at 76. This is precisely the point. *Travelers* may address the appropriate scope of objections under section 502, but nothing in *Travelers* purports to limit, much less eliminate, the long-recognized ability of the bankruptcy court to remedy inequitable conduct through equitable disallowance in the appropriate circumstances. As discussed below, this is indeed the type of case in which that remedy is appropriate.

2. The SNHs' Conduct Constitutes Insider Trading.

222. The SNHs' claims should be disallowed because they were trading while in possession of material, nonpublic information obtained through their active participation in the settlement negotiations between the Debtors and JPMC. There is no question that the terms of the settlement proposals and the details of the settlement discussions between the Debtors and JPMC were never made public. The SNHs offer three arguments as to why they were not engaged in insider trading. First, they contend that the undisclosed information they obtained during the settlement negotiations—*e.g.*, the terms of JPMC's offers or the views of JPMC's counsel on probably litigation outcomes—was not material. Second, the SNHs argue that because they relied on the Debtors' assurances that all material nonpublic information was disclosed, they did not have the requisite scienter. Third, they argue that they were not insiders and had no fiduciary duty to the other creditors or shareholders. Each of those arguments is incorrect.

(a) The SNHs Possessed Material Nonpublic Information

223. Information is "material" for the purposes of insider trading "'if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to [act].'" *Basic, Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (quoting *TSC Industries, Inc. v, Northway, Inc.*, 426 U.S. 438, 449 (1976)). "The standard only requires a substantial likelihood that disclosure of the omitted facts would have been viewed by a reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 231-32 (citing *TSC Industries*, 426 U.S. at 449). The fact that a party trades after receiving inside information can itself be an indication of the information's materiality. *See*, *e.g.*, *id.*, at 240 n.18; *S.E.C. v. Thrasher*, 152 F. Supp. 2d 291, 300-01 & n.9 (S.D.N.Y. 2001).

224. The SNHs argue, however, that the settlement discussions could not have been material because there was no final agreement and the parties remained "miles apart" during the negotiations, (Centerbridge Response [Docket No. 8193], at 13-16), and that "information about preliminary, inconclusive, or stale negotiations is immaterial as a matter of law," (Aurelius Response [Docket No. 8191], at 56.) Aurelius primarily relies on *Taylor v. First Union Corp. of S. Carolina*, 857 F.2d 240 (4th Cir. 1988), for the proposition that speculative events are per se immaterial. (*Id.* at 55.) But the reliance on *Taylor* is misplaced. In *Taylor*, the allegedly material information that had not been disclosed was a potential merger that had not even progressed to the point of negotiations, and for which there were significant federal and state legal impediments. *Taylor*, 857 F.2d at 244. In this case, by contrast, the settlement negotiations were underway, concrete terms were being proposed, the claim for $4 billion in deposits was essentially agreed as early as March 2009, and by the end of the second confidentiality period, settlement was imminent.

225. Moreover, in the merger context, the Court in *Basic* explicitly rejected a proposed rule that would make merger discussions only material once an "agreement-in-principle" had been reached. *Id.* at 234. According to the Court, that rule would ignore the central inquiry, which is not whether the information conveys certainty, but rather, whether the information is significant enough that a reasonable investor would consider it important. *Id.* (finding that "[t]he role of the materiality requirement is not to attribute to investors a child-like simplicity, an inability to grasp the probabilistic significance of negotiations, but to filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger mix of factors to consider in making his investment decision" (internal citations and quotation marks omitted)).

226. As discussed more fully in the Summary of Evidence, there is powerful evidence that beginning no later than March 2009, the SNHs possessed non-public information that was material within the meaning of the law and engaged in trading with full awareness of that information. There is no doubt that resolution of the disputed claims between the Debtors and JPMC would be the principle determinant of recovery by creditors in this case. By participating actively, and at critical times, during the course of the settlement negotiations, the SNHs obtained inside information that enhanced their ability to gauge how the disputed claims would likely be resolved.

227. The notion that immediately at the end of each negotiating session, the negotiations were "dead", the slate was wiped clean, the offers became "stale," and none of the offers which had been exchanged would have any influence on how the future would unfold is not only preposterous, it is clearly belied by the SNHs own conduct. At the end of each negotiating session, the parties moved closer together, and the SNHs knew that negotiations would likely resume, and would likely pick up where they had left off.

228. The SNHs would have this Court do precisely what the *Basic* court said should not be done – embrace a "child-like simplicity," with no appreciation for the "probabilistic significance of negotiations." They would have the Court embrace the idea that settlement negotiations cannot be material and that only a final settlement agreement can be material because negotiating parties can change their minds and there is never any assurance that a deal will be reached. But the issue is whether there is a substantial likelihood that a reasonable investor would have attached importance to what was happening in the negotiations had it been publicly disclosed. The answer is plainly yes.

(b) The SNHs Had The Requisite Scienter.

229. The SNHs argue that their conduct does not constitute insider trading because they did not have the requisite scienter. In particular, they argue that because they relied on the Debtors' assurance that all material nonpublic information had been disclosed at the end of the confidentiality periods, they could not have had the requisite scienter. (*See* Centerbridge Response [Docket No. 8193], at 11-12; Aurelius Response [Docket No. 8191], at 52-53.) This argument should be rejected for three reasons.

230. First, the SNHs are essentially raising a good faith defense, yet they do not cite a single case recognizing a good faith defense where the claimed reliance is on the assurances of a third party—here, the source of the information—that all material information had been made public. Such a rule would be unworkable because it would potentially vitiate the insider trading laws if a third party's assurances automatically insulated a party from insider trading liability, with no further duty of inquiry imposed on the recipient of the information. The usual good faith reliance case involves the reliance on advice of counsel, but the SNHs are precluded from raising that defense because they specifically declined to present evidence to support such reliance at the

risk of waiving the privilege.[20] (*See, e.g.,* Tr. 7/18, 82:16-19; Tr. 7/19 136:13-18.) Moreover, as Mr. Gropper unequivocally acknowledged on cross-examination (Tr. 7/19 at 91-92), and as is confirmed in the SNHs' own insider-trading policies, the SNHs clearly recognized that they had an independent duty to determine whether the non-public information they possessed was material — regardless of any determination made by the Debtors about what should or shouldn't be disclosed.

231. Second, Centerbridge argues that it only owed a duty to the Debtors not to misuse confidential information, and that because the Debtors were aware of and allowed the SNHs to begin trading again after the confidentiality period was over, the Debtors necessarily could not have been harmed. This argument is misplaced, however, because it conflates the duty requirement, which is addressed below, with the scienter requirement. The mere fact that the Debtors were aware of the SNHs' intention to begin trading after the confidentiality period does not absolve Centerbridge of culpability where Centerbridge also owed a duty to other affected constituents, including the equity holders.

232. Third, the Equity Committee was specifically prevented from obtaining discovery into many of the facts that would be relevant in proving scienter. For example, the SNHs convinced the Court to deny the Equity Committee discovery as to the internal communications within the funds regarding the reasons they had for making trades in WMI securities. This information obviously would have been probative of state of mind. Nevertheless, as described in the Summary of Evidence, the Equity Committee presented substantial circumstantial evidence

[20] Aurelius somehow argues that because Regulation FC, governing a corporation's disclosure obligations, places the obligation for avoiding selective disclosure on the issuer of a security, good faith reliance on the issuer should negate scienter. Aurelius Response, at 55. But Aurelius cites no case finding such an absolute defense, and in any event, the same regulation cited by Aurelius makes clear that "the market is best served by more, not less, disclosure of information," Securities Exchange Act Release No. 43154, Sec. II.A.3 (Aug. 15, 2000), 25 Securities Prac. Fed. & State Enforcement Appendix 2H; 17 C.F.R. § 243.101. which is the point here: the SNHs should have either disclosed all of the material facts regarding the negotiation or abstained from trading.

showing that the SNHs knowingly traded on the basis of material, nonpublic information, and certainly while in possession of such information. *See SEC v. Heider*, 1990 WL 200673, at *4 (S.D.N.Y. Dec. 4, 1990) (allegations that volume of call option purchases spiked prior to merger and that defendants were responsible for significant portion of that volume supported "strong inference" of defendants' scienter).[21]

(c) The SNHs Had A Duty Not To Trade

(i) The SNHs Were Temporary Insiders.

