IN THE UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re: WASHINGTON MUTUAL, INC.,[1] *et al.*, Debtors.	Chapter 11 Case No. 08-12229 (MFW) Jointly Administered
NANTAHALA CAPITAL PARTNERS, LP et al., individually and on behalf of all: holders of Litigation Tracking Warrants originally issued by Dime Bancorp, Plaintiffs, v. WASHINGTON MUTUAL, INC. et al., Defendants.	Adv. Pro. No. 10-50911 (MFW)

DEFENDANTS' POST-TRIAL BRIEF

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

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I. PRELIMINARY STATEMENT

Plaintiffs have failed to prove their ever-shifting theories that a litigation tracking warrant is not an equity warrant. The evidence proves that the intent of the Dime Litigation Tracking Warrants ("LTWs") was to give the holders the right "to receive . . . shares of Washington Mutual common stock," exactly as provided in the Warrant Agreement itself. Ex. 4, at 1 (2003 Warrant Agmt.).[2] Plaintiffs' contentions that WMI has failed to "protect" their interests and that they have been "disenfranchised," Pl. Br. at 55, are empty rhetoric. The LTWs are common equity interests, and the holders, including the plaintiff hedge funds who bought into these esoteric penny stocks *after the bankruptcy in the hope of using litigation to create windfall profits*, have no entitlement to any greater priority in bankruptcy.

In opposing summary judgment, Plaintiffs argued that they needed to take discovery from the drafters of the Warrant Agreement to ascertain the intent of the instrument. In particular, they sought to asked to depose Mitchell Eitel, the Sullivan & Cromwell lawyer hired by Dime Bancorp, Inc. ("Dime") in 2000 to prepare the 2000 Warrant Agreement and the Registration Statement for the Dime common stock issued to satisfy the LTWs. Jan. 7, 2011 Op. at 11. Plaintiffs took the deposition of Mr. Eitel, but their trial presentation and post-trial brief conspicuously excluded his testimony. The reason is that Eitel's testimony effectively guts their entire case, demonstrating that the intent of the LTWs was not to convey any direct right to receive 85 percent of the proceeds of the Anchor Litigation, as Plaintiffs claim, but rather to convey an equity interest in Dime (and later, WMI) which tracked the value of any eventual goodwill

[2] Defendants refer to the trial exhibits as "Ex." Unless otherwise noted, the trial exhibit citations herein refer to the original pagination for the documents cited.

litigation recovery. When Plaintiffs asked Mr. Eitel point blank to describe his understanding of the LTWs, he provided a crisp, clear and credible answer:

> Q. Okay. Let's just take a step back and, without reference to the documents, could you just describe your understanding of how the LTWs – the Dime LTWs were supposed to work?
>
> A. I have only – only a sketchy recollection. So I'm not going to dive into specific details of things like the formulas and the like, but—
>
> Q. Let me just – yes, whatever your recollection is, that's fine.
>
> A. Like I said, I don't remember if it was 85 or 80, because I haven't looked at these documents in 12 years. *But the purpose, to me, was, as I stated, to preserve the interest as equity holders of certain Dime shareholders, as distinct from others, in the potential value of a recovery by Dime of – in its then-pending goodwill litigation against the government.* So, you know, for example, if I am a stockholder and the company suddenly got half a billion dollars, my stock would presumably go up by some amount. It might not. But let's just assume that it, you know, that it would. *I'm attempting to preserve that equity increment, whatever it might be, for a certain group of shareholders, versus the new investors.* The manner in which that was done was by distribution of a dividend of warrants, which, if and when Dime Savings Bank ultimately recovered an amount from the government, and was able to distribute that value to its equity holder, Dime Bancorp, that *I, as a holder of an LTW, would be able to increase my proportionate interest in Dime Bancorp through exercise of the warrants*. So that I got more of that value than people who came after me. That's what they do.
>
> Q. The value that the LTW holders were going to get was going to be transmitted to them how?
>
> A. Exactly as I said. *They would, through exercise of the warrant, be able to have an increased participation in the total equity of Dime Bancorp.* And, therefore, to the extent Dime Bancorp's value, or common stock value, had increased as a whole, they would slice – re-slice the pie. In other words, undilute themselves, in effect. So that their equity interest in that half a billion dollars, in my scenario, instead of being this percentage, is now this percentage.

Eitel Dep. 114:13-116:18 (emphasis added).

Plaintiffs' claims have shifted continuously as each of their theories proved unfounded. Thus, they now relegate to page 49 of their 56-page brief the main theory with which they started this lawsuit – that section 4.4 of the Warrant Agreement *requires* WMI to confer priority status on the LTWs, elevating them above common stock, above preferred stock, and even above creditors, by ensuring the LTW holders receive 85 percent of the Anchor Litigation proceeds notwithstanding WMI's bankruptcy. They now focus instead on the incongruous assertion that WMI breached section 4.2(b) of the 2000 Warrant Agreement by "revoking" a non-existent right of election to choose between stock and cash supposedly granted to the LTW holders in connection with the 2002 merger of Dime and WMI. The Warrant Agreement, however, required no such election and none was given to the LTW holders in connection with the merger. Had such an election been given, it would have triggered exactly the adverse tax consequences that the LTWs were designed to avoid, as WMI's tax expert Richard Pomp explained in unrebutted testimony. Because no election right ever was required or provided to the LTW holders, the assertion that WMI wrongly revoked it is nonsensical.

Dime and WMI intended that the LTWs would be honored *in WMI common stock* after the merger. This was clearly stated in press releases, public securities filings, the proxy statements for the merger, and a direct notice sent contemporaneously to each LTW holder. The 2002 and 2003 amendments of the Warrant Agreement, which both clearly and unambiguously reflect the conversion from Dime stock to WMI stock, are not only permissible under Article IV, the anti-dilution provisions of the Warrant Agreement, they are expressly *required* by section 4.2(d), which states that any successor assuming responsibility for the LTWs would amend the Warrant Agreement to make adjustments

"as nearly equivalent as may be practicable" to those set out in Article IV. Swapping WMI common stock for Dime common stock was the most practical adjustment, and that is exactly what WMI did.

All of Plaintiffs' arguments, including new ones that they raise for the first time in their post-trial brief, fail for the same two basic reasons. First, Plaintiffs' entire case is based on a half-truth: that the purpose and intent of the LTWs was "to transfer the value of 85% of the thrift's net goodwill litigation recovery to the LTW holders." Pl. Br. at 1. Throughout the course of this adversary proceeding, Plaintiffs have systematically excluded the critical second part of this statement – reiterated in *every* document and by *every* witness – that the intent of the instrument was to deliver the value of the goodwill litigation to the LTW holders *in the form of a future right to acquire Dime (and later, WMI) common stock*:

- "Each Warrant represents the right to purchase shares or a portion of a share of [Dime] common stock (subject to adjustment as provided herein)[.]" Ex. 1, at 1 (2000 Warrant Agmt.).

- "The LTWs are securities that represent the right to purchase, upon the occurrence of the trigger, shares of our common stock equal in total value to 85% of the net after-tax proceeds, if any, from our pending lawsuit against the United States government." Ex. 6, prospectus at 1 (Registration Statement).

- "My general understanding is that this was a vehicle created by Credit Suisse First Boston to allow – to create a vehicle whereby Dime would give its shareholders these warrants as a way of participating in the resolution of the goodwill litigation and *the concept was that the shareholders would be able to buy common stock when the resolution occurred*." McQuade Dep. 33:3-10 (emphasis added).

- "Q. Can you generally describe what they are? A. Sure . . . . *Now, the specifics – they are warrants. A warrant is a right to purchase another security, in this case common stock of* . . . the issuer of the warrant, Dime Bancorp." Eitel Dep. 30:13-24 (emphasis added).

- "Q. The value that the LTW holders were going to get was going to be transmitted to them how? A. Exactly as I said. They would, through exercise of the warrant, be able to have an increased participation in the total equity of Dime Bancorp." Eitel Dep. 116:3-9.

- The LTW "was an instrument that was—once it was exercised, it would be exercisable into common stock." Sarkozy Dep. 128:9-11.

Second, Plaintiffs build their entire case around the conclusion of their expert witness (who has no education, training or expertise in accounting) that changes to Generally Accepted Accounting Principles ("GAAP") adopted *after* issuance of the LTWs require that they be accounted for as liabilities. Courts, however, including this one, universally have eschewed reliance on GAAP to determine whether an instrument is debt or equity. *See, e.g.*, *In re EBC I, Inc.* (*f/k/a eToys, Inc.*), 380 B.R. 348, 358 (Bankr. D. Del. 2008) ("GAAP rules for treating debt as equity and vice versa are not relevant to determining whether they are truly debt or equity.") (Walrath, J.), *aff'd*, 382 F. App'x 135, No. 09-1554 (3d Cir. June 1, 2010). Plaintiffs do not even attempt to distinguish this case law; rather, they try to skirt its implications with a misplaced three-step argument to the effect that: (1) the accounting rules require classification of instruments as liabilities when their economic substance is debt-like; (2) the accounting rules classify LTW-like instruments as liabilities; and (3) the LTWs therefore are debt. This *ergo propter hoc* fallacy flies in the face of every case, including *eToys*, that has declined to use the accounting treatment as a substitute for independent analysis of the true economic substance of the instrument based on the totality of the circumstances.

The lynchpin of Plaintiffs' accounting argument is that a warrant to acquire a variable number of shares, where that number is derived from something other than the value of the shares themselves, is in substance a debt rather than an equity interest. Plaintiffs, however, offer no reason why a warrant allowing the holder to acquire a

variable number of shares of worthless common stock should be treated any differently in bankruptcy than a warrant for a fixed number of worthless shares. Both are equity interests.

The testimony of Mr. Eitel and Mr. Sarkozy proves that the intent of the LTWs was to give the holders an equity interest in Dime that would track any recovery on the goodwill litigation. Mr. Sarkozy cogently explained that the "innovation" of the LTWs over prior variants of litigation participation securities was its structure as an equity warrant—the right to acquire stock—which permitted tax-free distribution to shareholders. Sarkozy Dep. 37:12-38:5; 44:24-25, 45:24, 47:2-8; 48:6-14, 48:25-49:3. Supplementing the testimony of the people actually involved in the issuance of the LTWs, Dr. Charlotte Chamberlain, a Ph.D. economist who served as vice chairperson and board member of a thrift, chief economist for the Federal Home Loan Bank Board, and, most relevant to her testimony here, an equity analyst covering litigation participation securities, provided compelling analysis of the economic substance of the LTWs. Dr. Chamberlain analyzed the structure of the LTWs, their exposure to equity risk, and the market view of the LTWs, and concluded that LTWs are, in substance, equity interests. Plaintiffs cannot counter Dr. Chamberlain's key conclusions that the LTWs are equity securities, so they resort to distortion of her testimony on factors that were not critical to her conclusions and raw *ad hominem* attacks, calling her testimony "vacuous" and "gibberish." Pl. Br. at 23, 27 n.22.

In contrast to Dr. Chamberlain's demonstrated expertise, Plaintiffs offered the testimony of Barry Levine, a "home-schooled," self-proclaimed expert in everything. Levine, 9/12/11 Tr. 115:25-116:5. Although basing their entire case on the accounting

classification of the LTWs, Plaintiffs proffered no expert on accounting, and instead, relied on Levine to provide foundation for the admission of various accounting guidelines and as a mouthpiece to preview the legal arguments of their counsel. Any veneer of credibility and expertise that Levine might have maintained as someone who, 18 years ago, had worked in the securities industry, was peeled away by the numerous admissions he was forced to make on cross-examination, including his:

- Lack of any prior familiarity or experience with LTWs or litigation participation securities prior to this engagement;
- Failure to take into account the testimony of Eitel and Sarkozy directly contradicting his conclusions;
- Failure to even review the various equity warrants to which he contrasted the LTWs; and
- Self-professed expertise in interpretation of merger agreements based on review of selected, incomplete comments of law-firm associates whom he had never met.

In the sections that follow, we demonstrate that every one of Plaintiffs' scattershot arguments is bereft of factual and legal support. The LTWs are equity securities that grant the holders a right to acquire WMI common stock. The LTW holders have no right to elect cash, and never were entitled to any election. There has been no breach of *any* provision of the Warrant Agreement. The amendment of the Warrant Agreement in 2002 (confirmed in 2003) to change the currency from Dime common stock to WMI common stock was completely consistent with the anti-dilution provisions of Article IV – common provisions found in virtually every equity warrant. Finally, the Warrant Agreement, a unilateral, non-executory contract, imposes no duty on WMI or its board to take action that would favor one class of equity interests, LTW holders, over every other creditor and equity constituency. The Court should deny relief on every count of Plaintiffs'

complaint. Even if the Court were to give credence to any of Plaintiffs' theories, any resulting claims are subject to mandatory subordination under section 510(b) of the Bankruptcy Code.

II. COUNTER-STATEMENT OF FACTS

A. The Origin of the Litigation Tracking Warrants.

Issued in December 2000, the Dime LTWs are stock warrants, and represent a tax-efficient innovation in a series of so-called "litigation participation securities" issued by thrifts to spin off the equity value of disputed supervisory goodwill claims against the United States. The goodwill litigation here, captioned *Anchor Savings Bank FSB v. United States*, No. 95-039C (Fed. Cl. 1995) (the "Anchor Litigation"), was filed in 1995 by Anchor Bank FSB, which merged into Dime Bank of New York, FSB and later, Washington Mutual Bank. *See* Stipulation Concerning the Testimony of James E. Carreon, ¶¶ 4-6 at 3-4 [Adv. Dkt. No. 280].

The uncertain value of the goodwill claims presented two interlocked problems to Dime Bank and other thrifts. *First*, undervaluation of these claims by market participants, including acquirers and acquisition targets, diluted the thrifts' equity, making their stock less valuable for use in acquisitions. *See* Sarkozy Dep. 34:25, 35:2-24. In response, from 1995-1998, California Federal Bank and Coast Federal Bank distributed litigation participation certificates ("LPCs") to their shareholders, entitling holders to a benefit proportionate to any damages awarded to the thrift upon final disposition of its goodwill litigation. Coast transferred the future proceeds to a trust, which then distributed to its shareholders trust certificates (the "CCPRZs") representing undivided interests in the trust's cash assets. In contrast, CalFed distributed to its shareholders certificates (the "CALGZs" and "CALGLs"), representing fixed proportions

of its goodwill claim. What these LPCs had in common, however, was that they took the equity value of the goodwill litigation and removed it from the balance sheet of the respective thrifts, *see* Chamberlain, 9/14/11 Tr. 12:16-19, because "upon a trigger event the holders would be paid in cash[.]" Chamberlain, 9/13/11 Tr. 196:4-11.

Removing the equity value of the goodwill litigation from the thrifts' balance sheets, however, was like curing a headache by decapitation. As Dr. Chamberlain explained, thrifts earn money "on the spread between the interest paid on the deposits and the interest earned on the assets." Chamberlain, 9/13/11 Tr. 209:9-25. Thrifts grow their profits not by reducing their equity but by increasing it – growing their balance sheets and deploying that equity capital to earn more income. *See id*. By distributing the value of goodwill litigations to shareholders in cash, LPCs severed the equity value of those claims from the company, foreclosing the opportunity to leverage the goodwill litigations into increased earnings. *Id.*; *see* Levine, 9/12/11 Tr. 132:22-134:1.