233. Outsiders, like the SNHs in this case, 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" become temporary insiders with the attendant fiduciary obligation to the entity's shareholders and other creditors. *Dirks v. S.E.C.*, 463 U.S. 646, 655 n.14 (1983).[22] Unlike the misappropriation theory, "the temporary-insider . . . twist on the classical theory retain[s] its core principle that the duty to disclose or abstain is derived from the corporate insider's duty to his shareholders." *SEC v. Cuban*, 620 F.3d 551, 554 (5th Cir. 2010). Under this theory, the temporary-insider SNHs have the same fiduciary duties as the Debtors do to their creditors and shareholders. *See Pepper*, 308 U.S. at 307.

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[21] Additionally, many courts have found that proving insider trading "does not require . . . that a causal connection exist between the knowing possession of the information and the trade, that is, it does not require that the defendant 'use' the information when trading." *In re Oxford Health Plans, Inc.*, 187 F.R.D. 133, 143 (S.D.N.Y. 1999). Rather, all that must be shown to prove the requisite scienter is that a party traded while in possession of material nonpublic information. *U.S. v. Teicher*, 987 F.2d 112, 120 (2d Cir. 1993).

[22] *See also* Mark J. Krudys, *Insider Trading by Members of Creditors' Committees – Actionable!*, 44 DePaul L. Rev. 99, 141-42 (1994) ("[M]embers of creditor steering committees, like official creditors' committees, appear to come within the temporary insider definition articulated in Dirks. While the transfer alone of confidential information to the creditor steering committee does not establish a relationship of trust and confidence between the distressed entity and the members of the committee, the additional circumstances surrounding the dealings between the parties suggest the existence of a confidential relationship." (citation omitted)); Donald C. Langevoort, 18 Insider Trading Regulation, Enforcement and Prevention § 3.8 (Database updated April 2011) ("More recently, the view has been expressed that members of a creditors committee overseeing a reorganization of the issuer would be treated as insiders." (citations omitted)).

234. The SNHs argue that this theory only applies to temporary insiders who essentially work for the corporation as an insider. (*See* Centerbridge Response [Docket No. 8193] at 17; Aurelius Response [Docket No. 8191] at 42-43.) But while a person working for a corporation—*e.g.*, a consultant or attorney—may become a temporary insider, the doctrine is not so limited. Rather, the question is whether "because of a special relationship," the person is "privy to [the company's] internal affairs, whereas other outsiders have no ready access to the inner workings of a company." *S.E.C. v. Monarch Fund*, 608 F.2d 938, 942 (2d Cir. 1979) (cited in *Dirks*). That is, the focus of the temporary-insider test is on whether the temporary insider can use the special relationship to gain an unfair advantage over other outsiders. *Id.*

235. As demonstrated in the Summary of Evidence, the SNHs functioned as temporary insiders through their direct and significant participation in multi-billion dollar settlement negotiations that were pivotal to the outcome of this bankruptcy. They amassed blocking positions in impaired classes of debt and then used those positions to insinuate themselves into those negotiations. They may have been negotiating in the service of their own selfish interests, but what they were negotiating would become the foundation for a Plan affecting all parties in interest. Having put themselves in a unique position deep within a process vital to the well-being of the Estates, they had a duty not to misuse the information they thereby gained in their trading.

(ii) The SNHs Were Non-Statutory Insiders.

236. Additionally, the SNHs may be considered non-statutory insiders for purpose of the insider-trading analysis. Non-statutory insiders are those that do not fall within the enumerated categories of section 101(31), but still have a sufficiently close relationship with the debtor to suggest that transactions were not conducted at arm's length. *In re Winstar Comm'ns, Inc.*, 554 F.3d 382, 396-97 (3d Cir. 2009); *In re Ingleside Assocs.*, 136 B.R. 955, 962 (Bankr. E.D. Pa. 1992) ("[T]he term 'insider' should be applied flexibly to include a broad range of

parties who have a close relationship with the Debtor." (citation omitted)). "In deciding whether the relationship with the debtor is such that a party should be regarded as an insider, one of the controlling considerations is the relative degree of control which either has over the other." *In re Locke Mill Partners*, 178 B.R. 697, 702 (Bankr. M.D.N.C. 1995).

237. The SNHs' principal argument is that their conduct was not sufficiently egregious, and that they did not sufficiently control the Debtors, to be considered non-statutory insiders. (Aurelius Response at 46-47; Centerbridge Response at 19-21.) But it is well settled that a showing of actual control is not necessary. Rather, it is sufficient for the insider analysis if a party "exercises significant influence over the business or decisions of the entity in question." *In re Locke Mill*, 178 B.R. at 702 (finding that controlling a significant percentage of voting rights and using that to its advantage made party non-statutory insider). This is particularly true where, as here, a party is instrumental in putting together the plan of reorganization and seeks and receives substantial information from the debtor that is the "type of information . . . available only to insiders." *In re Allegheny Int'l, Inc.*, 118 B.R. 282, 299 (Bankr. W.D. Pa. 1990) (party who received "a great volume of information that was not available to other creditors, shareholders, and the general public" was temporary insider). As demonstrated in the Summary of Evidence, the SNHs obtained positions of significant influence over Debtors in the settlement negotiations and ultimately in the structuring of the Plan. They plainly qualified as non-statutory insiders.

C. <u>**Post-Petition Interest Should Be Paid At The Federal Judgment Interest Rate.**</u>

238. The Plan should not be confirmed because it provides for payment of post-petition interest at the contract rate, but both legal precedent and the equities of this case compel payment of interest at the federal judgment rate. The Court should deny confirmation pending an

amendment to the Plan allowing for post-petition interest at the average federal judgment rate in effect during the pendency of the bankruptcy.

1. Debtors Failed To Account For The Possibility That Post-Petition Interest May Be Awarded At The Federal Judgment Rate, Potentially Causing Additional Delay.

239. The Debtors' Plan purports to offer the Court only one option for confirmation: interest must be paid to the bondholders at contract rates that are, in at least some instances, twenty times higher than the applicable federal judgment rate. The Modified Sixth Amended Plan incorporates contract-rate interest into its definitions and makes no provision whatsoever for payment of interest on any other basis (except for obligations that do not carry a contract rate.) Plan, § 1.151 (definition of "post-petition interest claim".) Seeking, once again, to maximize recovery to the favored hedge-fund constituency and ignoring both the objections of the Equity Committee and the Court's clear statement in the January Order that it would consider requiring post-petition interest payments at the federal judgment rate, the Debtors made an all-or-nothing bet on their ability to push through a Plan based on contract-rate interest. (*See also* Aurelius Response [Docket No. 8191] ¶ 128 ("If the Court determines that post-petition interest must be paid at the federal judgment rate, then the Court must deny confirmation of the Plan. It cannot re-write the Plan to change the interest rate.")) Thus, any delay created by the need to re-solicit the Plan at the federal judgment rate is attributable solely to the Debtors' intransigent failure to acknowledge the guidance provided by the Court it its January Order.

2. Post-Petition Interest On All Claims Should Be Paid At The Federal Judgment Rate

240. The Equity Committee urges the Court to reconsider its ruling in the January Order that it has discretion to award post-petition interest at the full contract rate. As explained in the Equity Committee's pre-hearing objection, a majority of Courts that have addressed the issue have interpreted the phrase "at the legal rate" in Section 726(a)(5) to mean the federal

judgment rate. (*See* Equity Committee Objection [Docket No. 8073] at 33 (citing cases)). At a minimum, the Court should hold, as it indicated in its January Order, that the default for post-petition interest is the federal judgment rate, and that the Court may only increase to the contract rate based on a showing that such a result would be equitable. *See In re Washington Mutual*, 442 B.R. 314, 358 (Bankr. D. Del. 2011) ("This Court . . .concluded that the federal judgment rate was the minimum that must be paid. . . .but that the Court had discretion to alter it."); *see also In re Coram Healthcare Corp.*, 315 B.R. 321, 346 (Bankr. D. Del. 2004) (holding that the statute provides for interest on a claim equivalent to interest on a money judgment but that the court has discretion to modify this rate based on what is 'fair and reasonable' in a given case).

(a) Debtors Favored Major Creditors And Ignored Fiduciary Obligations To Equity

241. No matter where the burden of proof lies on this issue, however, there is no doubt that the equities in this case favor payment of interest at the lower federal judgment rate. In violation of their fiduciary obligations to all claimants, the Debtors managed the WMI Estate for the benefit of the major creditors to the exclusion of equity. (*See supra* Section III. a. iv.) Because all creditors benefitted from this bias, it is fair and reasonable that all creditors receive post-judgment interest at the lower rate. *In re Coram Healthcare Corp.*¸ 315 B.R.321, 347 (Bankr. D. Del. 2004) (holding that the federal judgment rate should apply to all creditors claims because the misconduct of one major creditor accrued to the benefit of all.) Indeed, application of the federal judgment interest rate is particularly apt in the circumstances of this case because it would shift some of the recovery of the Estates from the favored class of creditors to the disfavored class of equity holders.

242. The majority of WMI's bonds are held by the SNHs and other hedge funds who acquired the debt at steep discounts after the bankruptcy filing. The record shows that after acquiring a large share of WMI's debt, the SNHs positioned themselves as insiders in the

bankruptcy process, with frequent access to the Debtors' management and professionals. This inside access gave these creditors the ability to advocate for their interests and, apparently, the power to get the Debtors to favor those interests above other constituencies.

243. The Debtors' willingness to defer to the SNHs is apparent from the very first in-person negotiation session with JPMC at which terms were exchanged (a session to which, of course, no equity representative was invited.) At that session the Debtors permitted a group of bondholders to present the opening demand to JPMC even though the Debtors' own advisors did not agree with the terms of the offer. (Tr. 7/21 at 141:1-14.) The same willingness to defer to the hedge funds continued right through the final weeks of the negotiation, when the Debtors were asking counsel for the SNHs to negotiate separately with the FDIC (EC 277) and when the Debtors CRO arranged for a face-to-face meeting between Appaloosa and JPMC so that Appaloosa could tell JPMC the final terms on which it would agree to a settlement. (EC 279; Tr. 7/21 at 196:16-197:19.) Notably, the SNHs participated in November and December of 2009 in formulating the 70/30 split of the first tax refund that was the basis for the final settlement agreement with JPMC, a basis that provided for near-complete recovery to creditors and nothing for equity.

244. By contrast, WMI's equity holders were left entirely in the cold by the Estate. Equity was not invited to participate in any settlement negotiations or given access to the Debtors' professionals or advisors during any of the negotiations that led to the GSA or the Plan. The Debtors actively opposed even the formation of an equity committee and, in conjunction with that opposition, told the Court in January 2010 that "As currently presented the Debtor is insolvent." (Tr. of Hearing, 1/28/10 at 12:21-22.) The Debtor presented a detailed analysis intended to demonstrate the billions of dollars by which Estate liabilities exceeded Estate assets, based on financials presented in the Monthly Operating Report for November 2009. (*Id.* at

12:23-17:15.) What the Court did not know at that time, but the Debtors did, was that at the terms of a tentative global settlement with JPMC had already been reached under which the Debtors would likely be within a few hundred million dollars of providing a recovery to equity.

(b) Settlement Negotiations Were Driven By The Hedge Funds' Bottom Line.

245. The impact on the Estates of the Debtors' favoritism toward creditors and disregard for equity is clear. As demonstrated at the evidentiary hearing, the Debtors' allowed the SNHs to drive the negotiations with JPMC and to determine the figure at which the Estates would be willing to settle. Not coincidentally, that figure was also the figure required to make all creditors whole, or nearly-so, while obtaining absolutely nothing for WMI's equity investors.

246. Not one of the demands made on JPMC by the Debtors or the SNHs contemplated a recovery for WMI's equity claimants. Indeed, even very early term sheets drawn up by the hedge funds for a proposed settlement, although characterized by Appaloosa's Jim Bolin as being so rich that they asked for the "cake" and the "ice cream," expressly contemplated that all equity interests in WMI would be extinguished. (Tr. 7/20 at 199:6-12 and 209:7-16.) Of course, the SNHs never *increased* their demands from this point in order to bring a recovery to Equity and the Debtors never sought such a recovery either.

247. JPMC understood perfectly well that the negotiations were being driven by the SNHs who were seeking to hit certain targets for the return on their bond investments. JPMC's Travis Epes, who personally participated in many of the negotiations, testified at his deposition last fall about his perception of the dynamic:

> I should characterize that very little of the term sheet discussion related to the merits of the individual assets but, rather, it was an effort, certainly on the part of a lot of the funds that were trying to be part of the settlement, to achieve certain hurdles of return.
>
> And so they were just talking about splitting assets up in a way that helped them achieve the returns that they were looking for.

> Q: Can you say a little more about what you mean by that? What returns were they looking for?
>
> A: Very substantial returns on the investment they made in their securities, hoping to effect a settlement that was favorable to their side of the equation.
>
> Q: Who is the "they" that you're referring to in this discussion?
>
> A: Well, again- -
>
> Q: WaMu?
>
> A: No. It was Appaloosa, Centerbridge, Owl Creek, Aurelius.

(Travis Epes, 11/12/10 Dep. Tr. at 179:8-180:4; *see also* EC-8.)

248. Of course any effort to obtain any recovery for equity was doomed by this substitution of the goals of major creditors for the merits of the underlying claims. Indeed, term sheets exchanged with JPMC ignored the "business tort" claims that were the most promising source for a substantial payment to equity, implicitly communicating to JPMC that it could obtain a release for these claims if it would agree to a division of the disputed tax refunds that would "achieve certain hurdles of return" for the SNHs.

3. The SNHs' Insider Trading Also Supports Payment Of Post-Petition Interest At The Federal Judgment Rate, At Least For Claims Asserted By Culpable Creditors.

249. The SNHs' enormous profits on their WMI investments are attributable, at least in part, to abuse of confidential information obtained from the Debtors. None of the members of the Settlement Note Holder Group agreed to restrict their ability to trade in the Debtors securities despite their involvement in the bankruptcy, except during limited periods. As a result, these creditors were able to use inside information they obtained from the Estate, including information about the progress of negotiations with JPMC, in the management of their investment portfolios. At least two of the SNHs, Centerbridge and Aurelius, appear to have used this information to acquire additional debt securities shortly after they learned about settlement

proposals from JPMC that would have netted recovery for the estate sufficient to make good on these same bonds. All four of the funds were aware of the generally positive course of the settlement negotiations and were able to rely on this information when determining to hold their large WMI investments. At the same time, the SNHs refused to formally restrict their trading and thus left open an escape hatch in case the negotiations with JPMC fell apart.

250. Even if the Court were not persuaded that the Debtors' favoritism to creditors is sufficient to justify application of the federal judgment rate to all creditors, it should nevertheless apply the reduced rate to claims being asserted by the SNHs.[23] These funds benefitted unduly from their access to the Debtors and to the details of settlement negotiations with JPMC. The Court should not condone this abuse of the bankruptcy process or authorize payment of interest to these funds that would increase by tens or even hundreds of millions of dollars the already enormous profits that they stand to collect on their investments in distressed WMI securities.

251. Aurelius argues that application of the federal judgment rate to only some creditors within a class would constitute disparate treatment of creditors in the same class, in violation of section 1123(a)(4) of the Bankruptcy Code. Aurelius' argument ignores the Court's authority to subordinate or disallow claims based on inequitable conduct. (*See supra* Section III. b. i., and cases cited therein.) Section 1123(a)(4) prohibits discrimination between different *allowed* claims in the same class, but does not impact the Court's authority to determine whether a claim should be allowed in the first instance. Equitable disallowance may be imposed on part of a claim, by, for example, disallowing the portion of the claim attributable to profits on insider trading.. *See Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims*, 160 F.3d 982, 991 (3rd Cir. 1998.). Under this line of authority, the Court has equitable power to

[23] The Equity Committee's request for use of the Federal Judgment Rate with regard to claims of the Settlement Note Holders is not intended to exclude the possibility that the Court would disallow some or all of these claims. *See* Section III B., *supra*.

disallow a portion of the interest claimed by a creditor who has acted inequitably and undoubtedly can do so by requiring that the claim be reduced to reflect a lower post-petition interest rate.

4. Objections Raised By The Debtors And SNHs Are Not Persuasive.

252. In their responses to the Equity Committee's pre-hearing Objection, the Debtors and several of the SNHs contend that payment of interest at the federal judgment rate is not warranted as a matter of law or equity in this case. None of these arguments are availing.

(a) The Facts Of This Case Justify Payment Of Interest At The Federal Judgment Rate.

253. Aurelis and, in their joint brief, Appaloosa, Owl Creek, and Centerbridge (collectively "AOC") argue that the misconduct alleged here is not as egregious as the conflict of interest at issue in *Coram*, and hence cannot justify imposition of federal judgment interest. (AOC Response [Docket No. 8196] at ¶ 46; Aurelius Response [Docket No. 8191] at ¶ 133-136.)