The distribution of LPCs to shareholders led to a second problem: any distribution of the future right to receive cash was currently taxable to the shareholder and in certain cases, the issuer, and thrifts "didn't want to put themselves and their shareholders through a taxable event on an asset whose value was completely uncertain." Sarkozy Dep. 48:2-14; 53:10-19; *see also* Ex. 231, at 5 (Pomp Expert Rpt.). "So the problem with issuing [LPCs] was that it was tax-inefficient . . . you were paying taxes on an asset whose value was completely uncertain, and could, ultimately, end up being zero." Sarkozy Dep. 45:16-20. The result is a disfavored state in tax law called "phantom income" where there is income but no cash to pay any tax liabilities. Pomp, 9/13/11 Tr. 135:6-8. Margaret Osmer-McQuade, a member of Dime's Board (and later,

WMI's Board), confirmed that Dime's Board paid "attention to trying to minimize any tax implications for the shareholders" when designing the LTWs. McQuade Dep. 55:6-11.

B. The Economic Purpose of the Litigation Tracking Warrants.

These two interlocked problems, which Sarkozy aptly called a "Rubi[k]'s cube," Sarkozy Dep. 47:24-25, 48:2-14, remained unsolved until Sarkozy developed the "elegant solution" of the LTW – a stock warrant, distributed as a tax-free dividend to shareholders, which tracked the thrift holding company's equity interest in any future goodwill litigation proceeds. *Id*. at 38:17-21. Sarkozy first developed LTWs for Golden State Bancorp, Inc. in 1998, and two years later, teamed up with Eitel to work on the Dime LTWs. Because Sarkozy left the drafting and review of the operative documents "to the lawyers,"[3] *see id.* at 90:20-25; 91:2-3, Eitel bore primary responsibility for drafting the 2000 Warrant Agreement and Registration Statements. *See id*. at 81:7-15; Eitel Dep. 18:20-22; 128:14-15. Eitel explained that the purpose of the Dime LTWs was to preserve the "equity increment" of the goodwill litigation for those Dime shareholders to whom the LTWs were distributed. Eitel Dep. 115:2-116:2; *see also* discussion *supra* p. 2. Upon Dime's eventual receipt of the goodwill litigation proceeds, the LTW holders could recover that equity increment and thus undilute their common shares by the tax-free exercise of the LTWs for Dime's common stock proportionate to the value of the Anchor Litigation. *See id.* at 116:2-18.

In contrast to the LPC structure, with the LTWs the eventual proceeds of the goodwill litigation "stayed with the company." Chamberlain, 9/13/11 Tr. 210:17-19.

[3] Sarkozy had neither seen, nor reviewed, the 2000 Warrant Agreement and Registration Statements. Sarkozy Dep. 66:20-25, 90:20-24.

The book value and equity base of the holding company would increase "creating the potential for growth of the balance sheet which increases earnings and potentially has the subsequent effect of raising stock price." Chamberlain, 9/14/11 Tr. 11:11-14. That is the incremental equity value to which the LTW holders were entitled by virtue of the warrant structure. Plaintiffs' own expert, Levine, acknowledged that the structure of the LTWs was different from LPCs in that the LTWs allowed any cash recovery from the goodwill litigation to come into the company, facilitating growth of its balance sheet. Levine, 9/12/11 Tr. 132:22-134:1. Thus, in the LTW structure, the cash from any judgment in the underlying goodwill litigation could be retained by the thrift or its holding company, which could decide where to spend it, including, for example, purchasing its own shares, investing in other securities, or opening new branches. Levine, 9/12/11 Tr. 134:2-136:2; 136:19-137:10; Chamberlain, 9/13/11 Tr. 197:7-13.

By structuring the Dime LTWs as stock warrants, Sarkozy and Eitel also avoided any potential taxable events. To Golden State, which issued LTWs before Dime did, tax-efficiency was not just important; it was clearly the "*determining component* of [its] decision to use the [LTW] structure." Sarkozy Dep. 55:22-56:3 (emphasis added); Chamberlain, 9/13/11 Tr. 205:5-18, 211:1-6. Accordingly, Sarkozy explained that "the objective was to separate it [the goodwill litigation asset] out in a way that was nontaxable to the issuer. And so, the innovation in the tracking warrant . . . was that, because it was a warrant, it was viewed, for tax purposes, as a stock split. And a stock split is a nontaxable event." Sarkozy Dep. 37:23-38:5. The Amended Registration Statement contained a Sullivan & Cromwell tax opinion confirming that "the distribution of the LTWs to [the Dime shareholders] should be treated as a tax-free stock dividend,"

and "a U.S. holder will not recognize gain or loss upon exercise of an LTW," except for cash received in "lieu of a fractional share." Ex. 7, at 2, 20-21. Richard Pomp explained at trial that the use of the warrant structure "is what makes it a stock dividend in the year 2000 and an exempt stock dividend," an outcome that is the "most desirable from a tax perspective." Pomp, 9/13/11 Tr. 135:13-21; Ex. 231, at 4 (Pomp Expert Rpt.).

To remain tax-neutral, Dime LTWs needed to be warrants exercisable for stock. If Dime merged in the future, Dime LTWs could be exchanged, tax-free, for warrants exercisable for stock of the acquiring corporation, and "that would be the end of the story . . . and a desirable tax result[,]" Pomp, 9/13/11 Tr. 130:18-20, just as the drafters had intended. If, however, Dime LTWs were exchanged for a new security entitling the holder to elect between cash and stock, that security would constitute "boot" – property which is "outside of what can be received tax-free in a reorganization." *Id*. at 131:2-4. Had that occurred, holders potentially would be exposed to tax liability notwithstanding having received no cash with which to pay that tax. *Id.* at 131:11-16.

Sarkozy and Eitel flatly rejected the notion that Dime LTWs were merely vehicles to deliver any cash proceeds of the Anchor Litigation to the holders. When asked if the Dime LTWs were exercisable for cash, Sarkozy explained that was impossible because their tax efficiencies were built on the cornerstone of equity:

> Q. [Y]ou had talked about the idea behind the LTWs was, in one way or another, to transfer 85 percent of the value of the Anchor litigation?
> A. Yes, sir.
> Q. But was it to do that in cash, or to do that in stock?
> A. It was to transfer it in a tax-efficient way.
> Q. Was it your understanding – which was your understanding, which was more efficient, stock or cash?
> A. In order for it to be tax-efficient, you needed to use the warrant. The warrants are exercisable in stock.

> Q. Would giving the warrant holders a right to be paid in cash have been tax-efficient?
> A. I don't know that it would have been possible, if that makes sense. A warrant is exercisable into stock.

Sarkozy Dep. 133:18-24; 134:2-3, 7-9, 12-14, 18-20, 22-24. Eitel also testified that Plaintiffs' view "that the LTW holders are entitled to some [cash payment] from Dime" is a "fundamental misunderstanding of the security," and "contradictory to [his] own [view]" and the meaning of the documents. Eitel Dep. 121:21-25; 122:2-5.

C. The Implementation of the Dime LTWs Confirmed their Purpose.

The 2000 Warrant Agreement and the Registration Statements for the common stock to be issued to satisfy the LTWs crystallized the innovation of the LTWs as stock warrants. The Registration Statements plainly state that the Dime LTWs confer the right to purchase common stock. *See* Ex. 6 & 7, prospectus at 1 (Registration Statements). The 2000 Warrant Agreement, too, defines the Dime LTWs as warrants representing the right to purchase shares of common stock. Ex. 1, at 1 (2000 Warrant Agmt.).

The Registration Statements and all three Warrant Agreements also specify that the Dime LTWs are exercisable exclusively for Dime (and later, WMI) common stock only upon the occurrence of specified trigger events (the "Trigger"), which required, among other things, entry of a final judgment in Dime's favor in the Anchor Litigation, actual receipt of a payment on that judgment, and "receipt of all regulatory approvals necessary to issue [the new] Common Stock." Ex. 1, 3, 4, § 1.1 (2000, 2002, and 2003 Warrant Agreements); Ex. 6, prospectus at 3; Ex. 7, prospectus at 2 (Registration Statements). Because the Anchor Litigation "belonged to [Dime Bank]," if there "was a recovery, the cash from the government would go to [Dime Bank]." Eitel Dep. 113:17-20. The "only way to collect value at the holding company level, or the only way that

anyone who has an interest in the holding company would be able to recognize any value, other than indirectly through the holding company's ownership of the equity of [Dime Bank], would be for [Dime Bank] somehow to distribute . . . the cash upwards" and there "are regulatory limitations on that." *Id.* at 113:25; 114:2-11.

D. The WMI-Dime Merger.

1. Background.

On June 25, 2001, Dime announced it had agreed to merge into WMI, and Dime Bank agreed to merge into WMB, for total consideration valued at approximately $5 billion. *See* Ex. 233, ¶ 37 (Chamberlain Expert Rpt.). To that end, WMI agreed to pay Dime shareholders $1.4 billion dollars in cash and 92.3 million shares of WMI common stock. Ex. 17, at 2 (WMI Press Release).

Neither Dime nor WMI intended the merger to change the nature of the Dime LTWs. As McQuade, a Dime (and later, WMI) director testified, the only change to the LTWs in the merger was that "the rights of the LTWs as pertained to the ability to purchase shares of common stock would transfer from the Dime to be able to purchase the common stock of Washington Mutual." McQuade Dep. 122:13-23. Sarkozy, who advised Dime on the merger, also testified that the merger was not meant to have any impact on the Dime LTWs. *See* Sarkozy Dep. 107:3-8.

Nor did Dime or WMI intend that the LTW holders would receive cash after the merger. When asked if the payment of cash to Dime shareholders in the merger would "create[] any change to what the litigation tracking warrant holder would get," McQuade confirmed that "cash was available to the shareholders, not the holders of the tracking warrants." McQuade Dep. 65:23-25, 66:2-11.

2. Public Disclosures to LTW Holders During the Merger.

Six months passed before the merger closed. Consistent with the purpose of the Dime LTWs and the expectations of their holders, *every* WMI and Dime disclosure after the execution of the Merger Agreement on June 25, 2001 declared that the Dime LTWs would be exercisable in WMI common stock; *no* WMI or Dime disclosure suggested that Dime LTW holders would receive any election to receive cash. The presentation slides for the June 25, 2001 WMI-Dime conference call, in which Dr. Chamberlain participated, declared that the Dime LTWs would become exercisable for WMI common stock, while the Dime shareholders would receive the right to elect cash, stock, or a mixture of cash and stock. Ex. 15, at 2-3 in attached Joint Press Release & 4-5 in attached Presentation (Dime Form 425); *see also* Chamberlain, 9/14/11 Tr. 48:4-10, 50:17-20, 52:2-5 (recalling the same). Dime delivered a special notice to the Dime LTW holders in mid-2001, which drew a sharp contrast between what Dime LTW holders and Dime shareholders would receive in the merger:

> Following the closing of the Merger, each outstanding LTW will entitle its holder to receive, upon exercise of such LTW in accordance with the terms of the Warrant Agreement, shares of Washington Mutual common stock. Under the terms of the Merger Agreement, each share of Dime common stock will be converted into either shares of Washington Mutual common stock or cash, in each case subject to cash/stock election and equalization procedures.

Ex. 41 (Dime LTW Notice). WMI and Dime reiterated this in at least six other public filings related to the merger between June 25, 2001 and December 2001. For example, WMI's Form S-4 and Amended Form S-4, dated August 28, 2001 and October 12, 2001, respectively, both state:

> Holders of Dime's litigation tracking warrants will not be affected by the merger, except that, upon any exercise of the litigation tracking warrants in accordance with their terms, holders of litigation tracking warrants will

> be entitled to receive shares of Washington Mutual common stock instead of Dime common stock on similar terms as prior to the merger.

Ex. 19, at 2-3 in attached proxy statement; Ex. 20 at 2-3 in attached proxy statement (WMI Form S-4 and Amended Form S-4).[4] "These public filings all said the same thing, namely that subsequent to the merger that holders of the LTWs, upon exercise, would get Washington Mutual common stock rather than Dime common shares." Chamberlain, 9/14/11 Tr. 73:5-18.

3. Dime Shareholders' Right of Election.

Consistent with those disclosures, in late 2001, Dime shareholders—but not LTW holders—were solicited to elect WMI common stock, cash, or any mixture thereof, subject to two restrictions. WMI capped the amount of cash it would pay at $1.4 billion, and the right to elect expired on January 3, 2002. The election right obviously is "no longer available" today. Ex. 21, at 35-36 (Dime Form 14A dated Oct. 25, 2001); Chamberlain, 9/14/11 Tr. 38:9-15; 52:17-21; Ex. 42, at STB07306 (Election Form); *see* Sarkozy Dep. 151:8-18. Dime shareholders who made no election were deemed to have elected WMI common stock. Ex. 42, at STB07306 (Election Form).

Owners of about 76 percent of Dime shares elected to receive their merger consideration in WMI stock; owners of only about 24 percent of Dime shares elected to receive cash. Chamberlain, 9/14/11 Tr. 52:24-25; 53:1-2. Because not enough WMI stock was available to satisfy demand, Dime shareholders who elected all stock ultimately received 88.4 percent of their consideration in stock and 11.6 percent in cash. Ex. 45 (Jan. 2002 WMI Ltr.). The receipt of cash was taxable; stock was not. Ex. 21, at

[4] *See, e.g.* Ex. 15 at 2-3 in attached Joint Press Release & 4-5 in attached Presentation (Dime Form 425, dated June 25, 2001); Ex. 16 at 2-3 in attached Merger Release & 4-5 in attached Presentation (WMI Form 8-K, dated June 25, 2001); Ex. 21 at 2-3 in attached proxy statement (Dime Schedule 14A Proxy Statement, dated Oct. 25, 2001); Ex. 22 in attached Press Release (WMI Form 8-K, dated Dec. 21, 2001).

35-36 (Dime Form 14A). Further, around the time of the merger, WMI's common stock was much more liquid than Dime's. Ex. 233, at 17 (Chamberlain Expert Rpt.). Any shareholder who wanted cash could simply sell WMI shares for cash after the merger closed. Sohn Dep. 145:21-24; Chamberlain, 9/14/11 Tr. 53:16-54:8. Likewise, any LTW holder who did not want to continue holding a warrant that would be satisfied in WMI common stock could simply sell it for cash because the LTWs traded on NASDAQ. Chamberlain, 9/13/11 Tr. 211:7-9.