254. These arguments misread *Coram* by attempting to convert an equitable analysis into a bright-line test. Nothing in the *Coram* decision indicates that inequitable conduct must correspond the conduct at issue there or rise to any particular level of misconduct to warrant the lower interest rate. The thrust of the decision, following the precedent from other cases, is that the court must consider all of the relevant facts and circumstances in determining the proper interest rate. *Coram*, 315 B.R. at 346 ("The specific facts of each case will determine what rate of interest is 'fair and reasonable.'") (quoting *In re Dow Corning Corp.*, 244 B.R. 678, 692 (Bankr. E.D. Mich. 1999)).

255. In any event, the misconduct at issue in this case is sufficiently egregious to justify payment of interest at the federal judgment rate rather than the contract rate. The SNHs maintained their ability to trade in the Debtor's securities, and all of them executed trades, while in possession of material, non-public information concerning the multi-billion dollar settlement

with JPMC that was the primary asset of the Estate. The record shows that the SNHs effectively took advantage of their ability, as substantial creditors in a bankruptcy, to gain inside access to the Debtors' operations. The hedge funds then exploited that access to generate and protect enormous profits on their investments. Even if this conduct were not tortuous or potentially criminal, it is an abuse of the bankruptcy process and should be condemned.

256. The Debtors were not only aware of this misconduct, they facilitated it by agreeing to a confidentiality and disclosure procedure that provided a measure of cover for the trading (as the SNHs' disingenuous claims to have relied on the Debtors' disclosures demonstrate.) Most importantly, the Debtors' facilitation of the SNHs' desire to participate in crucial settlement negotiations while preserving their ability to trade at the end of arbitrarily measured confidentiality windows was part and parcel of the Debtors' overall approach to the case, which was to cater to the interests of the major creditors at the expense of other constituencies, including equity. And the imbalance between the Debtors' treatment of their different constituencies unquestionably supports the application of an interest rate that has the potential to shift at least some of the recovery from the favored class to the disfavored one. Contrary to the self-serving arguments of the SNHs, these facts present a paradigm case for the payment of interest to creditors at the federal judgment rate on equitable grounds.

(b) The Court's Finding That The GSA Was Fair And Reasonable Does Not Preclude The Contention That The Amount Of The Settlement Demonstrates Bias In Favor Of Creditors And Against Equity.

257. The Debtors insist that the Court's prior finding that the GSA is fair and reasonable prohibits the Equity Committee from challenging the Debtors' decision to settle for an amount that makes all creditors whole but provides nothing to equity. (Debtors' Confirmation Br. [Docket No. 8121] at 67.) The fair and reasonable finding, however, does not preclude the argument that the settlement evidences favoritism to the creditors. As the Court found in its

January Order, the fair and reasonable test sets a very low bar and requires only that the settlement be at or above the very bottom of the range of reasonable litigation possibilities. *In re Washington Mutual*, 442 B.R. at 328. This test does not require that the Debtors obtain the best possible deal; it says nothing about the goals of negotiation or the possibility of applying greater efforts to obtain a greater return. Such a finding does not eliminate the possibility that the Debtors arrived at a settlement that satisfies the test without adequately discharging their fiduciary responsibility to maximize the recovery for all stakeholders, including equity.

(c) Additional Arguments Raised By The SNHs Are Not Persuasive.

258. Aurelius argues that, even if it is found to have engaged in insider trading based on the Debtors' confidential information, such conduct caused no harm to WMI's equity holders. (Aurelius Response [Docket No. 8191] at ¶ 137.) This argument fails because it ignores the relationship between the insider trading and the Debtors' favoritism to creditors more generally (including, for example, allowing them to participate and direct the course of settlement talks.) This favoritism unquestionably did substantial harm to the equity holders.

259. AOC argues that applying the federal judgment interest rate will provide "a mechanism for out of the money or unhappy constituents to obstruct chapter 11 cases by simply submitting fanciful allegations of wrongdoing." (AOC Response [Docket No. 8196] at ¶ 49.) There is no justification for such alarmism; the claimed "mechanism" has, in fact, been in place for years—as this Court's *Coram* opinion makes plain—and there is no reason to believe that it has been abused by disgruntled claimants or otherwise interfered with the bankruptcy process. Moreover, what the Court has before it on the current record are not "fanciful allegations" but probative evidence of misconduct that should not be ignored.

260. Both Aurelius and AOC insist that *Coram* is not applicable here because, unlike the creditors accused of misconduct in that case, the SNHs have caused no delay here and are

actually harmed by delay. (Aurelius Response [Docket No. 8196] at ¶ 135.) Again this argument reads *Coram* too narrowly as calling for particular types of misconduct. The relief sought by the Equity Committee is appropriate to the misconduct that has been shown to have occurred. Moreover, the SNHs and the Debtors *have* caused substantial delay and expense for the Estate, both by engaging in conduct that ultimately required the investigation into insider trading and by inserting provisions in this Plan and the previous Plan (such as releases favoring the SNHs) that provided unjustified benefits to favored constituents and therefore led to the Court's denial of confirmation – and should lead to the denial of confirmation once again.

5. The Federal Judgment Rate Should Be Determined Monthly Or The Rate At Emergence Should Be Used.

261. This case presents an unusual fact pattern in which interest rates did not just decline but actually crashed shortly after the filing of the bankruptcy petition. The federal judgment rate stood at 1.95% on September 26, 2008, the day of the filing. *See* EC 301. Six weeks later, on November 14, 2008, it was down to 1.12%. *Id.* By the end of the year it had dropped all the way to 0.4%, less than one-forth of the value that it had three months earlier when the petition was filed. *Id.* The interest rate has continued to decline steadily since then and was only 0.18% on June 17, 2011, *less than 1/10th of the value at filing*. *Id.*

262. In these circumstances, the Court should find that the equitable rate for post-petition interest is the rate in effect at the end of each month during which the bankruptcy was pending or, alternatively, the rate at emergence. As the SNHs acknowledge, the purpose of post-petition interest is to compensate creditors for the lack of access to their funds during the bankruptcy. (AOC Response [Docket No. 8196] at ¶ 52, citing *In re Melenyzer*, 143 B.R 829, 833 (Bankr. W.D. Tex. 1992)). The creditors should be paid an interest rate that reflects the return that they would have been able to obtain on their funds if they had received cash on the day the petition was filed because an allowed claim is deemed to be equivalent to a federal

judgment against the debtor issued as of that date. *See, e.g., In re Cardelucici,* 285 F.3d 1231, 1235 (9th Cir. 2002). The inflated interest rate that was in effect at the time of the filing bears no relationship to the creditor's actual loss attributable to delay, and use of this inflated figure would therefore generate a windfall for the creditors. Such a result is anything but equitable.

263. AOC argues, on the contrary, that it would not be a windfall for the creditors to receive interest at the rate on the petition date because their return should be compared not to the prevailing federal judgment rate, but to the contract rate on their bonds. (AOC Response [Docket No. 8196] ¶ 52.) Contrary to the principles announced in the case law, AOC's theory would put it *not* in the position of having received a judgment as of the petition date, but in the position of never having had a judgment against the Debtors at all.

264. More fundamentally, AOC ignores the predicate for this debate: the Court's initial determination that the equitable rate of interest that should be used to compensate creditors is the federal judgment rate, not the contract rate. The return that these hedge fund creditors (most of whom invested only after the petition was filed) would have earned in a hypothetical world in which WMI never declared bankruptcy is irrelevant. The question is *which federal judgment rate* best captures the loss to creditors, (i) the rate in effect on the day the petition was filed, or (ii) the rate(s) actually in effect during the three-year pendency of the bankruptcy.

265. The Debtors and the SNHs argue that the Court has no power to use any federal judgment rate other than the one in effect on the day of the filing. Other cases have looked to the rate on the petition date, but none of those cases involved a near-immediate crash in rates generating such an enormous disparity between the initial rate and the rate in effect over the course of the bankruptcy. Given the Court's general equitable authority to determine the proper rate under all of the circumstances of the case, as explained in *Coram*, *Dow Corning*, and other

decisions, the argument that the Court has no authority to deviate from the arbitrary rate in effect on the date of the petition is baseless.

D. Reorganized WMI Is Undervalued.

1. The Valuation Of Reorganized WMI Must Take Into Account All Assets, Including The NOL.

266. For purposes of plan confirmation, the value of the debtor's estate is determined as of the effective date of the plan. *In re PWS Holding Corp*., 228 F.3d 224, 244 (3d Cir. 2000); 7 *Collier on Bankruptcy* ¶, 11129.05[2][e] at 1129-154 (16th ed.). The court's determination of value is not limited, however, to a review of only those facts and circumstances that exist as of the effective date. Rather, under long established Supreme Court precedent, the Court must consider all specific, predictable and foreseeable circumstances in determining the value of a reorganized debtor. *Protective Comm. for Ind. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 452-53 (1968). Specifically, the court's determination:

> must be based on an informed judgment which embraces *all facts relevant to future earning capacity* and hence to present worth, including, of course, the nature and condition of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance.

Consol. Rock Prod. Co. v. Du Bois, 312 U.S. 510526 (1941) (emphasis added). A full accounting of all factors is especially important here given the magnitude of the assets in question – approximately $6 billion of NOLs. Indeed, this Court has previously recognized that "NOLs can be a reorganized debtor's largest asset." *In re Coram Healthcare Corp*., 315 B.R. 321, 341 (Bankr.D.Del. 2004).

267. In their pretrial brief, the Debtors cited a handful of cases for the proposition that valuation of NOL carryforwards must take into account the associated risk of disallowance. (Debtors' Confirmation Br. [Docket No. 8121] at 89-90 n.32.) The Equity Committee does not dispute that the present value of the NOLs should reasonably account for any such material risk.

However, the Debtors' argument relegating the substantial likelihood that the Reorganized Debtor will utilize the $6 billion of NOLs to "purely hypothetical" status such that the Court cannot consider it when determining the value of the Reorganized Debtor is simply preposterous. (*See Id.* at 98). The Debtors cite two decisions, neither of which supports their extreme position. In *Coated Sales, Inc. v. First Eastern Bank, N.A.*, 144 B.R. 663, 668 (Bankr.S.D.N.Y. 1992), the valuation at issue was done for the purpose of an adversary proceeding to recover a preferential transfer under section 547 of the Bankruptcy Code. That decision had nothing to do with valuing a reorganized debtor under section 1129 of the Bankruptcy Code and, therefore, it is inapposite here. Similarly, *Gretz v. Inner Spirits, Inc.*, 2011 WL 1048635 (Bankr.D.Del. Mar. 18, 2011), also cited by the Debtors, has nothing to do with valuation of a reorganized debtor, but rather, the extent to which a claim was secured under section 1331(b)(2) of the Bankruptcy Code for purposes of a Chapter 13 plan. *Id*. at *3-4. The paltry, inapposite authority cited by the Debtors does not preclude this Court from considering the Reorganized Debtors' clearly foreseeable efforts to maximize the value of the NOLs. To ignore that eventuality is to ignore reality.

2. The Debtors Have Intentionally Undervalued WMI.

(a) The Assumptions Underlying Blackstone's Report Are Inappropriate.

(i) Blackstone's $127MM Cap Is Wholly Arbitrary And Unwarranted.

268. The Debtors estimate that Reorganized WMI will have $2 Billion in unlimited NOL carryforwards that can be used to offset income taxes for the next 20 years. (Tr. 7/13 at 110:3-9.) Through the use of unwarranted assumptions designed to lower the value of WMMRC, the Debtors once again fail to even analyze the value of this large NOL.

(1) The Debtors' Have Again Imposed Arbitrary Limits On The Value Of Reorganized WMI, As They Did In The Previous Plan

269. In this Court's decision denying confirmation of the Sixth Amended Plan, the Debtors were criticized for making an artificial assumption regarding the emergence date that caused them to fail even to *analyze* the full value of the NOL carryforward. *See In re Washington Mutual, Inc*., 442 BR 314, 361 & n.47 (Bankr. D. Del. 2011) (noting that if emergence occurred in January 2011 "the Debtors could potentially have the full use of their approximately $5 billion in NOLs" but "[t]he Debtors' valuation expert acknowledged that based on the business plan and projections for the Reorganized Debtor which assumed emergence before December 31, 2010, <u>his valuation did not consider the ability of the Debtors to use more than $100 million of their NOLs")</u>.

270. The Debtors' newest valuation repeats the same error through another unwarranted assumption that eviscerates the value of the NOL. This time, Blackstone's report assumes that there will be a $127 million "cap" on the aggregated size of future capital raises and investments in WMMRC, even though the NOLs can only be fully utilized through new capital raises and investments. (Tr. 7/13 at 302:2-5.) Blackstone imposed this cap because it could not get an opinion of counsel that an investment above that amount would more likely than not comport with Section 269 of the IRS Code. (*Id.* at 302:23-304:1.) As discussed below, this new assumption is wholly arbitrary and unwarranted. As before, the effect of the assumption is to avoid valuing the potentially largest asset of the reorganized estate: the $2 billion NOL that can only be utilized through the "rais[ing] more capital to bring in additional income producing assets." (*Id.* at 299:17-18.)

(2) The Debtors' Valuation Incorporates A Limit On The Investment Of Additional Capital In Reorganized WMI Based On A Vague And Inapposite Tax Opinion From Another Expert.

273. The Debtors' valuation expert Steven Zelin limited his valuation by capping the potential investment into Reorganized WMI at the value of WMMRC. Mr. Zelin purported to

limit the investment in this fashion to avoid running afoul of section 269 of the Internal Revenue Code. This section authorizes the IRS to disallow the use of net operating loss carry forwards when the principal purpose of the acquisition of control of a business is the avoidance of federal income tax.

274. Mr. Zelin explained that he imposed this limitation solely as a result of the opinion of the Debtors' tax expert, Richard Reinhold. Mr. Reinhold opined that "if Reorganized WMI raises additional capital in an amount no greater than the value of its non-tax assets and the Internal Revenue Service (the "IRS") asserts the application of Section 269, it is more likely than not that a court would determine that the principal purpose for the acquisition of Reorganized WMI was not tax avoidance." Debtor 404 at 4. Notably, Mr. Reinhold could not opine that raising capital in an amount exceeding the value of WMMRC would more likely than not result in the IRS disallowing the use of NOLs. *Id.* Mr. Reinhold also admitted that section 269 imposes no per se cap on the investment that could be made in WMMRC post-emergence. (Tr. 7/13 at 217:19-23.) Despite the inconclusive nature of this opinion, and the lack of any assertion that a larger investment was likely to impair the value of the NOL, Mr. Zelin limited his valuation of the reorganized Debtor by the assumption that tax law would prevent a capital investment of over $127 million.

(3) Section 269 Has Minimal Importance in Tax Law And Should Not Be Interpreted To Establish An Absolute Limit On Future Capital Investments In Reorganized WMI.

275. Mr. Reinhold likely could not give a more definitive opinion on the application of section 269 because the statute plays virtual no role in modern tax law. Indeed, in more than 30 years tax advisory practice, Mr. Reinhold testified that he has never been involved in any transaction in which the IRS has asserted section 269, has never sought a ruling from the IRS on

the application of section 269, has never corresponded with the IRS on behalf of a client with respect to the application of section 269, and has never worked on any tax litigation involving section 269. (Tr. 7/13 at 211:5-213:22.) Moreover, despite the fact that the "principal purpose" test under section 269 is a fact-based test, Mr. Reinhold admitted that he could not find a single apposite case to support his opinion. (*Id.* at 221:10-16.)

276. The Equity Committee's tax expert, Kevin Anderson, also testified that in 30 years of tax advisory, section 269 has never been "front and center," even if always considered. (Tr. 7/13 at 137:10-21.) Mr. Anderson testified that, in his opinion, the reason for the greatly diminished importance of section 269 in modern tax law is the more specific statutory tool contained in the more recently enacted section 382 of the Internal Revenue Code. (*Id.*)

277. Notably, in *In re Coram*, where it was recognized that an NOL can be the "largest asset" of the estate, no party asserted—and this Court did not entertain—the argument that section 269 somehow reduced the NOL.

(4) At Minimum, Blackstone Should Have Applied A Risk-Adjusted Value To The NOL For Investments Above The $127 Million Cap.