E. Post-Merger Amendments.

1. The January 4, 2002 Replacement Warrant Agent Agreement and the 2002 Amended and Restated Warrant Agreement.

In connection with the January 4, 2002 closing of the merger, WMI and Mellon Investor Services LLC, its replacement warrant agent, entered into Agreement Concerning Litigation Tracking Warrants™ and Replacement Warrant Agent. This brief agreement provided that Mellon would act as the new warrant agent and satisfied the requirement in section 4.2(d) of the 2000 Warrant Agreement that any successor by merger confirm applicability of the anti-dilution provisions and commit to enter into an amended Warrant Agreement that provided for adjustments "as nearly equivalent as may be practicable" to the terms of Article IV of the existing Warrant Agreement. *See* Ex. 2, at 1 (Jan. 2002 Replacement Warrant Agent Agmt.). Three days later, WMI did just that by executing the January 7, 2002 Amended and Restated Warrant Agreement (the "2002 Warrant Agreement"), which declared:

> On January 4, 2002, Dime merged with and into the Company and the Company succeeded to Dime's rights and obligations with respect to the Warrants. As a result of the merger, Warrant holders will be entitled to receive, if and when the Warrants are exercised and in accordance with the terms of this Agreement, for each Warrant they hold, shares of Washington Mutual common stock (the "Common Stock").

Ex. 3, at 1 (2002 Warrant Agmt.).[5] Two WMI disclosures followed, reiterating that, after the merger, the Dime LTWs were converted into the "contingent right to receive the Company's [WMI's] Common stock." Ex. 27, at 5 (WMI 10-Q dated Aug. 14, 2002); Ex. 28, at 5 (WMI 10-Q dated Nov. 14, 2002).

2. The 2003 Amended and Restated Warrant Agreement.

In early 2003, developments in the Anchor Litigation prompted WMI to make additional disclosures regarding the LTWs and to make further amendments to the 2002 Warrant Agreement. Responsibility for this task fell to Richard Sohn, who had recently joined WMI as an assistant general counsel. Sohn Dep. 11:21-24. Sohn updated the formula for calculation of the number of shares of WMI common stock which LTW holders would be permitted to acquire upon a Trigger. Sohn did not make any material change to the terms of the LTWs in the 2003 amendment; rather, he intended only to "clarify" and "effectuat[e] . . . the intent of the original warrant agreement with respect to what happened in the Washington/Mutual Dime transaction." *Id.* at 87:20-88:1, 88:8-11.

That intent, as Sohn understood from reviewing the 2000 Warrant Agreement and Registration Statements, "was to essentially convey to warrant holders *in the form of the common stock of the issuer* approximately 85 percent of the net recovery in the litigation." *Id.* at 35:4-7 (emphasis added). Further, after reviewing numerous SEC filings regarding the effect of the merger a year earlier, Sohn found "the public statements had been consistent in that [Dime LTW holders] would receive shares of Washington Mutual common stock if a trigger event had occurred after the Dime/WaMu transaction." *Id*. at 122:24-123:7.

[5] *See* discussion on admissibility of the 2002 Warrant Agreement, *infra* at p. 62.

Sohn confirmed that the change to WMI common stock was one he believed had been accomplished more than a year earlier at the time of the merger. *See id.* at 46:16-19, 51:6-11. The only new changes he wrote into the 2003 version of the Warrant Agreement were adjustments to the exchange ratio and the exercise price, reducing the latter to $0 from $0.01 because WMI common stock had no par value. *Id*. at 23:15 to 25:15; 25:18-21; 93:5-16: Although the change to the ratio prompted inquiries from holders, there is absolutely *no* record of any complaints about the substitution of WMI stock for Dime stock upon exercise of an LTW. *Id*. at 37:7 to 38:17; 118:23-25; 119:1-7.

WMI incorporated those adjustments in the 2003 Amended and Restated Warrant Agreement, dated March 12, 2003 (the "2003 Warrant Agreement"), and attached it to a Form 8-K filed that same day, which described in detail how the Dime LTWs would be exercisable for WMI stock. Simultaneously, WMI's general counsel, Fay Chapman, attested in an Officer's Certificate that the 2003 Warrant Agreement complied with section 7.2 of the 2002 Warrant Agreement in that it made no change adverse to the holders. Ex. 5, at 41 (Officer's Certificate). WMI made no further changes to the Warrant Agreement and it is the 2003 version that governs today.

III. ARGUMENT

A. The Dime LTWs Are Equity Interests.

1. The Economic Substance of the Dime LTWs Makes Them Equity Interests In Bankruptcy.

As Eitel and Sarkozy testified, and as the documentation governing the LTWs makes clear, the LTWs are warrants to acquire common shares, and thus they are equity securities under section 101(16)(C) of the Bankruptcy Code. "The Bankruptcy Code defines 'equity security' as a 'share in a corporation' and includes the right to purchase

shares within the definition." *Allen v. Levey* (*In re Allen*), 226 B.R. 857, 865 (Bankr. N.D. Ill. 1998). Specifically, the statute says that "equity security" means, in relevant part, "*warrant or right*, other than a right to convert, *to purchase, sell, or subscribe to a share*, security, or interest" of a "share in a corporation, whether or not transferable or denominated 'stock,' or similar security." 11 U.S.C. § 101(16) (emphases added). An instrument is an "[e]quity investment," and an interest rather than a claim, if it represents "a share of ownership in the debtor's assets—a share that is subject to all of the debtor's payment obligations." *In re Insilco Techs. Inc.*, 480 F.3d 212, 218 (3d Cir. 2007).

Where "certainty of payment is missing, the security is equity, not debt." *In re Color Tile*, Nos. 96–76 (HSB), 2000 WL 152129, at *4 (Bankr. D. Del. Feb. 9, 2000) (quoting *Estate of Mixon v. United States*, 464 F. 2d 394 (5th Cir. 1972)). Securities are thus equity if the "right of shareholders to redeem stock is not guaranteed." *In re Revco D.S., Inc*., 118 B.R. 468, 474 (Bankr. N.D. Ohio 1990); *see also Harbinger Capital Partners Master Fund I, Ltd. v. Granite Broad. Corp*., 906 A.2d 218, 225 (Del. Ch. 2006) (same) (collecting cases). For bankruptcy purposes, "[s]tock redemption rights are contingent upon the financial health of a company," and because redemption rights are not guaranteed, they are equity interests. *In re Federated Dep't Stores, Inc*., 1991 Bankr. LEXIS 67, at *6 (Bankr. S.D. Ohio Jan. 23, 1991). In addition to certainty of payment in the event of the corporation's insolvency, also relevant is the "*name given to the instrument*, the intent of the parties, the presence or absence of a fixed maturity date, the right to enforce payment of principal and interest, the presence or absence of voting rights"[6] and the "status of the contribution in relation to regular corporate contributors"

[6] "Although the right to vote is necessarily a characteristic right of equity, its absence is not fatal to a finding that a security is equity." *Granite*, 906 A.2d at 225 & n.56.

(*i.e*. where the party stands in line for payment relative to other parties). *Color Tile*, 2000 WL 152129, at *4 (citations omitted) (emphasis added); *see also In re USDigital, Inc.*, 443 B.R. 22, 52 (Bankr. D. Del. 2011) (adopting *Color Tile*'s test in deciding if debt should be recharacterized as equity).

Here, the Dime LTWs do not confer any certainty of payment. To the contrary, the Registration Statements warn LTW holders that the Anchor Litigation may not result in any distribution of stock, let alone any payment in cash. *See* Ex. 6, 7, prospectus at 4 (Registration Statements). The Registration Statements and Warrant Agreements further mandate that Dime LTWs cannot vest before the Trigger occurs, which awaits, among other events, the receipt of Anchor Litigation proceeds. *See* discussion *supra* p. 13. Most importantly, there was no assurance that LTW holders would receive any value at all upon a Trigger, because WMI common stock might have no value if the company was insolvent.

The right of Dime LTW holders to redeem shares depends on the solvency of Dime (and later, WMI) as a matter of law. *See Revco*, 118 B.R. at 474 (rights "to redeem stock are not guaranteed but are dependent on the financial solvency of the corporation"). Because Dime LTWs are warrants exercisable for stock, Dime (and later WMI) needed common stock to back them, and if it did not have enough, section 3.7(b) of the Warrant Agreements required it to "commence a tender offer or buyback the aggregate Number of shares of Common Stock at least equal to the Number of Shortfall Shares or . . . call a special meeting of the holders of Common Stock for the purpose of increasing the number of [shares]," but only "to the extent permitted by applicable law[.]" Exs. 1, 4, and 5; section 3.7(b) (2000, 2002, and 2003 Warrant Agreements). Regardless of

whether Washington (WMI's state of incorporation), Delaware (Dime's state of incorporation), or New York (the law governing the Warrant Agreement) law applies to Dime or WMI's internal affairs, all three jurisdictions prohibit a company from purchasing its shares if it is insolvent, or if that purchase would tip the holding company into insolvency.[7] Just like "the right of shareholders to recover dividends or redeem their stock[,]" which depends on the "financial solvency of the corporation, and is therefore not a fixed liability," Dime LTWs do not guarantee any right of redemption, and are therefore not liabilities. *Granite*, 906 A.2d at 218.

Application of all of the other factors confirms that Dime LTWs are equity interests. The "intent of the parties," as every witness has confirmed, was to convey a contingent equity interest in the Dime corresponding to any recovery in the Anchor Litigation. Dime LTWs, unlike debt instruments, lack a "fixed maturity date" and "the right to enforce payment of principal and interest." *Color Tile*, 2000 WL 152129, at *4. And Dime LTWs, once exercised into common stock of WMI, conferred on their holders voting rights typical of a common equity security.

The last factor, the "name given to the instrument," says it all: Litigation Tracking Warrants. Although Plaintiffs dismiss the name of the instrument as marketing fluff, its significance is much deeper. LTWs are called "warrants" because they convey the right to acquire common stock. They are tracking warrants because they are akin to "tracking stocks," Ex. 138, at 12, 27 (Esty), conveying an equity interest that corresponds

[7] *See, e.g.* Wash. Rev. Code. § 23B.06.400 (a company may not make distributions to its shareholders such as the "purchase, redemption, or other acquisition of the corporation's shares" if "after giving it effect . . . [WMI] would not be able to pay its liabilities"); 8 Del. C. § 160(a)(1) ("no corporation shall . . . purchase or redeem its own shares of capital stock for cash or other property when the capital of the corporation is impaired or when such purchase or redemption would cause any impairment of the capital of the corporation"); N.Y. Bus. Corp. Law § 513(a) ("the shares of a corporation may not be purchased by the corporation ... the corporation is then insolvent or would thereby be made insolvent").

to a discrete asset or line of business rather than the entire company. *See Solomon v. Armstrong*, 747 A.2d 1098, 1106 (Del. Ch. 1999), *aff'd*, 746 A.2d 277 (Del. 2000) (noting that General Motors tracking stocks "derived their value from the GM operations to which they were tied"). Tracking stocks are equity securities designed to undilute their issuers' equity by tracking the equity value of a specific asset or operation without severing it from the issuer. Courts have universally held that tracking stocks are equity interests. *See, e.g.*, *id.* (finding that tracking stock is "an equity instrument"); *Liberty Media Corp. v. Bank of N.Y. Mellon Trust Co., N.A.*, CIV.A. 5702-VCL, 2011 WL 1632333, at *10 (Del. Ch. Apr. 29, 2011) (noting that issuer referred to tracking stock as a "separate equity security" and an expert testified that "creation of the trackers did not negatively affect Liberty's bondholders, because during the pendency of a tracking stock structure, there is really no change in terms of the assets that the debtholders can look to"); *In re Staples, Inc. S'holders Litig.*, 792 A.2d 934, 945 (Del. Ch. 2001) ("[W]hen the Staples.com tracking stock was created, the Staples board had believed it to be important for it and top Staples management to have an equity stake."); *Sedighim v. Donaldson, Lufkin & Jenrette, Inc.*, 167 F. Supp. 2d 639, 647-48 (S.D.N.Y. 2001) (referencing the equity interests of tracking stock shareholders).

Contrary to Levine's theory that LTWs are the "great-great-great-grandchildren" of asset-backed securities (Levine, 9/12/11 Tr. 131:5-25), a simple paternity test confirms litigation tracking warrants are the children of tracking stocks. Dime LTWs were designed, in part, to spin-off Dime's "litigation business" because bankers and investors did not always understand it or know how to value it. Sarkozy Dep. 34:21-35:24. Tracking stocks are also designed, in part, to attract investors who might be more familiar

with a particular segment of the issuer's business. For example, Staples, a traditional "bricks and mortar" retailer, created a tracking stock to track the performance of its e-commerce business in order to provide a means of attracting and compensating employees with expertise in that sector. *Staples*, 792 A.2d at 945.

Dime LTWs were also designed to undilute Dime's (and later, WMI's) common stock, allowing those issuers to leverage their equity for acquisitions. *See* discussion *supra* p. 8; Ex. 138, at 19 (Esty). Tracking stocks, too, were designed to do just that. Upon issuing a tracking stock, Liberty Media declared, "[c]reating a separate equity security . . . will increase the trading value of both securities, thereby reducing the discount in the current Liberty Media stock and creating better currencies for both entities to use in pursuit of acquisition activity." *Liberty*, 2011 WL 1632333, at *4.

Like the Dime LTWs, which "separate[d] ownership interests in the pending litigation proceeds from ownership interests in the thrift franchise," Ex. 233, at 33 (Chamberlain Expert Rpt.); one objective of a tracking stock "was to realize a higher combined market value for the company by separating its . . . assets from the rest of the entity [before a merger]." *Lillis v. AT&T Corp*., CIV.A. 717-N, 2007 WL 2110587, at *3 (Del. Ch. July 20, 2007). Plaintiffs' characterization of Dr. Chamberlain's observation as a "stunning admission" illustrates their shallow understanding of the distinction between debt and equity. Pl. Br. at 8. The ownership interest in the pending goodwill litigation proceeds represented by Dime LTWs, just like ownership interests granted by tracking stocks, are *equity* interests. LTW holders are entitled to share in the incremental equity value of the litigation, not directly in any litigation recovery.

The economic separation of the Anchor Litigation from Dime's common stock did not grant Dime LTW holders any direct rights in the Anchor Litigation, which remained under the control of Dime. Ex. 233, at 33 (Chamberlain Expert Rpt.). The same is true for holders of other tracking stocks. *See In re Gen. Motors Class H S'holders Litig.*, 734 A.2d 611, 613 (Del. Ch. 1999) (holding that tracking stock conveyed no direct right to assets of GM's Hughes subsidiary, only rights in the equity of the parent issuer, GM); *see also In re Alcatel Sec. Litig.*, 382 F. Supp. 2d 513, 520 (S.D.N.Y. 2005) (same). Accordingly, "holders of the tracking stock continue to hold an equity interest in the general corporation[,]" *Riggs v. Termeer*, 03 CIV.4014 MP, 2003 WL 21345183, at *1 (S.D.N.Y. June 9, 2003), and so do Dime LTW holders here. The unmistakable resemblance between the Dime LTWs and tracking stocks confirms that Dime LTWs are equity interests, not asset-backed securities.

2. FAS150 Is Irrelevant.

Plaintiffs cling to a recent amendment to a GAAP rule, Financial Accounting Standards Board 150 (later codified as FAS480), and accounting documents referencing it, as the "major" basis of their argument that Dime LTWs are liabilities and thus debt. Levine, 9/12/11 Tr. 68:8-17. This reliance is misplaced.