278. Even if there were a material risk that Section 269 might prohibit investments in new entities notwithstanding the sufficient non-tax reasons to invest (which there is not), there is no justification for assigning zero value to the possibility of raising more than $127 million to generate new income sources. Mr. Zelin testified that the $127 million cap was imposed because tax counsel would not give a "more likely than not" opinion that investments above that amount would comport with Section 269. (Tr. 7/13 at 302:23-304:1.) As a result, Blackstone assigned <u>zero</u> value to investments above $127 million. That conclusion does not follow from that premise.

279. The proper technique, followed by this Court in *In re Coram*, is to assess the likelihood of the risk occurring and then to discount the value of utilizing the full NOL by that likelihood – even if that likelihood is less than 50% (or not "more likely than not"). In *In re Coram*, this Court credited testimony that there was a good chance that the consolidated tax basis of the debtors might, from a tax perspective, eviscerate the NOL carryforwards. *See In re Coram Healthcare Corp.,* 315 BR 321, 342 (Bankr. D. Del. 2004) ("If the Debtors were required to treat the reduction of debt on a consolidated basis, much of the NOLs would be lost."). However, rather than assigning zero value to the NOLs, this Court correctly applied a 70% reduction to the value of the NOL by reducing the $33 million present value of the NOL to $10 million:

> Recognizing that there is a level of risk associated with the NOLs, we conclude that it is proper to value them in accordance with the testimony of Patrick Hurst ("Hurst"), the Noteholders' rebuttal witness. Although Hurst testified that the NOLs should not be utilized because no buyer would pay for them, he opined that the risk adjusted present value is approximately $10 million. We conclude that $10 million is a fair valuation of the Debtors' NOLs, which should be added to the value of the Debtors being retained by the Noteholders.

Id.

280. Just as in *In re Coram*, if there were a material risk that section 269 would prevent utilization of the full NOL (which there is not), the proper method would be to assign a "risk-adjusted present value" to the use of the NOL above $127 million and to multiply the total present value of the NOL -- $450 million – by the likelihood that the NOLs will be utilized. Mr. Maxwell testified that there is no recognized practice in the valuation field of requiring a "more likely than not" tax opinion as a precondition to assigning any value to the NOL – and indeed, he had never seen a valuation that appended a "more likely than not" tax opinion from a major firm. (Tr. 7/15 at 52:17-53:10 ("If that criteria were involved in every valuation in bankruptcy, I don't think you'd ever have any attribution of value to a NOL")). Rather, if there were, for example, a 20% chance of utilizing the NOL the one should simply multiply the full value of the NOL by

20% to arrive at a valuation of the NOL. (Tr. 7/15 52:11-15.) This Court followed the same method in *In re Coram*. And, notably, one of the SNHs – who is in the best position to evaluate the likelihood of there being sufficient investments to utilize the NOL – applied this very method by running spreadsheets that assigned a $100 million value to the NOL on the theory that there was a 20% chance that the NOL would be utilized and a $500 present value of the NOL prior to applying a 20% factor. (Tr. 7/15 at 51:20-52:10.)

(ii) Blackstone Again Assumes No New Business And Debtors Propose No Business Plan.

281. Based on instructions from the Debtors, Blackstone once again assumes that WMMRC will take on no new business and will operate simply as a run-off company. (Tr. 7/13 at 308: 15-18.) Indeed, Blackstone was never presented with a business plan for WMMRC and WMMRC has no business plan. (Tr. 7/13 at 176:16-19; 278:5.) Again, in the opinion denying confirmation of the last Plan, this Court criticized the Debtors for providing Blackstone with projections that failed to consider new business that the Debtors might take on:

> The expert acknowledged that his valuation was based only on the cash flows expected to be generated by the runoff of the insurance assets currently held by the Reorganized Debtor and did not consider that the Reorganized Debtor might start or acquire another business. (Tr. 12/6 at 32.) The fact that the Reorganized Debtor is raising new capital through the rights offering suggests otherwise.

442 B.R. at 360-61. Notwithstanding this admonition, the Debtors continue to assume that the company will operate in run-off and will acquire no new business. Curiously, at the end of Blackstone's report, Blackstone performs a "corporate opportunity" valuation that seems to assume that Blackstone will generate new income, but Blackstone does not import this assumption into the rest of its report by valuing the company as a going concern nor does it bother to do any financial analysis of the non-tax value of generating new income. This repeats the exact same error criticized by this Court previously. As a result, Blackstone fails to capture

the higher value that the company would have if operated as a going concern. As Mr. Maxwell explained, a company that is valued as a going concern "inherently has greater value" because of the potential for future cash flows that is reflected in the "terminal value" of the company and the increased value of going concerns that is reflected in the precedent transaction analysis. (Tr. 7/15 at 54:20-55:4; 47:1-18.) Even though Blackstone seemed to acknowledge that the Company will attempt to generate new income streams, Blackstone failed to analyze the company as a going concern – and as a result failed to analyze the increased inherent value that a going concern has.

282. To be clear, the fault lies with the Debtors, not Blackstone. The Debtors failed to provide Blackstone with a business plan, thereby forcing Blackstone to value the company as a run-off entity. The gist of PJS's critique is that that "the business could be operated as a going concern, and as a going concern, would reasonably have greater value than reflected in the liquidation analysis that is the focus of the Blackstone valuation." (Tr. 7/15 at 37:3-7.) As Mr. Maxwell explained, if the future owners "are at all sophisticated and looking to maximize the return on their residual investment in the estate, . . . they would be compelled to investigate this opportunity" of operating company as a going concern "and in due course pursue the opportunity." (*Id.* at 50:1-14.) Incredibly, the Debtors fail to provide Blackstone with a business plan that even attempts to maximize the value of the estate, even though Blackstone assumes in a different part of its report that the company will generate new income.

(iii) Blackstone Fails to Consider Debt Raises.

283. Blackstone's analysis assumes that no debt will be raised and that the entire $127 million investment will be generated through an equity raise. (Tr. 7/13 at 305:1-2.) This is yet another unreasonable assumption that artificially deflates WMMRC's value. "[D]ebt, by definition, is . . . generally speaking, less expensive than equity capital." (Tr. 7/15 at 45:16-21.)

Here, the current market rate for debt is six percent, whereas, according to Blackstone's assumptions, the company must pay back equity investors 13-15% or even 25-35% in returns. Thus, no reasonable business owner would conduct an equity raise without a corresponding debt raise. Moreover, a debt raise of at least 40% of the value of the company is "a supportable level of leverage" based on "transactions in the market." (*Id.*, Tr. 7/15 at 40:9-18.) Accordingly, there is no justifiable reason for Blackstone to assume that the entire capital raise will be procured through an equity raise, when a debt raise is both feasible and more profitable for the company.

(iv) Blackstone's WACC Rates Are Far Too High.

284. Blackstone could not settle on an appropriate Weighted Average Cost of Capital in its report: in one part of the report, Mr. Zelin assumes 13-15%; at another part, he assumes 25%-35%; at another part, including the adjustment he makes, he assumes an effective discount rate above 50 percent. (Tr. 7/13 at 314:24-315:1; *id.* at 332:6-9; Tr. 7/15 at 55:21-23.) All of these are too high: 12% is the right number for the WACC, as the Debtors assumed it to be in March 2010 before they had an interest in lowering the valuation. (*See* EC 283; Tr. 7/13 at 323:17-324:3.)

285. The WACC rate is a key component of the valuation because the equity rate effectively equals the interest rate at which the Company must pay back new investors. Accordingly, the lower the WACC the higher the valuation of the company, all else being equal. (Tr. 7/13 at 314:8-11.) In arriving at its inflated WACCs, Blackstone completely disregarded the large downward shifts in the 2-year WACC averages and in distressed insurers that have occurred since the time of Blackstone's last report. (Tr. 7/13 at 317:6-14.) This data was disregarded even though Blackstone's reports consistently charted these figures and professed to look at "the universe of insurance companies," (Tr. 7/13 at 264:17), and even though the 2-year

average would do a better job of achieving the stated goal of disregarding fluctuations "from the volatility in the markets" experienced in the industry in 2008 and 2009. (Tr. 7/13 at 321:7-11.)

286. Indeed, it simply makes no sense to assume that an investor in an industry with 8-12.5% returns on equity will expect 25-35% returns on its investment. When pressed on how an investor could expect to earn far more than what is commonly earned in the industry, Mr. Zelin could only point to the "benefit of leverage" debt. (Tr. 7/15 at 326:19-22.) But the benefits of leveraged debt cannot help Blackstone's analysis because Blackstone assumed that no debt would be raised by WMMRC. Confronted with this fact, Mr. Zelin noted that the return on equity rate would increase beyond industry averages through "the future addition or expansion of business." (Tr. 7/13 at 329:13-17.) But again, Mr. Zelin was forced to acknowledge that Blackstone's report also fails to evaluate these growth opportunities. (Tr. 7/13 at 329:22-25.) In the end, Blackstone is left with the untenable assumption that equity investors will expect far more returns than is justified by anything in its report, which high rate of expected equity return is used by Blackstone to lower the value of the company.

287. To make matters worse, as explained below, Blackstone applies an amorphous downward "adjustment" to the final corporate opportunity valuation, which double-counts the risks already accounted for in the high WACC and results in an astounding 50% effective discount rate.

(b) Blackstone's Corporate Opportunity Valuation Is Flawed And Incomplete.

288. Blackstone's corporate opportunity valuation is a far cry from the detailed analysis carried out in PJS's Report: whereas PJS analyzed how a modest debt and equity raise would impact the value of the company operated as a going concern, Blackstone simply calculates the present value of the tax savings generated by a $127 million equity raise. Somewhat incredibly, Blackstone values the company on the assumption that it will generate no

new business and yet assumes, for purposes of the corporate opportunity valuation, that the Company will generate new income through capital raises. Where PJS analyzed debt rates and equity returns to deduce both the NOL and non-NOL value of the company, Blackstone considered only the NOL savings generated by the new business investments and made no analysis of the Company's non-NOL going concern value. This failure to consider the non-NOL consequences of the corporate opportunity valuation caused Blackstone to implausibly assume that an investor with 25-35% expected return would invest in a company with 12% expected returns. In an unnoticed irony, Blackstone's implausible assumptions make it clear that no investor would ever have a non-tax purpose for investing in the Company – for an investor with 35% expected returns would not invest in a company with 12.5% returns if there were no tax benefits to doing so.

(c) PJS Shows That The Minimal Value For WMMRC Is $275 Million.

289. The principal expert opinion offered by PJS is that if WMI is treated as a going concern that makes a modest debt and equity raise, then WMI is worth $275 million rather than $160 million, as reflected in the Blackstone report. (Tr. 7/15 at 148.) The Debtors do not meaningfully quarrel with PJS's analysis.[24] Rather, they principally argue that it is "speculative"

[24] In response to the Debtors' charge that PJS failed to account for the initial costs and risks of restarting the company as a going concern, Mr. Anders explained that (a) the WACC takes into account the costs and risks of operating the company and (b) bankruptcy valuation experts commonly agree that the WACC should not be distorted by placing too much weight on the risks and costs attendant to every emergence because for the vast majority of the debtors' reorganized existence, the company will not be any more risky or costly than any other similar company, so "it's appropriate to look at a stable long-term cost of capital in valuing these businesses as they emerge from bankruptcy." (Tr. 7/15 at 152). Nor is there any flaw in PJS's decision to show income in the first year; notably, Blackstone does the exact same thing in its corporate opportunity valuation and both PJS and Blackstone are justified in doing this to account for the vagaries of emergence. Of critical importance, the debtors presented no evidence or testimony that any of their misbegotten quibbles would have a material impact on PJS's monetary conclusions – and none does. Thus, it is not contested that if the company is operated as a going concern, it will have significantly more value.

to assume that the equity and debt raise will occur and that the company will operate as a going concern. This argument has no merit.

290. First, regarding the equity raise, it is reasonable to assume that WMRRC will be able to raise $140 million in equity because: (a) similar recent transactions in the industry support this; (b) the Debtors assumed in December that a $140 million equity raise was feasible and assume this time that $127 million raise is feasible; (c) the tax advantages of WMMRC will attract investors (but will not be their principal purpose for investing); (d) many of the future owners are wealthy enough that they could back the loan on their own if they wish (through pro rata contributions) – as the SNH already offered to do. (Tr. 7/15 at 42-43.)

291. Second, regarding the debt raise, it is reasonable to assume that the debt raise will occur because (a) debt raises are more profitable for a company than equity raises and (b) the debt raise assumed in the PJS report gives the company a .4/1 ratio of debt to equity, which is common in the industry. (Tr. 7/15/11 at 45.)

292. Third, regarding operation as a going concern, it is reasonable to assume that this will occur for the simple reason that the company is more <u>profitable</u> as a going concern. While the Debtors quarrel with some of the details of the PJS analysis, it is uncontested that a company that operates as a going concern has greater intrinsic value than a run-off company. This is especially true in a company, such as this, that can generate tax-free income, which only adds to the value of the company operating as a going concern.

293. In sum, PJS's assumptions are far from "speculative": to the contrary, all that is assumed is that the future owners will want to make money and that their investments will follow currents trends in the market. There is nothing remotely speculative in either assumption.

294. The real oddity, of course, is not that PJS places a value on the business from the perspective of a business that wants to make money, but that the Debtors do not even bother to

put forward any business plan that would allow the company to make money. The Debtors have the audacity to move to strike PJS's report on the ground that it is "speculative", even though PJS's report is unquestionably less speculative than Blackstone's corporate opportunity valuation, in which Blackstone simply assumes that the Debtor will conduct an equity raise and generate income, without doing any analysis of how the income will be generated or the non-tax consequences of that income generation. Blackstone then applies an unexplained "adjustment" to the NOL savings to reflect the fact that "this value is nothing more than an option value," of which no explanation is given. (Tr. 7/13/11 at 277:16-18.) The only proffered rational for this adjustment, and for the WACC figures upon which corporate opportunity value is based, is that "valuation is an art not a science." (Tr. 7/13 at 315:9-10.) If Blackstone's "art" merits any weight, PJS's science clearly merits more. Accordingly, the Debtors' augments against PJS only further weaken Blackstone's analysis.

295. PJS also opines that if the NOLs are used in the next 15 years, they will have a net present value of $365 million. This is uncontested. Further, PJS opines that wealthy owners are in the best position to utilize the entire NOL because they have the most access to debt capital and can make their own equity raises to fuel investments. This is also uncontested. The testimony at trial established that the Settlement Noteholders have the motive, means and opportunity to utilize much if not all of the NOLs: as future owners, they clearly have the motive to maximize the company's value; as wealthy hedge funds, they have the means to do so; as both, they will have the opportunity to do so provided there are sufficient non-tax reasons at some point in the next 15 years to make the investments and acquisitions. These facts are amply established by the record: Centerbridge and Appaloosa discussed infusing their own capital into the company; Owl Creek ran spreadsheets assigning a 20% chance to the entire NOL being utilized.

(d) Debtors' Strong Incentive To Devalue WMMRC Undermines The Credibility Of Their Valuation.

296. In nearly every bankruptcy case, Debtors have an incentive to undervalue the reorganized company and courts weigh the parties' incentives to overvalue or undervalue the company in fixing the value. *See In re Exide Technologies*, 303 BR 48, 66 (D. Del. 2003) (noting that debtors allegedly undervalued the reorganized debtor and the creditors committee allegedly overvalued it and reaching a valuation that took into account "the competing incentives of the parties to either overvalue or undervalue the company"). As evidenced by the series of unwarranted, devaluing assumptions made by the debtors in the case, the debtors have acted with an extreme bias in this case toward undervaluing the company. The Debtors' steadfast determination to appease the major creditors in this case – who seek to take over the company at a discount price in such a manner that they will not have to share it with equity holders – has only exacerbated their bias.

297. The Debtors' conduct throughout this case has demonstrated a heightened willingness to devalue WMMRC and to accede to the SNHs' desire to take over the company at a discount price. Shortly after Blackstone was first hired, Blackstone met with at least two of the SNHs to learn "their views of the NOL opportunity" and "whether they were committing capital." (Tr. 7/13 at 336:11-15.) The Debtors told Blackstone that these SNHs would be the right creditors to speak to because they were "the larger holders in the case" and they "had been spending a significant amount of time in negotiating and prosecuting the restructuring." (Tr. 7/13 at 335:3-22.) Meanwhile, Appaloosa and Centerbridge discussed infusing capital into WMMRC through pro rata contributions in order to acquire other businesses or to acquire new policies under the existing business. (Tr. 7/20 at 183:14-21). And Owl Creek ran frequent spreadsheets assuming that the Company had a 20% chance of using all the NOLs. Not only did the Debtors present successive valuations that failed to even consider the value that such

investments would add to the company, the Debtors inserted a provision in the last Plan – rejected by this Court – that would preclude all but the largest PIERS holders from participating in WMMRC, thus ensuring that large owners would be the sole beneficiaries of the estate.