FAS150 carries no weight in the bankruptcy context. "GAAP rules for treating debt as equity and vice versa are not relevant to determining whether they are truly debt or equity." *eToys*, 380 B.R. at 358 (collecting cases); *see also In re Joshua Slocum, Ltd.*, 103 B.R. 610, 622-24 (Bankr. E.D. Pa. 1989) (holding that the redemption value of redeemable stock is not a debt despite its accounting treatment as a liability). "Instead, the Court must consider the totality of the circumstances to determine if the obligation is, in fact, debt or equity." *eToys*, 380 B.R. at 358.

The Delaware Chancery Court, too, recently held that FAS150 is immaterial to whether an instrument is equity or debt. *See Granite*, 906 A.2d at 225. In *Granite*, holders of mandatorily-redeemable shares sought to classify those shares as debt, and argued that "even if FASB regulations are not determinative factors" in whether an instrument is equity or debt, "the accounting treatment of shares should at least raise an issue of fact for the court as to whether the preferred shares should be treated as debt or equity." *Id*. at 222. Although neither party disputed that FAS150 classifies the shares as liabilities, the court rejected that argument and held that the shares are equity interests, reasoning that, "FAS150 is not so determinative as the plaintiff asserts," and to "believe that it decides the case would grant FASB, which is neither lawmaker nor judge, the power to fundamentally alter the law's understanding." *Id.*

Notwithstanding that precedent, Plaintiffs argue that the anti-dilution provisions in Article IV of the Warrant Agreements convert the LTWs into an obligation requiring their issuer to redeem the warrants for cash in certain circumstances, making them debt instruments. This is a veiled argument that LTWs (and any equity warrant containing a typical anti-dilution clause) are in essence a form of mandatorily-redeemable stock, the redemption being triggered by a bankruptcy effecting a reorganization of the issuers' capital structure. The existence of a theoretical right to cash payment in the event of an all-cash merger or other transaction requiring adjustment under anti-dilution provisions does not make the LTWs (or any other equity warrant) debt for bankruptcy purposes.

Courts have universally held that mandatorily-redeemable stocks are equity interests. *See eToys*, 380 B.R. at 358 (collecting cases); *Granite*, 906 A.2d at 225 (same). and even if the LTWs have certain debt-like features, that is not dispositive because

Instruments straddling the line between debt and equity should be treated as equity. *Granite*, 906 A.2d at 218 ("[W]here preferred shares in some way straddle the line between debt and equity, . . . cases . . . in the context of bankruptcy law have held, almost universally, that those shares are forms of equity.").

Even closer to the facts of this case is *Carrieri v. Jobs.com*, 283 B.R. 209 (Bankr. N.D. Tex. 2002), *aff'd* 301 B.R. 187, 194 (N.D. Tex. 2003), 393 F.3d 508, 513 (5th Cir. 2004). In *Carrieri*, the debtor issued warrants which represented the right to acquire preferred stock at specific prices. After March 19, 2002, upon demand by warrant holders, Jobs.com would buy back the warrants for a cash payment of $6.00 per share of preferred stock conferred by those warrants if it had "legally available funds" at the time of demand. *Id.* After Jobs.com filed for bankruptcy in 2001, warrant holders demanded that the debtor buy the warrants with cash, and filed claims with the bankruptcy court.

The district court considered the warrant holders' argument that they held claims and concluded that, where there is a close call between a security being categorized as debt or equity, equity status will prevail:

> The rights of redemption and to require repurchase seem to come within the Bankruptcy Code's definition of "claim," 11 U.S.C. § 101(5)(A), as well as its definition of "equity security." Thus, the issue becomes the proper treatment to give a right or interest in the debtor that fits the statutory definitions of both "claim" and "equity security." . . .
>
> After considering the various authorities, the court concludes that the equity security status of an interest will prevail over the claim status of the same interest if it is an interest in the debtor. . . .

Carrieri, 301 B.R. at 194. Thus, even if the Court finds the issue of whether the LTWs are debt or equity to be a close call, the equity status of the LTWs should prevail.[8]

The Fifth Circuit affirmed the district court's decision in *Carrieri*, finding even more decisively that the warrants were equity, and holding that "warrants with redemption provisions . . . are equity interests until their expiration (*or until the right to receive a cash payment properly matures on or before the petition date*)." 393 F.3d at 522 (citations omitted) (emphasis added). Because Jobs.com had filed bankruptcy before the date upon which the holders could force it to repurchase the warrants for cash, the court held that the warrants remained equity interests. 393 F.3d at 522 & n.14; *see also In re Einstein*, 257 B.R. 499, 506-08 (Bankr. D. Ariz. 2000) (holding that put right requiring debtor to purchase claimant's ownership interests in cash or stock was an equity interest even if construed to create an obligatory cash obligation because the right to receive cash or stock had not matured by the petition date).

It is undisputed that the LTW holders had no matured right to anything – either stock or cash – before WMI filed for bankruptcy because the Anchor Litigation had not yet been resolved and no Trigger had occurred. Accordingly, even if theoretically entitled to cash under certain circumstances, the LTWs are still equity interests for purposes of bankruptcy.

The reasoning of the *Granite* court applies to *all* instruments covered by FAS150, not just mandatorily-redeemable preferred shares. *See Granite*, 906 A.2d at 227. "The court can imagine any number of other financial instruments whose accounting treatment might, in the future, be changed by FASB, and would thus require some concomitant, and

[8] During his deposition, Levine admitted that LTWs meet the definition of both "equity security" and "claim" as those terms are defined in the Bankruptcy Code. Ex. 202, Levine Dep. 323:3-5 ("LTWs fit the definition for Claim as well as for Equity, so it didn't seem to be very illustrative.").

major, innovation in Delaware precedent." *Id*. at 226-27. "Further, if FASB ever shifted its view again, under this theory both Delaware and New York law would have to shift with it." *Id*. at 227. "It is not the role of FASB to enact such significant changes in Delaware law, or in the . . . law of other states." *Id.*

Here, the case law universally treats tracking stocks as equity interests. *See generally*, *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 167 (Del. 2006) (deciding motion to dismiss in derivative suit brought by tracking stockholders); *Lewis v. Termeer*, 445 F. Supp. 2d 366, 373 (S.D.N.Y. 2006) (same); *Staples*, 792 A.2d at 937; *In re Tele-Commc'n, Inc. S'holders Litig*., CIV.A. 16470, 2005 WL 3642727, at *1 (Del. Ch. Dec. 21, 2005) (denying defendants' motion for summary judgment in suit brought by tracking stockholders against company's directors). Dime LTWs and tracking stocks are similar. LTWs represent contingent equity ownership interests in the form of warrants to acquire common stock, while tracking stocks represent current equity ownership interests in the form of a special class of common stock. Indeed, Sarkozy expressly called the issuance of the LTWs a "stock split." *See* Sarkozy Dep. 37:25-38:5; 46:19-47:8; 48:22-49:3; 73:3-8; 128:6-17; 130:12-131:3.

Esoteric warrants like the LTWs are hardly the first type of equity interests that might be classified as liabilities due to a change in accounting principles. Prior to 2004, for instance, stock options issued to employees as compensation generally were not characterized as liabilities for accounting purposes, *Police and Fire Retirement Sys. of Detroit v. SafeNet Inc.*, 645 F. Supp. 2d 210 (S.D.N.Y. 2009), and courts universally treated them as equity under the Bankruptcy Code. *In re Lawton*, 261 B.R. 774, 777 (Bankr. M.D. Fla. 2001); *Allen v. Levey*, 226 B.R. 857, 865 (Bankr. N.D. Ill. 1998); *In re*

Am. West Airlines, 179 B.R. 893, 897 (Bankr. D. Ariz. 1995). Despite the adoption of accounting rule SFAS123 (Revised) in 2004, which required employers to expense employee stock options, those options remained equity interests. *See In re Enron Corp.*, 341 B.R. 141, 168-89 (Bankr. S.D.N.Y. 2006) (holding that employee stock options are "security equity interests); *In re WorldCom, Inc.*, No. 02-13533, 2006 WL 3782712 at *5-6 (Bankr. S.D.N.Y. 2006) (holding that because the claimant's stock options "enabled him to participate in the success of the enterprise and the distribution of profits," such options are treated as an equity interest, not a compensation claim).

Here, by its own terms, FAS150 applies to "many . . . instruments" which were "previously classified as equity" before May 2003. Ex. 142, at FAS150-1 (FAS150). Specifically, "certain obligations settleable by delivery of the issuer's equity shares but not indexed to the issuer's shares may have been classified as equity." *Id.* at FAS150-3. That accounting rules can sometimes classify "warrants as liabilities," and "classify them as equities" at other times, "reinforces the fact that you cannot rely on [them] to determine the true essence of an obligation." Chamberlain, 9/14/11 Tr. 213:3-14. In stark contrast, nothing about the Dime LTWs changed before or after May 2003, the date FAS150 became effective. *See* Ex. 142, at FAS150-3 (FAS150). "The warrant agreements hadn't changed, the public filings hadn't changed, nothing had changed but the accounting rules did." Chamberlain, 9/14/11 Tr. 80:21-25.

FAS150 is thus a classic example of a shifting accounting rule, and Plaintiffs cannot credibly claim that FAS150 reflects the economic essence of an instrument. Rather, the standard for a debt instrument adopted by FAS150 – the *possibility* of a payment obligation, *see* Ex. 142, at FAS150-5 (FAS150) ("an *obligation* is a conditional

or unconditional duty . . . to issue equity shares"), is very different from the standard established by *Color Tile*, which is the *certainty* of a payment obligation. *See* discussion *supra* at p. 20. Thus, there are many instruments that might be treated as liabilities under FAS150 because there is a "possibility" of a payment obligation but considered equity interests in bankruptcy because there is no "certainty of payment."

In their misplaced zeal to focus the Court on accounting theory, Plaintiffs point to the accounting treatment for the similar LTWs issued by Golden State Bancorp. In doing so, however, Plaintiffs ignore Dime and WMI's own accounting. Dime booked the expenses associated with the Dime LTWs as equity-related expenses under the header, "Consolidated Statements of Changes in Stockholders' Equity." Ex. 307, at F-4 (Dime Form 10-K405 dated April 2, 2001). Furthermore, the unrebutted testimony of Jonathan Goulding demonstrated that WMI never booked the LTWs as liabilities. Goulding, 9/20/11 Tr. 17:7-13; Ex. 27, at 1, 2 (WMI Form 10-Q dated Aug. 14, 2002). What WMI did disclose in its public financial statements is a clear statement summarizing the obligation to issue additional shares of stock to satisfy the LTWs if the Company succeeded in the goodwill litigation. Ex. 305, at 81 (WMI Form 10-K dated Dec. 31, 2007). Any LTW holder reading this could expect only to receive common stock and would have no expectation of payment ahead of creditors. Similarly, any creditor reading this could only expect that she would be ahead of LTW holders.

3. Dr. Chamberlain's Testimony Establishes That Dime LTWs Are Equity.

a. Equity Warrants Are Flexible Instruments.

Dr. Chamberlain, a former federal thrift regulator and thrift executive – and, most relevant here – an equity research analyst at Jefferies, Inc., covered thrift LPCs and

LTWs from their issuance and testified convincingly that the economic substance of the Dime LTWs here is equity. *See* Chamberlain 9/13/11 Tr. 193:15-197:24.

Consistent with Sarkozy's and Eitel's views that LTWs are equity warrants, the essential characteristic of a warrant is whether it is a derivative security issued by the company representing a conditional interest in the issuing firm's equity. *See* Chamberlain, 9/14/11 Tr. 33:10-15; Ex. 233, at 32 (Chamberlain Expert Rpt.). "Equity warrants have characteristics that can vary widely," *id.* at 33:10, and warrant terms may be tailored to meet the needs of the firm in almost limitless ways by the issuer. *See* Chamberlain, 9/14/11 Tr. 33: 16-25; Ex. 143 (Bodie, Kane, and Marcus article); Ex. 233, at 32 (Chamberlain Expert Rpt.).

Equity warrants do not always have a fixed exercise price, time period, or number of shares. In "today's world of amazingly complex and flexible instruments . . . the strike price and exercise period can . . . be complex formulas based on events or based on prices of other securities." Chamberlain, 9/14/11 Tr. 33:17-25; *see also* Sarkozy Dep. 49:13-50:5 ("A warrant has, you know, a number of features that, I guess, make it a warrant. *Typically*, they have a time frame. This one didn't, as I recall. And they have a strike price. This one doesn't. But, *typically*, warrants are an agreement to allow the holder to buy, *typically*, stock, at a future date, at a set price. As I recall, this warrant didn't have either the set price, or the future date. *But it was a warrant, nonetheless*.") (emphases added). In particular, strike price is unimportant here because the LTWs were "inverted, relative to most warrants" and thus the value of the LTWs depended not on their exercise price, but on any value that was "ultimately realized" in the goodwill litigation. Sarkozy Dep. 38:6-16.

Accordingly, "lack of a *predetermined* exercise price, number of shares, and expiration date does not change the fundamental nature of a warrant or convert a warrant into a debt security." Ex. 233, at 31 (Chamberlain Expert Rpt.); *see also* Ex. 137, at 1041 & n.1 (Chen article) (noting that some equity warrants have "indefinite length of life"). Although Plaintiffs reject Dr. Chamberlain's common-sense observation that formulas and contingencies may replace predetermined numbers, Plaintiff Nantahala's Rule 30(b)(6) representative hit the nail on the head when he agreed that one "can't generalize" when it comes to warrants. Mack Dep. 43:12-17.[9]

The Warrant Agreements here provide that each Dime LTW "represents the right to purchase shares or a portion of a share of Common Stock." Ex. 1, at 1; Ex. 3, at 1; Ex. 4, at 1 (2000, 2002, and 2003 Warrant Agreements). Because the Dime LTWs are securities that "represent the right to purchase, *upon the occurrence of the trigger*, shares of our common stock," Ex. 6, prospectus at 1; Ex. 7, prospectus at 4 (Registration Statements), and because the trigger may never occur, the Dime LTWs "represent conditional interests in the issuing firm's equity." Ex. 233, at 32 (Chamberlain Expert Rpt.). Further, Dime LTWs had a set "exercise period," namely, 45 days after the Trigger, and a set "exercise price," *id*., namely, the par value of the issuer's stock, and are equity warrants. Chamberlain, 9/14/11 Tr. 34:6-10.

[9] Dr. Chamberlain is not alone in rejecting Plaintiffs' rigid interpretation of equity warrants. In a research report provided from the files of Plaintiff Nantahala in discovery, Kevin Starke, a distressed-debt analyst at CRT Capital Group LLC, also rejected the Plaintiffs' definition of a warrant. "What the [Plaintiffs] [don't] recognize is that they [the Dime LTWs] do resemble warrants in most key aspects except that they have, in a sense, a zero strike price." Ex. 132, at NANT000024–25 (Starke Rpt.). Nantahala's 30(b)(6) witness, Daniel Mack, testified that Starke does a "nice job of tracking situations that other . . . research analysts don't want to focus on," Mack Dep. 72:19-21, and had read and interpreted the operative documents in "*good faith*," *id*., 75:18-21, in reaching his conclusions that the Dime LTWs are equity. Thus, while the Plaintiffs' counsel accused Mr. Starke of bias, their client considers him to be a reliable analyst.