298. Moreover, the Debtors consistent pattern of making unwarranted assumptions to devalue the company undermines the credibility of the valuation. The Debtors bear the burden to establish the company's value and the debtors have failed twice to meet this burden. PJS alone attempted to place a value on some of the benefits of operating WMMRC as a going concern, yielding an average valuation range of $275. Because this value is based only on one scenario – and does not represent the full value of the Debtor under a business plan -- this is a floor for WMMRC's value. (Tr. 7/15 at 50:21-51:6). Given that the Debtors have failed twice to offer a reasonable valuation – many times for the exact same reasons previously criticized by this Court – the Court should respectfully assume that the full NOL will be utilized in the next 10-20 years, yielding a valuation of $485 million – i.e., the portfolio value of $127 million plus the $358 net present value of utilizing the NOL in 15 years (EC 152, p. 13).

E. <u>The Modified Plan Improperly Conditions Distributions On Claimants' Agreement To Third-Party Releases.</u>

299. The Equity Committee argued in its Confirmation Objection that the conditioning of distributions on claimants' agreement to the Plan releases violates section 1129(a)(7) of the Bankruptcy Code. (Equity Committee Objection [Docket No. 8073] at 39-41). In response, the Debtors criticize the Equity Committee for even raising the issue "<u>because holders of Equity Interests are not receiving any distribution pursuant to the Modified Plan, they are not being asked to grant third party releases and will retain their claims against such parties</u>." Debtors' Confirmation Br. [Docket No. 8121] at 72 (emphasis in original). The Debtors, however, solicited votes from holders of Preferred Equity Interests, who were also given an opportunity to

elect whether to grant the Plan releases, with the understanding that such elections and releases would become effective only when such holders "begin receiving distributions pursuant to the Modified Plan." (Supp. Disclosure Statement [Docket No. 6697] at 13; *see also* Class 20 Ballot attached as Exh. 12 to Disclosure Statement Order [Docket No. 7081].) To the extent that distributions to Preferred Equity holders and their release elections remain open issues, the Equity Committee must press its objection.

300. In *In re Conseco*, 301 B.R. 525, 528 (Bankr. N.D. Ill. 2003), the Court determined that conditioning receipt of distributions upon creditors' agreement to a release of non-debtors violated the best interest of creditors test under section 1129(a)(7)(ii) of the Bankruptcy Code. *See also In re Adelphia Communications Corp*., 368 B.R. 140, 275-76 (Bankr. S.D.N.Y. 2007) ("This "carrot and stick" provision, by which a creditor is offered an inducement to vote on plan of reorganization, is not inconsistent with any provision of the Code – though I'd prefer to qualify that general statement to make it applicable *if (but only if) the inducement is to give a stakeholder more than it would be entitled to, rather than to threaten to take an existing right away.*") (emphasis added)); *In re Monroe Well Serv., Inc*., 80 B.R. 324 (E.D. Pa. 1987) (non-debtor third party release permissible where creditors were permitted to render individual decisions whether to provide a release to non-debtors in return for additional distribution provided by non-debtor plan funders); *In re AOV Indus., Inc.,* 792 F.2d 1140, 1150 (DC Cir. 1986) (third party releases proper where creditors granting release would receive estimated distribution of 13% whereas creditors rejecting the third party release would receive estimated distribution of 4%). The Equity Committee would urge this Court to reject the Debtors' requirement that equity holders must agree to grant the Plan releases in order to be eligible to receive distributions to which they are otherwise entitled.

F. <u>The Modified Plan Distributes Estate Assets To WMB Bondholders Who Are Not Properly Classified As Creditors.</u>

301. The Equity Committee also objected to the Plan's proposed distribution of $335 million to the holders of WMB Senior Notes on the basis that they do not hold legitimate claims against the Debtors. (Equity Committee Objection [Docket 8073] at 47.) In response, the Debtors simply offer their opinion: "Ultimately, the Debtors determined it would be in the best interests of the estate to settle such claims." (S*ee* Debtors' Omnibus Response [Docket No. 8186] Exh. A at 5.) However, the Debtors have not introduced any evidence at trial on the Modified Sixth Amended Plan in support of their proposed settlement that would even begin to satisfy their burden. *See In re Martin*, 91 F.3d 389, 393 (3rd Cir. 1996) (stating proposed settlement must be reviewed in light of (1) the probability of success in the litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience, and delay necessarily attending it; and (4) the interest of creditors; *In re Spansion*, 2009 WL 1531788, at *4 (Bankr. D. Del. June 2, 2009) (the settlement proponent bears the burden of persuasion that the proposed settlement is fair and equitable and in the best interest of the estate). To be informed, the Court "must be apprised of all relevant information that will enable it to determine what course of action will be in the best interest of the estate." *In re Key3Media Group, Inc.*, 336 B.R. 87, 92 (Bankr. D. Del. 2005). That is, the Court's judgment must be based upon an "adequate factual record." *See Arkoosh Produce*, 2003 WL 25273746, at *8 (Bankr. D. Idaho July 1, 2003); *In re Lion Capital Group*, 49 B.R. 163, 176, 189 (Bankr. S.D.N.Y. 1985) (requirement that record contains adequate information set forth in sufficient detail to enable approval of settlement). Here, the Debtors have failed to establish an adequate factual record upon which this Court could review and determine the proposed settlement with the holders of WMB Senior Notes is fair and reasonable.

G. The Court Should Reconsider Its Finding That The GSA Is Fair And Reasonable Based On The DC Circuit's ANICO Decision.

302. In its Objection, the Equity Committee urged this Court to reconsider its finding that the Plan and GSA is fair and reasonable, which was based, at least in part, on the prior decision of the District Court of Columbia's decision that claims against the FDIC and JPMC were preempted under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. Equity Committee Objection [Docket No. 8073] at 47-48. The District Court of Columbia's decision has been recently overturned opening the door once again for the prosecution of potentially multi-billion dollar claims against JPMC. *See Am. Nat'l Ins. Co. v. FDIC*, 642 F.3d 1137 (D.C. Cir. June 24, 2011). The Equity Committee would urge this Court to reconsider its prior findings as a result of this new significant development.

IV. CONCLUSION

303. For the foregoing reasons, the Modified Sixth Amended Plan should not be confirmed.

Dated: August 10, 2011
Wilmington, Delaware

ASHBY & GEDDES, P.A.

/s/ Gregory A. Taylor

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William P. Bowden (DE Bar No. 2553)
Gregory A. Taylor (DE Bar No. 4008)
Stacy L. Newman (DE Bar No. 5044)
500 Delaware Avenue, 8th Floor
P.O. Box 1150
Wilmington, DE 19899
Telephone: (302) 654-1888
Facsimile : (302) 654-2067
wbowden@ashby-geddes.com
gtaylor@ashby-geddes.com
snewman@ashby-geddes.com

Delaware Counsel to the Official Committee of Equity Security Holders of Washington Mutual, Inc., et al., and with respect to the Settlement Note Holders, only as to Centerbridge Partners, L.P., Appaloosa Management L.P., and Owl Creek Asset Management, L.P.

-and-

SUSMAN GODFREY, L.L.P.

Stephen D. Susman (NY Bar No. 3041712)
Seth D. Ard (NY Bar No. 4773982)
654 Madison Avenue, 5th Floor
New York, NY 10065
ssusman@susmangodfrey.com
sard@susmangodfrey.com

Parker C. Folse, III (WA Bar No. 24895)
Edgar Sargent (WA Bar No. 28283)
Justin A. Nelson (WA Bar No. 31864)
1201 Third Ave., Suite 3800
Seattle, WA 98101
Telephone: (206) 516-3880
Facsimile: (206) 516-3883
pfolse@susmangodfrey.com
esargent@susmangodfrey.com
jnelson@susmangodfrey.com

Co-Counsel to the Official Committee of Equity Security Holders of Washington Mutual, Inc. et al.

-and-

SULLIVAN HAZELTINE ALLINSON LLC

/s/ William D. Sullivan
William D. Sullivan (DE Bar No. 2820)
901 N. Market Street, Suite 1300
Wilmington, DE 19801
Telephone: (302) 428-8191
Facsimile: (302) 428-8195
Email: bsullivan@sha-llc.com

Conflicts Co-Counsel for the Official Committee of Equity Security Holders of Washington Mutual, Inc., et al., as to Aurelius Capital Management, L.P.