Plaintiffs insist that equity warrants must have an exercise price, and a fixed exercise period, and must be susceptible to Black-Scholes valuation. But equity warrants do not need to have exercise prices or fixed dates. Ex. 137, at 1041 (Chen article). If Plaintiffs' standards were applied, many classic equity warrants would also fall short. For instance, the Golden State Five-Year Warrants, which Plaintiffs cite as a typical equity warrant, *see* Ex. 232, at 18 & n.26 (Levine Expert Rpt.), have an exercise price of zero. *See* Ex. 56, at Ex. 4.3, § 2.01 (Golden State Five-Year Warrant Agmt.). The perpetual warrants at issue in *R.A. Mackie & Co., L.P. v. PetroCorp Inc.*, 329 F. Supp. 2d 477 (S.D.N.Y. 2004), cited by Plaintiffs in their brief (Pl. Br. at 34), similarly lack any fixed time period for exercise. *Mackie*, 329 F. Supp. 2d at 481 ("the perpetual nature of the warrant . . . by definition, does not have an expiration date") (citations omitted).

Further, if susceptibility to Black-Scholes valuation is a litmus test for equity warrants, *see* Ex. 232, at 19 (Levine Expert Rpt.); Levine, 9/12/11 Tr. 80:12-23, that test simply confirms that Dime LTWs are equity warrants. As Dr. Chamberlain emphasized, "I guarantee you had the trigger event occurred, we could have Black-Scholes'd this thing [the Golden State LTWs] to death . . . ." Chamberlain, 9/14/11 Tr. 202:6-8. Plaintiffs' argument that Dr. Chamberlain's research reports did not use the Black-Scholes methodology to value the Golden State LTWs she followed as an analyst is a clumsy attempt at impeachment. No trigger had occurred when Dr. Chamberlain wrote those reports and Golden State was not in financial distress. Thus, the driver of the Golden State LTWs' value was the anticipated recovery in the goodwill litigation and that, sensibly, was the focus of Dr. Chamberlain's research and analysis.

At bottom, Plaintiffs are trying to use a ruler to measure a rubber band. Warrants are not defined rigidly. Instead, the "essential characteristic of a warrant" is whether its terms "represent conditional interests in the issuing firm's equity[,]" and that is exactly what the Dime LTWs represent. Ex. 233, at 32 (Chamberlain Expert Rpt.).

b. Equity Warrant Agreements Commonly Contain Adjustment Provisions.

Plaintiffs also insist the anti-dilution provisions in the Warrant Agreements show that Dime LTWs are not equity warrants, *see* Ex. 232, at 17 (Levine Expert Rpt.), and suggest that Dr. Chamberlain's reading of the relevant documents is "incomplete and inaccurate" because she did not include certain language from the 2000 Warrant Agreement in her report. *See* Pl. Br. at 31. This is a shallow attempt to impugn her diligence and it fails.

Dr. Chamberlain was forthright about the anti-dilution provisions, and she testified about her analysis of those provisions in her direct testimony. Dr. Chamberlain reviewed ten thrift equity warrant agreements, and testified candidly that "[t]hey all had . . . from the perspective of a financial analyst, similar adjustment provisions." Chamberlain, 9/14/11 Tr. 46:13-18, 38:16-25. In fact, anti-dilution clauses are a "standard type of provision [in] warrant agreements." Eitel Dep. 139:9-11; *see also id*. at 130:8-15 ("all warrants [with some exceptions] contain anti-dilution features . . . that would deal with adjustment to what you get, based on subsequent events."); 130:16:19; 149:13-16. Golden State's equity warrants, which Plaintiffs proffer as examples of standard equity warrants, contain substantially similar anti-dilution provisions permitting them to be "exercised for other securities, property, or cash" and adjusted in certain

circumstances.[10] Dr. Chamberlain's opinion that the possibility of adjustment does not change the economic substance of the instrument from equity to debt is thus well-supported. Anti-dilution provisions like those found in Article IV of the Warrant Agreements are common in equity warrants; their presence does not make the Dime LTWs debt instruments.

c. The Dime LTWs Traded as Contingent Equity Interests.

As Dr. Chamberlain testified, "[f]rom the start, Dime issued the Dime LTWs to its common shareholders . . . and listed them on NASDAQ, the same market where the GSBNZs, CALGLs, and CALGZs traded." Ex. 233, at 27 (Chamberlain Expert Rpt.). "Primarily equity securities and warrants of equity securities" trade on the NASDAQ, and accordingly, "[m]arket makers (like Jefferies) and broker-dealers use NASDAQ to post, bid, and offer prices primarily for equity securities." Chamberlain, 9/13/11 Tr. 211:11-19; Ex. 233, at 27 (Chamberlain Expert Rpt.). By contrast, instruments that are primarily debt instruments do not trade on the NASDAQ, and "[e]ven registered debt instruments . . . issued under an S-3 are generally traded over the counter . . . [including] U.S. Treasury Securities[.]" Chamberlain, 9/13/11 Tr. 211:14-19; *see also* Ex. 146, § 5225(a)(1)(A) (NASDAQ Listing Rules) ("All units shall have at least one equity component").

Consistent with Plaintiffs' focus on everything but the Dime LTWs at issue here, Plaintiffs claim that other litigation participation securities, such as the LPCs issued by Coast and Cal-Fed., are debt instruments yet trade on the NASDAQ. Dr. Chamberlain

[10] *See, e.g.* Ex. 56, at Ex. 4.3, § 3.03 (Five-Year Warrant Agreement between Glendale Federal Bank, FSB and Chemical Trust Company of California, dated Feb. 23, 1993); *id* at Ex. 4.4, §§ 3.01(e), (k) (Seven-Year Warrant Agreement between Glendale Federal Bank, FSB and Chemical Trust Company of California, dated Aug. 15, 1993).

explained, however, that when the LPCs were issued, "they were equity securities." Chamberlain, 9/14/11 Tr. 147:15-19. The characterization of the LPCs for bankruptcy purposes is, of course, not before this Court, but regardless of how one might characterize the LPCs for bankruptcy purposes, it is clear that Dime LTWs are much more like equity. In the LTW structure, any proceeds of the goodwill litigation stayed at the issuer and could be used to grow the balance sheet, and the warrants were exercisable for the issuers' common stock, not cash.

d. Equity-Market Participants Viewed LTWs as Contingent Equity Interests.

Plaintiffs contend Dr. Chamberlain's interaction with equity investors was limited to answering questions about the likelihood of success and magnitude of damages in goodwill litigation, and excluded any traditional analysis of equity valuation, thus suggesting that the LTWs were not, in substance, equity interests. *See* Pl. Br. at 23. This is mischaracterization on a grand-scale: Dr. Chamberlain presented overwhelming evidence that equity investors understood that LTWs were equity interests.

As a researcher in Jefferies' equity department, Dr. Chamberlain spoke frequently to clients about LPCs and LTWs. These clients included two of the largest mutual funds in the United States, as well as managers of mutual funds and hedge funds interested in buying and selling equity. *See* Chamberlain, 9/14/11 Tr. 200:5-25; Ex. 233, at 3 (Chamberlain Expert Rpt.). Those clients understood LTWs were an equity rights offering—"an issuance of stock by a publicly traded company first to its existing common shareholders before it's made available to the public," in direct proportion to shareholders' existing holdings, thus preserving their proportionate interest in the equity of the firm. *See* Chamberlain, 9/14/01 Tr. 34:12-20; Ex. 233, at 27 (Chamberlain Expert

Rpt.). This is consistent with Dr. Chamberlain's 1998 equity research report, which stated expressly that the Golden State LTWs were a rights offering. Ex. 110, at 4 (Chamberlain Golden State LTW Rpt.). The Dime LTWs were therefore an "equity offering" of common equity that is the "riskiest part of the capital structure." Eitel Dep. 109:15-16, 110:18-21.

Further, clients "clearly regarded them [LTWs] as equity securities," due to "the risk of regulatory intervention which affected both the common shares as well as the LTWs" and also because the equity value conveyed by the LTWs upon exercise depended on the price of the common stock. *See* Chamberlain, 9/13/01 Tr. 214:7-18; Ex. 233, at 28 (Chamberlain Expert Rpt.).

e. The Dime LTWs are Subject to the Equity Risk of Regulatory Intervention, and Their Price Reflected That Risk In *Extremis*.

Federal regulators, thrifts, and equity investors understood that LTWs were subject to regulatory risks. *See* Ex. 233, at 28 (Chamberlain Expert Rpt.); Chamberlain, 9/13/11 Tr. 197:5-13. In such situations, a regulator concerned that a thrift could become under-capitalized could block the distribution of goodwill litigation proceeds from the thrift to its holding company. Ex. 233, at 19-22 (Chamberlain Expert Rpt.). If regulators did that, the holding company would not be able to distribute common shares to the LTW holders because one of the prerequisites for the Trigger was regulatory approval. *See* Chamberlain, 9/13/11 Tr. 217:17-24. Further, even if regulators somehow permitted a thrift holding company to issue shares, doing so likely would cause catastrophic dilution of its equity capital. Issuing shares in these circumstances would defy "common sense and sound financial practice." *Id.* at 218:20-219:11. If regulators prevented the upstreaming of the dividend because the thrift was in financial distress, there would be

severe downward pressure on the stock price, making it infeasible to issue sufficient shares to satisfy the LTWs. *See id.* at 219:22-25; Chamberlain, 9/14/11 Tr. 15:16-20. Under the terms of the Warrant Agreements, the LTW holders would be fully exposed to this risk during the period between the Trigger date and their actual receipt of the shares. *See* discussion *supra* p. 42.

Plaintiffs' contention that the Registration Statements for the Dime LTWs are more typical of a debt instrument than an equity security is frivolous. The Registration Statement is expressly one for "common stock" and no investor could mistake it for anything other than an equity instrument. Plaintiffs insist the regulatory risk factors for Dime LTWs and Dime junior debt are "substantially identical" because holders of both securities faced similar risk of OTS intervention. *See* Pl. Br. at 20. The differences between the two passages in the registration statements, however, confirm that the Dime LTWs are equity interests, not debt. The regulatory risk factor for Dime LTWs groups the value of "Dime LTWs and Dime Common Stock" together, Exs. 6-7, at 5 (Registration Statements); in contrast, the risk factor for Dime's debt says it is dependent on its ability to receive that cash flow from Dime Bank because holders of that debenture receive cash "payments" from the holding company. Ex. 9, at S-4, S-3, S-5, S-16 (Dime 424(b)(5) filing).

Although Dime LTWs and Dime junior debt both shared regulatory risks, they did not share the same *degree* of regulatory risk. The risk factor in the debt instrument provides that in the event of a bankruptcy, the junior debt holders will be entitled to receive payments after the senior debt holders are paid off in full. *See* Ex. 9, at 15-16 (Dime 424(b)(5) filing). In contrast, the LTW Registration Statements did not suggest

the Dime LTW holders had any priority over other securities in bankruptcy. Furthermore, the absence of disclosures relating to the effect of a bankruptcy on LTW holders says nothing about the nature of the LTWs. As Dr. Chamberlain testified, "[t]he risk of bankruptcy is an ever present risk . . . [i]t's something that you would expect a broker to advise a client . . . [b]ut since it's an ever present risk not something idiosyncratic to any particular company or its securities, no [you would not expect to see it disclosed in a registration statement]." Chamberlain, 9/14/11 Tr. 31:15-19; *see* Ex. 233, at 30 (Chamberlain Expert Rpt.). Eitel, who actually drafted both Registration Statements, testified to the same effect. *See* Eitel Dep. 109:5-10. And if the testimony of the drafter of the documents were not sufficient, Dr. Chamberlain refuted Plaintiffs' argument empirically, reviewing equity registration statements for ten thrifts comparable to Dime at or near the time that Dime issued the LTWs and finding that *none* included any "cautionary statement on bankruptcy." Ex. 233, at 31 (Chamberlain Expert Rpt.).

f. The Price of the Dime LTWs Reflected Regulatory And Equity Risk When WMI Faced Equity Pressure.

In 2008, federal regulators did intervene. OTS forced WMI to reduce its dividends to its shareholders, Chamberlain, 9/14/11 Tr. 23:22-25, 24:1-25, 25:2, causing the price of the Dime LTWs to tumble. As Dr. Chamberlain testified:

> Q. [L]ooking at the time period from the end of 2007 to . . . September 2008, what [do] the facts that you see on this chart and the documents tell you about the potential impact of risk of regulatory intervention on the price of the DIMEZ?
>
> A. I think this is an outward and visible sign as measured by the plummeting of the stock price of DIMEZs of the shared equity risk between the Dime LTWs and the common shares of WMI. As I said previously, the price of WMI plummeted 82%. The price of the DIMEZs plummeted roughly 61% between March 18th and September 25th. I think this is a very strong outward and visible sign of this shared equity risk

> that's defined in the documents, both the registration statement and the warrant agreement.

Chamberlain, 9/14/11 Tr. 25:8-21. Nor was the decline in the Dime LTWs' price related to the overall health of the thrift industry during that time. From March 17, 2008 to September 2008, the "NASDAQ index for banks . . . actually went up three percent" and "the S&P index that tracks banks . . . that are part of the S&P index went [down] fourteen percent." *Id.* at 21:19-25, 22:1-6.

Plaintiffs' objections to this analysis have no merit. *First,* Plaintiffs attribute the drop in the Dime LTWs' price to the Federal Court of Claims' July 16, 2008 clerical reduction of the $382 million judgment by $26 million, and the government's appeal of that judgment in early September 2008. But $26 million dollars is less than seven percent of the $382 million dollar award; and given that the government had stretched the Anchor Litigation into its thirteenth year as of 2008, no one would expect the government *not* to appeal.[11] These two factors cannot account for the 61 percent drop in the price of Dime LTWs. Second, Plaintiffs complain that Dr. Chamberlain did not perform any statistical correlation; but Dr. Chamberlain's conclusion is driven by her analysis of the events and application of her professional judgment, not statistical correlation. Chamberlain, 9/14/11 Tr. 161:17-25, 162:1-2. Third, Plaintiffs admit WMI common stock "moved" more than banking indices, but assert this does not prove why the Dime LTWs' price moved. But WMI's share price did not just "move," it cratered, causing the price of the Dime LTWs to drop too, while the overall index of bank holding company stocks moved by far less. Fourth, Plaintiffs complain that if Dr. Chamberlain had chosen the day before

[11] Indeed, Dr. Chamberlain's own research report advised a decade before that the government likely would appeal an adverse judgment. *See, e.g.* Ex. 110, at 4 (Chamberlain, May 5, 1998) ("the trial has progressed with glacial speed and is likely to be appealed by the Department of Justice in the probable event that the US Court of Claims awards the $1.9 billion Glendale seeks.").

as her starting point, the LTWs would have increased in price when WMI stock price plummeted. This simplistic truism proves nothing; WMB won the Anchor Litigation that day, so naturally including that one day, when the LTWs soared in value, will skew the results. Defendants do not assert that the price of the LTWs will *always* move in sync with the price of WMI common stock, only that, in times of financial distress, when there is concern in the market about solvency, the two securities move together. Finally, Plaintiffs contend that after November 2008, there was no correlation between WMI common stock and the Dime LTWs' prices. WMI, however, filed for bankruptcy in late September 2008, so the prices for all its securities after that date were driven by the restructuring process and, as to the LTWs, by Plaintiffs' claims in this litigation.

g. The Dime LTWs Are Subject To Equity Market Risk At The Time of the Trigger.

Holders of Dime LTWs plainly were exposed to risk and reward based on the market price of WMI common stock. Once Dime received the Anchor Litigation proceeds, among other contingencies, the number of shares Dime LTW holders would receive was to be determined based on the stock prices in the *prior* 70 days. Then, after a mandatory delay, the price of delivered shares would be determined in the *next* 75 days when the warrants vested. *See* Ex. 233, at 23-26 (Chamberlain Expert Rpt.).[12]

In a hypothetical situation based on historical WMI stock prices, where Dime was awarded $300 million dollars and the Trigger occurred on October 5, 2007, Dime LTW holders would have received just $120 million in equity value. *See* Ex. 233, at 24-25

[12] Plaintiffs allege that Dr. Chamberlain focused "only on a theoretical 40-72 day period" of the overall existence of the LTWs. Pl. Br. at 20. This is a deliberate mischaracterization of the length of the LTWs' exposure to equity risk. Those two numbers refer to two, non-overlapping, periods, and should be summed. As Dr. Chamberlain's report makes clear, the LTWs were exposed to the equity risk for 145 calendar days. *See* Ex. 233 at Ex. 3B (Chamberlain Expert Rpt.).

(Chamberlain Expert Rpt.). Conversely, if the Trigger occurred on December 30, 2005, the holders would have received over $336 million in equity value. *Id.* at 25; *see generally*, Chamberlain, 9/14/11 Tr. 26:23-30:12. Dr. Chamberlain's hypothetical, which was unrebutted at trial, shows that LTW holders stood to lose or gain substantially based on nothing other than price movement in WMI common stock. *Id.*

Plaintiffs dismiss the 145-day window of risk exposure to the price of Dime (and later, WMI) stock as a short part of the Dime LTWs' lifespan. *See* Pl. Br. at 21.[13] This period, however, cannot simply be ignored. In fact it was the most critical period for the LTW holders because, absent the trigger, they would never be entitled to anything. The decisive factor is *whether* warrants are exposed to equity risk, not the *length* of that exposure. For example, a "European" warrant can be exercised only on its expiration date. Ex. 137, at 1041 (Chen article). Its value is thus dependent on the price of the underlying stock that *one* day, but it nevertheless is an equity warrant. Here, Dime LTWs were indisputably subject to equity risks.

4. Levine's Analysis was Not Credible.

In contrast to Dr. Chamberlain's demonstrated expertise on the economic substance of the Dime LTWs, Plaintiffs' expert Barry Levine has scant qualifications, had not even heard of litigation participation securities or LTWs before Plaintiffs hired him, failed to apply any methodology other than parroting Plaintiffs' legal arguments, and was shown at trial to be wrong on virtually every point he discussed. Determination of an expert's credibility is left to the discretion of the trial judge and will not be overturned except for an abuse of discretion. *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146

[13] Plaintiffs assert that "some of the equity risk during this theoretical period can be hedged[,]" but this is an admission that the LTWs do share equity risk and are in substance equity. *See id.* at 21 & n.20.

(1997); *Dow Chem. Can., Inc. v. HRD Corp.*, 656 F. Supp. 2d 427, 434 (D. Del. 2009). The Court should reject Levine's testimony because it was not credible.

Apparently unaware of the ample authority rejecting reliance on GAAP treatment to characterize an instrument as debt or equity, Levine testified that the accounting was a "major" factor in his analysis and spent much of his direct testimony reviewing accounting principles. Levine, 9/12/11 Tr. 57:16-59:17, 68:9-79:21, 86:23-88:3, 93:2-96:5, 96:25-98:14, 110:24-111:13. This was a transparent attempt by Plaintiffs to divert the Court from Levine's actual opinions on the economic substance of the LTWs, which were thoroughly discredited. Indeed, the Court need not look further than Levine's own report to see that Plaintiffs' reliance on GAAP is an after-the-fact attempt to salvage his testimony. Levine's report, required by Fed. R. Civ. P. 26(a)(2)(B)(ii) to disclose the data Levine considered in reaching his opinions, does not even mention FAS150 (or its current codification at FAS480) either in the text or in the list of materials considered. *See generally* Ex. 232 (Levine Expert Rpt.).

Every operative document and every fact witness actually involved with Dime LTWs stated that LTWs were meant to be exercisable for common stock, but Levine simply disregarded all information that contradicted his preordained conclusions.[14] Faced with Eitel's and Sarkozy's testimony that LTWs are stock warrants, Eitel's clear and crisp testimony that the intent was to give the LTW holders an equity interest in Dime corresponding to a portion of any eventual proceeds of the goodwill litigation, and Sarkozy's explanation that tax considerations were important driver of the decision to use

[14] *See, e.g.*, Ex. 5 (2003 Warrant Agmt.); Ex. 6 (Registration Statement); McQuade Dep. 32:23-33:10; Eitel Dep. 116:3-9; Sarkozy Dep. 49:13 to 50:5.

an equity warrant structure, Levine simply concluded that he knew better. Levine, 9/12/11 Tr. 143-44, 152; 9/13/11 Tr. 26-27.

Levine's testimony regarding the economic substance of the Dime LTWs was grounded on several key points relating to the nature of the instruments, each of which was proven wrong. He claimed that the only purpose of equity warrants is to raise money for the issuer, a proposition refuted by the testimony of Eitel and Sarkozy, who characterized the LTWs as equity warrants even though they were distributed as a dividend to shareholders rather than transferred for cash payment. *Compare* Levine, 9/12/11 Tr. 77:20-78:4; Ex. 232, at 17; *with* Ex. 193, Eitel Dep. 30:8-25, 31:2-9, 114:13-116:18; Ex. 195, Sarkozy Dep. 49:13-50:5. Levine claimed that equity warrants must have a fixed exercise price, Levine, 9/12/11 Tr. 162:4-8; Ex. 232, at 6, 17 (Levine Expert Rpt.), a proposition proven false when it was shown on cross examination that the Golden State warrant to which Levine himself pointed as an example of an equity warrant had an exercise price of zero, just like the Dime LTWs.[15] Levine, 9/12/11 Tr. 167:25 to 168:1; 168:23 to 169:11. He further claimed that an equity warrant must be exercisable "exclusively" for stock of the issuer, pointing to the anti-dilution adjustment mechanisms of Article IV of the Warrant Agreement as evidence that the Dime LTWs are not equity warrants, again ignoring the overwhelming evidence that virtually every warrant, including the ones he cited as examples, contains similar anti-dilution and adjustment mechanisms. Levine, 9/12/11 Tr. 158:3-25; Ex. 232, at 18 (Levine Expert Rpt.). Levine also asserted that the value of the Dime LTWs was tied only to the value of the

[15] Levine conceded on cross-examination that he had not even read the Golden State warrant agreements. Levine, 9/12/11 Tr. 166:19 to 167:10; 167:18 to 169:4, 12-21; 171:9-11. The Court should give his testimony no weight because he had not even done the most basic diligence necessary to understand the instruments on which he opined.

underlying goodwill litigation, dismissing the data clearly showing that the Dime LTWs followed the same downward path as did WMI common stock during times of severe financial distress, as occurred during 2008. *Compare* Levine, 9/12/11 Tr. 46:2-47:13; *with* Ex. 163 (graph of WMI stock vs. LTW price). In sum, Levine's opinions were based on unsupported theories, shoddy research, and outright dismissal of every stitch of evidence that contradicted his preordained conclusions. The Court should give his testimony no weight.

5. The Dime LTWs Are Not Asset-Backed Securities.

There simply is no support for Levine's theory that LTWs are asset-backed securities. Levine conceded, as he must, that the "asset" supporting an asset-backed security is typically held in a special-purpose vehicle. *Id.* at 156:5-12. Levine, 9/12/11 Tr. 155:19-22. The LTWs lack any separate trust. Indeed, the LTW structure was an explicit departure from the trust structure used in earlier variants of litigation participation securities, a change made specifically to accomplish economic goals and tax efficiency. Further, registered debt securities are generally subject to review and rating by rating agencies, unlike the Dime LTWs here. Chamberlain, 9/13/11 Tr. 211:16-25; 212:1-6, 10-25; 213:1-9.

Levine ignored the SEC's explicit guidelines for what constitutes an asset-backed security. SEC regulations define asset-backed securities as "a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, . . . that by their terms convert into cash within a finite time period[.]" 17 C.F.R. § 229.1101(c)(1). Additionally, the SEC states that "[t]he activities of the issuing entity for the asset-backed securities are limited to passively owning or holding the pool of assets, issuing the asset-backed securities supported or serviced by those assets, and other

activities reasonably incidental thereto." 17 C.F.R. § 229.1101(c)(2)(ii). Levine's testimony is that the asset backing the LTWs is the issuer's contingent "promise to pay" by issuing a "variable number of shares" upon the eventual resolution of the goodwill litigation. Levine, 9/12/11 Tr. 70:4-5; 131:5-132:8; 153:12-154:15. This conflicts with the SEC's requirement that asset-backed securities be "primarily serviced by cash flows of a discrete pool of receivables" and "convert to cash within a finite time period." 17 C.F.R. § 229.1101(c)(1)-(2). Indeed, Levine emphasized in his testimony that the LTWs lack a finite exercise or maturity period. Levine, 9/12/11 Tr. 154:9-15. Further, Levine's admission that WMI and Dime could continue running their primary business as savings and loan institutions while being the issuer of the LTWs directly contradicts the SEC's rule that the activities of the issuer of asset-backed securities are limited to "passively owning or holding the pool of assets[.]" *Compare* Levine, 9/12/11 Tr. 156:5-157:4, *with* 17 C.F.R. § 229.1101(c)(2)(ii).

B. WMI Did Not Breach the 2000 Warrant Agreement.

1. The Warrant Agreements Should Not Be Construed Against WMI.

Faced with overwhelming evidence that the economic substance of the Dime LTWs is equity, not debt, Plaintiffs must fall back on a series of claims, each one more tenuous than the last, for breach of contract. This section addresses Plaintiffs' claim that the 2002 and 2003 amendments to the Warrant Agreement stripped away an ostensible right to elect cash upon exercise of the LTWs. The plain language of the Warrant Agreement and extrinsic evidence demonstrate that the LTW holders had no such right.

A court should give a contract's language its ordinary and plain meaning, *Krumme v. Westpoint Stevens Inc.*, 238 F.3d 133, 139 (2d Cir. 2000), and construe an

agreement to give full meaning and effect to all of its provisions. *Paine Webber v. Bybyk*, 81 F.3d 1193, 1199 (2d Cir. 1996). Where ambiguity is found, extrinsic evidence may be introduced to aid the court in determining intent. *Seiden Assocs., Inc. v. ANC Holdings, Inc.*, 959 F.2d 425, 429 (2d Cir. 1992); *Mellon Bank, N.A. v. Aetna Bus. Credit, Inc.*, 619 F.2d 1001, 1009 (3d Cir. 1980). Here, the extrinsic evidence concerning the intent of all three versions of the Warrant Agreement and the Merger Agreement overwhelmingly demonstrates that the intent was that LTW holders would receive stock.

Plaintiffs improperly invoke the doctrine of *contra proferentum.* *Contra proferentum* is used only as a matter of *last resort* after all aids to construction have been used but have failed to resolve ambiguities in a written instrument. *Union Ins. Soc'y of Canton v. William Gluckin & Co.*, 353 F.2d 946, 951 (2d Cir. 1965); *Schering Corp. v. Home Ins. Co.*, 712 F.2d 4, 10 (2d Cir. 1983) (observing that *contra proferentum* as an aid of last resort is "clearly the law in New York"); *Prior v. Innovative Comm'n Corp.*, 207 F. App'x 158, 166 n.2 (3d Cir. 2006) (same). The language of the Warrant Agreement itself and the extrinsic evidence of intent resolve any ambiguities in the documents, making it improper to invoke *contra proferentum* as a tool of contract construction. Further, Plaintiffs are sophisticated hedge funds trading in highly-distressed securities, and thus "sophisticated business entities, familiar with the market in which they deal[.]" *Id.* The *contra proferentum* doctrine is intended to protect unsophisticated parties and does not apply here.

2. WMI Did Not Breach Section 4.2(b) of the 2000 Warrant Agreement.

Plaintiffs rely on section 4.2(b), which provides:

> The proportion and type of capital stock, other securities or property that the Holders will have the right to receive in the circumstance set forth in

> Section 4.2(a) will be in the same proportion and type as one share of Common Stock was exchanged for or converted into as a result of such Combination . . . .

Ex. 1, § 4.2(b) (2000 Warrant Agmt.). Plaintiffs contend that section 4.2(b) requires that LTW holders receive the same mixture of cash and stock as given to Dime shareholders. The plain language of section 4.2(b), however, applies only to Combinations where "*one share* of Common Stock" was "exchanged for or converted" into a particular "proportion and type of capital stock, other securities or property." *Id.* (emphasis added). Section 4.2(b) therefore only applies when all shareholders receive *unitary* consideration, *i.e.* where every share of stock is converted into identical consideration. Under the terms of the merger, Dime shareholders received *variable* consideration: WMI stock, cash, or a mixture of WMI stock and cash, all depending on the outcome of an election process. At the time of the merger, no shareholder knew exactly what she would receive, and even *after* the merger, shareholders received differing consideration—some received all cash and some received a mixture of cash and WMI stock.

Plaintiffs offered no extrinsic evidence relating to the intent of section 4.2(b). The only evidence they offered at trial was the treatment of the Golden State LTWs after the Citigroup-Golden State merger. In that situation, the Golden State LTW holders were not given any election and they did not receive exactly the same consideration as shareholders. Rather, the warrant terms were modified to provide for payment partly in cash and partly in stock, in the same proportion as was provided to shareholders in the aggregate. *See* Ex. 64, § 4.2(b) (Golden State LTW Agmt.); Ex. 61, at 1-2 (Citigroup Prospectus). Industry custom and practice is only relevant where the practice is known through "such regularity of observance in a place, vocation or trade as to justify an

expectation that it will be observed" with respect to the transaction in question. *Flower City Painting Contractors v. Gumina Constr. Co.*, 591 F.2d 162, 165 (2d Cir. 1979). The party introducing industry custom or practice has the burden of clearly establishing that either (1) the other party had actual knowledge of the custom, or (2) that the custom or practice is so notorious, well established, and reasonable that the other party should have had such knowledge. *B.P Apparel, Inc. v. Hunt*, No. 97-4095, 1999 WL 551892, *5 (E.D. Pa. June 16, 1999). Plaintiffs have not met their burden to establish a "notorious, well established and reasonable" standard for interpreting the anti-dilution provisions of section 4.2(b). The Golden State-Citi merger which closed after the WMI-Dime merger, does not reflect any industry-wide custom or practice with respect to adjustment of LTWs. *See Pub. Serv. Elec & Gas Co. v. Tech. for Energy, Corp*. (*In re Tech. For Energy, Corp.*), 140 B.R. 214, 227 (Bankr. E.D. Tenn. 1992) (holding that "a custom of the trade cannot be proved by an isolated practice confined to a peculiar kind of [instrument]").

Because section 4.2(b) is inapplicable by its own terms to transactions where variable consideration is provided to shareholders, Plaintiffs were never entitled to any cash election under the Warrant Agreement. Because no election right ever was required or provided to the LTW holders, Plaintiffs' assertion that WMI wrongfully revoked it is nonsensical.

3. WMI Did Not Breach Section 4.2(c) of the 2000 Warrant Agreement.

Nor was there any breach of section 4.2(c), which applies only in circumstances where the sole consideration payable to shareholders is cash. The preface to the section makes it clear that it applies only "[i]n the event of a Combination where consideration is

payable to holders of Common Stock in exchange for their shares *solely in cash. . .*]" Ex. 1, § 4.2(c) (2000 Warrant Agmt.) (emphasis added). It is beyond dispute that consideration paid to Dime shareholders was not "solely in cash," it was a mixture of cash and stock. Section 4.2(c) thus does not apply.[16]

Plaintiffs argue that "holders of Common Stock" refers to *any* shareholder of common stock, suggesting that if any *one* Dime shareholder received 100 percent cash consideration, then all Dime LTW holders are entitled to cash. The next clause of that sentence, however, refers to LTW holders collectively, not individually. Read together, the terms "holders of Common stock" and "Holders" of LTWs refer to the entire class of common stock and LTW holders, respectively. *Id.* Further, in the 2000 Warrant Agreement, the phrase, "holders of Common Stock" always refers to collective holders of Common Stock. *See, e.g.*, Ex. 1, § 4.5 (a notice will be sent to "holders of Common stock"); § 3.7(b) (specifying a meeting of the "holders of Common stock."). Nor have Plaintiffs provided even an iota of extrinsic evidence in support of their strained interpretation. Indeed, the sole evidence offered—the example of the Golden State-Citigroup merger—refutes their claim. Golden State's LTW Warrant Agreement contains a provision substantially identical to section 4.2(c), and some shareholders in the Golden State-Citibank merger received all cash, but holders of Golden State LTWs were not provided an all-cash option as Plaintiffs now contend the Warrant Agreement requires. *See* Ex. 64, § 4.2(c) (Golden State LTW Agmt.); Ex. 61, at 1-2 (Citigroup Prospectus).

[16] The claim for a breach of section 4.2(c) was never asserted before appearing in Plaintiffs' post-trial brief, and is absent from both the complaint and the pre-trial order. Under Del. Bankr. Local Rule 16.3(d)(4) it is barred.

4. WMI's Amendment To The 2000 Warrant Agreement Was Required By Section 4.2(d) And Permitted By Section 7.2.

The only provision in Article IV that applies to the Dime-WMI merger is section 4.2(d), which requires a successor by merger to make adjustments as "nearly equivalent as may be practicable" to the adjustments provided in Article IV. That is precisely what WMI did here. Every fact witness testified that the 2000 Warrant Agreement contemplated exercise of the LTWs for common stock, and the Registration Statements and Warrant Agreements and more than a dozen other public filings say just that. *See* discussion *supra* p. 15. WMI and Dime never granted any election to the Dime LTW holders, and the post-merger amendment to the Warrant Agreement was consistent with section 4.2(d) and the expectations of the LTW holders that their equity warrants would not be involuntarily converted into cash instruments, potentially triggering tax consequences.

Even if sections 4.2(a), (b), or (c) somehow applied, amendment of the Warrant Agreement to substitute WMI stock for Dime stock was expressly permitted under section 7.2 because it did not adversely affect the holders:

> **Amendment**. This Agreement may be amended by the parties hereto without the consent of any Holder for the purpose of curing any ambiguity, or of curing, correcting or supplementing any defective provision contained herein or making any other provisions with respect to matters or questions arising under this Agreement as the Company and the Warrant Agent may deem necessary or desirable; provided, however, that such action will not affect adversely the rights of the Holders . . . .

Conversion to WMI common stock had no adverse affect on the holders, and was permissible under section 7.2 without holder consent. The Dime LTWs were designed and implemented as warrants exercisable for common stock, and the amendments kept them that way, preserving the original expectations of Dime LTW holders. Sohn Dep.

125:14-23, 126:1-13. Further, Dime LTWs had been designed to avoid adverse tax consequences to the holders, and giving Dime LTW holders an option to elect stock or cash would have risked exactly the tax consequences the instruments were designed to avoid. *See* Ex. 231, at 5 (Pomp Expert Rpt.).

In a variety of contexts, courts assess actions affecting contracts at the time those actions are taken, even if they later become adverse due to subsequent events. *See, e.g.*, *In re Pittsburgh-Canfield Corp.*, 283 B.R. 231, 240 (Bankr. N.D. Ohio 2002) ("The test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable manner, and it is immaterial that hindsight may later prove that the method of cover used was not the cheapest or most effective."); *L.L. Bean, Inc. v. Metro-Autospan, Inc.*, No. CV-88-1362, 1989 Me. Super. LEXIS 250, at *11-12 (Me. Super. Ct. Dec. 11, 1989) ("[W]hen determining whether an entire contract or any of its parts is so unconscionable as to justify its judicial rescission or cancellation, the matter will not be judged in hindsight but by the situation as it existed at the time the bargain was struck."); *Wilson v. Dexter*, 135 Ind. App. 247, 253 (Ind. Ct. App. 1963) (contract execution "may not be viewed from hindsight," but rather "[t]he circumstances surrounding the parties at the time of the execution . . . should be all controlling"). Here, the effect of the amendment must be measured at the time of the adjustment, in 2002. At that time it was "inconceivable that WaMu would go bankrupt." Sarkozy Dep. 70:22-23. Plaintiffs have offered no evidence to refute the plain fact that the change from Dime stock to WMI stock after the merger was not adverse to LTW holders in any way.

Plaintiffs cite *R.A. Mackie & Co. v. PetroCorp Inc.*, 329 F. Supp. 2d 477 (S.D.N.Y. 2004) and *Continental Airlines Corp. v. Am. Gen. Corp.*, 575 A.2d 1160 (Del.

1990) for the proposition that LTW holders are entitled to an election of cash or stock. Both cases, however, concern changes that adversely affected warrant holders at the time the changes were implemented. *R.A. Mackie* involved a merger agreement that terminated the perpetual exercise period of warrants, which was expressly preserved by the warrant agreement in the event of a merger. 329 F. Supp. 2d at 482. In *Continental*, the merging companies eliminated the warrant holders' rights to receive stock options, despite numerous public disclosures to the contrary. *Continental*, 575 A.2d at 1165-66. In both of those cases, the merging companies effectively destroyed the value of the warrants as of their merger date. In contrast, WMI's amendment to the 2000 Warrant Agreement was not adverse to the holders. See supra at p. 52. Moreover, neither *R.A. Mackie* nor *Continental* involved a claim for damages in bankruptcy on account of an alleged adverse change to the warrant. In the one case on point, the bankruptcy court rejected application of *R.A. Mackie* and concluded that no claim for breach existed. In *In re Calpine Corp.*, No. 05-60200 (BRL), 2007 WL 4326738, at *12 (S.D.N.Y. Nov. 21, 2007), holders of convertible debt sued the debtor for breach of contract, alleging that their notes – which were convertible to cash or stock upon certain contingencies – entitled them to convert the notes into cash. *Id.* at *1, 8. The Court rejected that argument, and held that because conversion rights were not exercisable as of the petition date and there was nothing in the relevant agreement preserving those conversion rights in the event of a bankruptcy filing, the warrant holder could not claim damages. *Id.* at *12.

5. Professor Pomp's Testimony Is Relevant To Demonstrating That The Adjustments Made by WMI At The Time of the Merger Were Not Adverse To The LTW Holders.

Professor Pomp's testimony shows that if the LTW holders had been given a right of election at the time of the merger, they would have been subject to tax on phantom income. Plaintiffs concede that Dime issued its LTWs with "tax considerations in mind." Pl. Br. at 41. Avoiding phantom income, however, was not just a "consideration": it was a critical reason why thrifts used the LTW structure in the first place, as confirmed by Sarkozy and other witnesses. Sarkozy Dep. 55:22-25, 56:2-3; McQuade Dep. 55:6-11; Chamberlain, 9/13/11 Tr. 205:5-18, 211:1-6.

Plaintiffs offered no evidence to rebut Pomp's testimony and instead attack it on the sole basis that WMI allegedly lacked evidence showing that tax implications for the LTW holders actually were considered a decade ago at the time of the merger. This misses the mark. The issue is whether the adjustments made by WMI adversely affected the LTW holders under the objective standard set forth in sections 4.2(d) and 7.2 of the Warrant Agreement, not whether, ten years later, WMI is able to find a witness who can testify about its subjective considerations. After carefully analyzing the tax consequences of granting a future election to the Dime LTW holders as of 2002, Pomp testified that any such election would have created phantom income for those holders in 2002, and that WMI's amendment of the 2000 Warrant Agreement avoided this adverse tax impact.

6. The Merger Agreement Supports WMI's Interpretation of the 2000 Warrant Agreement.

The lynchpin of Plaintiffs' arguments under sections 4.2(b) and (c) is their contention that section 2.10 of the Merger Agreement grants the LTW holders, upon

exercise of the LTWs, a right to receive an election. The plain language of the Merger Agreement and its drafting history contradict this argument.

As a threshold matter, section 10.10 of the Merger Agreement precludes the LTW Holders from asserting any claim for breach of that agreement. That section states "this Agreement including the documents and instruments referred to herein is not intended to confer upon any person other than the parties hereto any rights or remedies hereunder." Ex. 12, § 10.10 (Merger Agmt.). Plaintiffs were not parties to the Merger Agreement; to the extent they assert their breach of contract claims under section 2.10 of the Merger Agreement, those claims are foreclosed as a matter of law. *See Everest Props. II, L.L.C. v. Am. Tax Credit Props. II, L.P.*, No. 99C-08-122, 2000 WL 145757, at *5 (Del. Super. 2000) (barring third party from asserting rights where contract had a clear no-beneficiary clause).

The Merger Agreement itself makes clear that section 4.2(d) – not sections 4.2(a), (b), and (c) of the 2000 Warrant Agreement – controls the consideration that LTW holders will receive. Section 7.13 of the Merger Agreement states:

> Washington Mutual shall enter into an agreement with the Warrant Agent confirming the rights of holders of LTWs as provided in Section 4.2(d) of the Warrant Agreement. Washington Mutual shall use its best efforts to maintain the trading designation of the LTWs on the Nasdaq Stock Market.

Ex. 12, § 7.13 (Merger Agmt.). Section 4.2(d) requires the successor to make only changes be "as nearly equivalent as may be practicable" to the other provisions of Article IV. Where section 4.2(b) was inapplicable because of the variable nature of the consideration paid to Dime shareholders, and section 4.2(c) was inapplicable because it

was not "solely" a cash transaction, application of those sections in the way Plaintiffs urge was not "practicable."

The defined term "Merger Consideration" in the Merger Agreement does not include any election. In point of fact, the express language refers to a "method of elect[ion]" that falls outside the definition of "Merger Consideration." Ex. 12, § 2.15 (Merger Agmt.). Further, an election is a mechanical procedure, not an "amount or kind of consideration." The remainder of the Merger Agreement, too, makes clear that there was no intent to provide any right of election to LTW holders. For example, section 2.6 of the executed Merger Agreement, titled "Election Procedures," provides that an election form will be sent to holders of Dime common stock and Warburg Warrants, but lacks any reference to LTW holders.

When the drafters of the Merger Agreement intended to convert an equity security into a right to receive cash, they did so expressly. Thus, section 3.1 requires WMI to make "Merger Consideration" available in the form of cash and WMI common stock for holders of the Warburg Equity Warrants and Dime common shares, but lacks any reference to the Dime LTWs. Ex. 12, §§ 2.6 & 3.1 (Merger Agmt.). In fact, all other provisions referencing LTWs allude only to their right to get WMI common stock: section 8.1(b) provides that shares of WMI common stock to be issued to LTW holders will be authorized for listing on the NYSE and section 7.6 states that WMI will try to get shares of WMI common stock issued in the merger to LTW holders approved for listing on the NYSE. *Id*. §§ 8.1(b), 7.6.

The drafting history of the Merger Agreement resolves any ambiguity and confirms Dime and WMI intended for the LTWs to be exercisable solely for common

stock after the merger. The Merger Agreement was drafted by Simpson Thacher & Bartlett LLP ("STB") and Heller Ehrman LLP ("Heller") (counsel for WMI) and Sullivan & Cromwell LLP ("S&C") (counsel for Dime), and every draft of that agreement up to the execution date unequivocally stated that the Dime LTWs would be exercisable for WMI common stock. On June 22, 2000, Myrna Barakat, an S&C associate, provided a blackline of her comments on section 2.10 of the draft Merger Agreement. Significantly, Barakat did not change the fundamental concept that the Dime LTWs would be satisfied in WMI common stock after the merger and addressed her comments only to the formula language. She edited section 2.10 as follows:

> [E]ach outstanding Litigation Tracking Warrant ("LTW") issued by Dime pursuant to the Warrant Agreement . . . shall entitle the holder thereof to receive upon exercise of such LTW in accordance with the terms of the Warrant Agreement a number of shares of W Common Stock ~~equal to the Adjusted Litigation Recovery (as defined in the Warrant Agreement) *divided by* the Maximum Number of Warrants (as defined in the Warrant Agreement) *divided by* the aggregate Adjusted Stock Price (as defined in the Warrant Agreement) of the consideration provided in Section 2.5(b) for one share of Empire Common stock.~~ **determined pursuant to the Warrant Agreement.**

Ex. 88, at STB06606 (blackline draft merger agreement). That same day, Bernard Russell, a Heller Ehrman partner, circulated his comments on that same provision. He, too, did not change the basic idea that the Dime LTWs would be exercisable for WMI common stock, but disputed the formula's math. *Id.* at STB06641. The drafts thus show no intent by either party to provide any election to LTW holders. The lawyers were simply tinkering with the formula, apparently in an attempt to ensure consistency with the formula set forth in section 4.2(a) of the 2000 Warrant Agreement. *See, e.g.*, Ex. 89, at STB 06574 (draft merger agreement reflecting S&C's changes to the formula); Ex. 1, § 4.2(a) (2000 Warrant Agmt.) (providing the correct formula).

On June 25, 2001, hours before the execution of the Merger Agreement, an STB associate resolved the competing comments to the formula by eliminating it altogether, replacing the whole clause with "Merger Consideration, consistent with the terms of the Warrant Agreement thereof." Ex. 92, at 1 (STB Cover Email); Ex. 93, at STB24172 (Draft Merger Agmt.). The drafting history thus demonstrates that the parties to the Merger Agreement intended the LTWs to be exercisable for WMI common stock after the merger. Consistent with that, Mr. Sohn testified that the problem with defining "Merger Consideration" was not whether it represented stock or cash, because it was clear that LTW holders would receive WMI common stock. Instead, the issue was how much stock that term represented under the relevant formula. *See* Sohn Dep. 47:5-14, 51:24-25, 52:1-10; 88:4-11.

7. WMI and Dime's Public Disclosures Support WMI's Interpretation of the 2000 Warrant Agreement.

From June 25, 2001, the date that Merger Agreement was concluded and the merger was announced, through January 2002, when the merger closed and the 2002 Warrant Agreement was executed, Dime and WMI made numerous public disclosures consistently reporting that the LTWs would be exercisable for WMI common stock after the merger. None of these documents even hint that LTW holders would have any right to elect cash. In addition to a notice delivered to LTW holders that stated what Dime LTW holders and Dime shareholders would receive in the merger,[17] WMI and Dime also filed *six* public disclosures between June 25 and December 2001 reiterating that fact. *See*

[17] Section 4.5 of the 2000 Warrant Agreement required Dime to "send the Holders a Notice . . . [which] will briefly indicate the effect of such action on the Common Stock and on the number and kind of any other shares of stock and on other securities or property, if any, *and the number of shares of Common Stock and other securities or property, if any, purchasable upon exercise of each Warrant* and the Exercise Price *after giving effect to any adjustment which will be required as a result of such action*." Ex. 1 at § 4.5 (2000 Warrant Agmt.) (emphases added).

discussion *supra* p. 15. This extrinsic evidence confirms that the intent of the Merger Agreement, the January 4, 2002 Replacement Warrant Agent Agreement, and the 2002 and 2003 Warrant Agreements was to satisfy the LTWs in WMI common stock after the merger.

Plaintiffs insist the phrasing of the public disclosures somehow refers to a right to elect cash, pointing to the italicized language: "[f]ollowing the closing of the Merger, each outstanding LTW will entitle its holder to receive, *upon exercise of such LTW in accordance with the terms of the Warrant Agreement*, shares of Washington Mutual common stock." Ex. 41 (Dime LTW Notice) (emphasis added). This is nonsense: these disclosures plainly state that Dime LTW holders will get WMI stock. The reference to the terms of the Warrant Agreement means only that no shares of WMI stock would be available to the holders unless all the other requirements of the Warrant Agreement were satisfied (*i.e.* the Trigger occurs). If anyone intended LTW holders to have election rights or to be entitled to anything other than WMI common stock, those disclosures would certainly have said so explicitly.

8. Any Claims Are Barred by the Statute of Limitations.

a. Any Claims Accrued in Mid-2001.

Plaintiffs' claim for breach of the 2000 Warrant Agreement has no merit, but even if it did, any claim is barred by New York's six-year statute of limitations. *See* N.Y. C.P.L.R. § 213; *Porwick v. Fortis Benefits Ins. Co.*, 99 CV 10122 (GBD), 2004 WL 2793186, at *4 (S.D.N.Y. Dec. 6, 2004) (holding that the New York statute of limitations for a declaratory judgment claim arising from a contractual dispute is six years).

"In New York, a breach of contract cause of action accrues at the time of the breach" and thus the statute of limitations "runs from the time of the breach though no

damage occurs until later." *Ely-Cruikshank Co., Inc. v. Bank of Montreal*, 615 N.E.2d 985, 986 (N.Y. 1993) (collecting cases) (citations omitted). "For purposes of the statute of limitations, it is the fact of breach, not its effects, that sets the clock ticking." *Employers Ins. v. 1133 Bldg. Corp.*, No. 93 Civ. 1393, 1994 U.S. Dist. LEXIS 1836, at *6 (S.D.N.Y. Feb. 24, 1994) (citing *Ely-Cruikshank*). "Except in cases of fraud where the statute expressly provides otherwise," which is not pled here, "the statutory period of limitations begins to run from the time when liability for wrong has arisen *even though the injured party may be ignorant of the existence of the wrong or injury*." *Ely-Cruikshank*, 615 N.E. 2d at 987 (emphasis added). Specifically, when warrant holders bring an action against a company to seek what shareholders received in a merger, the statute of limitations begins running on the date the adjustment provision becomes operative and there is no longer "legitimate uncertainty" as to what warrant holders would receive after the merger. *Gandal v. Telemundo Grp., Inc.*, 23 F. 3d 539, 542 (D.C. Cir. 1994).

Here, the alleged breach occurred on June 25, 2001, when WMI and Dime publicly and unequivocally declared that Dime LTWs would be exercisable for WMI stock after the merger. Anyone who cared to read what WMI and Dime said in 2001 would have been aware that the LTWs would be honored solely in WMI common stock after the merger. Plaintiffs' Rule 30(b)(6) representative, Daniel Mack, confirmed that anyone who believed the LTWs were entitled to something other than common stock would have recognized that the companies' public disclosures stated otherwise. *See* Mack Dep. 95:23-25; 96:1-4.

At latest, the breach would have occurred on January 7, 2002, the date the Warrant Agreement was amended to substitute WMI stock for Dime stock. Plaintiffs themselves contend the amendment has legal significance. For example, the complaint alleges that, by "virtue of the WMI/Dime Combination, and the availability of the cash election, *as of 2003*, LTW holders were entitled to be paid their share of the 85% net recovery in the Anchor Litigation in the form of cash." Ex. 212, at 3, 18 (3d Am. Compl.) (emphasis added). Plaintiffs assert the breach "as of" execution of the 2003 Warrant Agreement in March of 2003, the only event in 2003 relating to the Warrant Agreement. The evidence at trial has now shown that the change to the Warrant Agreement about which Plaintiffs complain actually occurred 14 months earlier, on January 7, 2002.

Any cause of action for breach of the 2000 Warrant Agreement thus accrued in June 2001, when Dime and WMI made clear their intention to convert the LTWs into a right to acquire WMI common stock, or at latest on January 7, 2002 when WMI entered into the 2002 Warrant Agreement after fully disclosing the intention to honor the Dime LTWs in WMI common stock. The six-year statute of limitations thus ran no later than January 2008, before WMI filed for bankruptcy.

b. The 2002 Warrant Agreement Is Authentic And Admissible.

There is no question that the 2002 Warrant Agreement is authentic. The copy offered into evidence as Exhibit 3 is signed by *both* parties: Mellon Investor Services LLC and WMI. It was produced from the files of the warrant agent, Mellon, in response to a subpoena served by *Plaintiffs*. This alone is sufficient foundation to establish

authenticity. *McQueeney v. Wilmington Trust Co.*, 779 F.2d 916, 929 (3d Cir. 1985) (fact that plaintiff produced documents in discovery held probative of their authenticity).

Dennis Treibel, in charge of the WMI account at Mellon, maintained Mellon's records relating to the LTWs—mainly the warrant agreements and fee schedules. Treibel Dep. 13-14, 26-27, 31-32. Upon receipt of Plaintiffs' subpoena, Treibel sent his files to Mellon's New York counsel, who produced copies to Plaintiffs' and Defendants' counsel. These copies produced by Mellon are admissible "to the same extent as originals" under Federal Rule of Evidence 1003.[18]

The timing of the 2002 Warrant Agreement also supports its authenticity. After the merger, Mellon replaced Equiserve Trust Company, N.A, as the LTWs' warrant agent, and Mellon required a new contract with WMI to govern that relationship and establish a fee schedule. *See* Ex. 2 (Jan. 2002 Replacement Warrant Agent Agmt.); Roh Dep. 23, 26-29, 33-34; Treibel Dep. 9-12, 26. WMI had also committed to amending the 2000 Warrant Agreement pursuant to section 4.2(d). Ex. 2, at 1 (Jan. 2002 Replacement Warrant Agent Agmt.). Amendments made in the 2002 Warrant Agreement accomplished both objectives. For example, section 7.2 added a requirement that "[p]rior to executing any amendment or supplement to this Agreement, an Officer of the Company shall deliver to the Warrant Agent a certificate that states that the proposed supplement or amendment is in compliance with the terms of this Section 7.2." Ex. 3, § 7.2 (2002 Warrant Agmt.). No such requirement existed in the 2000 Warrant

[18] "[W]hen the only concern is with getting the words or other contents before the court with accuracy and precision, then a counterpart serves equally as well as the original, if counterpart is the product of a method which insures accuracy and genuineness. By definition in rule 1001(4), a duplicate possess this character." Fed. R. Evid. 1003, advisory committee's note.

Agreement. The last page of the 2003 Warrant Agreement is an "Officer Certificate" signed by WMI's general counsel, Fay Chapman, which states:

> Pursuant to *Section 7.2 of the Amended and Restated Warrant Agreement, dated as of January 7, 2002*, by and between the Company and the Warrant Agent (the "Prior Agreement"), the undersigned officer does hereby certify to the Warrant Agent that the New Agreement and the execution thereof are in compliance with Section 7.2 of the Prior Agreement.

Ex. 5 (Officer's Certificate, last page) (emphasis added). This certificate confirms that the 2002 Warrant Agreement in fact existed. *See id.*; Ex. 3, § 7.2 (2002 Warrant Agmt.); Treibel Dep. 18-23.

Multiple witnesses with knowledge authenticated the 2002 Warrant Agreement, satisfying Fed. R. Evid. 901(b)(1).[19] Julie Roh, the assistant vice president and relationship manager at Mellon for its WMI account from 1989 to 2005, identified her signature on the 2002 Warrant Agreement and testified that she had read it in its entirety in 2002 at the time she signed it. Roh Dep. 5-6, 8-10, 29-30. Her successor, Mr. Treibel, who inherited the WMI account at Mellon, including servicing the LTWs, also testified that the 2002 Warrant Agreement is authentic. Treibel Dep. 7-10, 13-14, 18-23, 26-27, 31, 36. He further explained that, in his experience, a page of an agreement may occasionally be found out of order in the document, and situations arise where signature pages are executed separately. This is ample explanation why the signature page is out of order and the signature page trailer is not identical to the trailer on the rest of the document. *Id.* at 16-17.

[19] "The burden of proof for authentication is slight," and "all that is required is a foundation from which the fact-finder could legitimately infer that the evidence is what the proponent claims it to be." *McQueeney*, 779 F.2d at 928; *United States v. Reilly*, 33 F.3d 1396, 1404-05 (3d Cir. 1994) ("There need be only a *prima facie* showing of authenticity").

Section 7.7 of the Warrant Agreement, titled "Counterparts and Facsimile," states that "this Agreement may be executed in any number of separate counterparts," and deems each counterpart "an original," as well as providing that "[e]xecuted signature pages to this Agreement may be delivered by facsimile and such facsimiles will be deemed as sufficient as if actual signature pages had been delivered." Ex. 3, § 7.7 (2002 Warrant Agmt.). The agreement itself thus contemplated both that a copy would be sufficient to prove its terms and that the signature page(s) could be executed separately. Plaintiffs' contention that "facsimile" means only a telecopy is inconsistent with the plain meaning of the word. *See* Black's Law Dictionary 483 (Abridged 7th ed. 2000) (defining "facsimile" as "[a]n exact copy."); Shorter Oxford English Dictionary 916 (6th ed. 2007) (same); The Am. Heritage Dictionary 633 (4th ed. 2006) (same). Plaintiffs also assert that the fully-executed agreement was never delivered back to WMI, but do not cite a single case requiring proof of delivery of a contract to prove its authenticity.

C. Defendants Did Not Breach the 2003 Warrant Agreement.

1. Defendants Did Not Breach Section 4.2(d).

Plaintiffs allege that WMI and its Directors breached section 4.2(d) of the 2003 Warrant Agreement in connection with the Global Settlement Agreement ("GSA").[20] Section 4.2(d), however, only applies in the event of a "Combination," defined as "an event in which the Company consolidates with, merges with or into, or sells all or substantially all its property and assets to another Person." Ex. 4, at 3 (2003 Warrant Agreement). Plaintiffs argue that 4.2(d) applies because the GSA (Ex. 250) is a sale of substantially all WMI's assets. Joint Pre-Trial Order at 12. This allegation was

[20] Section 4.2(d) states: "The Company hereby represents and warrants that any Successor Company will enter into, and the Company will provide, an agreement with the Warrant Agent confirming the Holders' rights pursuant to this Section 4.2[.]" Ex. 5 at § 4.2(d) (2003 Warrant Agmt.).

completely disproved by the evidence at trial. The testimony clearly established that the GSA is not a sale of substantially all assets but a comprehensive settlement of competing claims of ownership.

WMI did not sell its assets through the GSA; the GSA resolved disputes of competing ownership, allowing WMI to clawback assets over which it claimed ownership but had lost possession or control as a result of the seizure of WMB. Goulding, 9/20/11 Tr. 18:20-24. The resolution of the parties claims to disputed assets will be implemented, in part, by a section 363 mechanism in the Debtors' plan of reorganization (the "Plan") by which JPMC will relinquish any right, title or interest it may have had to the assets WMI will retain for the bankruptcy estate, and WMI will relinquish any right, title or interest it may have had to the assets JPMC will retain.

Plaintiffs' contention that the GSA is a sale of substantially all assets is completely unsupported by any evidence. Levine's entire analysis is one conclusory sentence in his report. Ex. 232, at 29 (Levine Expert Rpt.). In contrast, Jon Goulding, WMI's treasurer, testified about the details of the GSA and offered ample support for the conclusion that the GSA is not a sale of substantially all assets but rather a comprehensive resolution of competing claims to disputed assets. Goulding, 9/20/11 Tr. 18:18-24. If and when the GSA becomes effective, WMI will hold *substantially more* assets than it currently has.

The evidence showed that the GSA "*substantially increased* the [Debtors' assets] by about *six and a half billion [dollars]." Id.* at 19:3-4 (emphasis added); *see also* Ex. 250 (GSA). The plain fact is that, without the GSA, WMI had about $1 billion in undisputed assets and after the GSA it will have about $7.5 billion. Goulding, 9/20/11

Tr. at 20:6-9, 20-23. In addition to the non-disputed assets it held at the petition date, WMI will retain ownership of the deposits, tax refunds, payment on the intercompany notes, certain BOLI-COLI assets, the American Savings Bank goodwill litigation and the Ahmanson Rabbi Trust. *Id.* at 12-19. The GSA does include a sale of the VISA shares for $25 million and a sale of other minor assets, but, in all, WMI is selling only approximately $40 million of assets. A sale worth $40 million encompassed in a $6.5 billion settlement is not a sale of "substantially all" assets.

Plaintiffs' non-bankruptcy authorities are inapposite. In *Gimbel v. Signal Co., Inc.*, 316 A.2d 599 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974), *In re Nantucket Island Assoc. Ltd. P'ship Unitholders Litig.*, 810 A.2d 351 (Del. Ch. 2002), *Thorpe by Castleman v. CERBCO, Inc.*, 676 A.2d 436 (Del. 1996), *Winston v. Mandor*, 710 A.2d 835 (Del. Ch. 1997) and *Katz v. Bregman*, 431 A.2d 1274 (Del. Ch. 1981), each company at issue had the option of not entering the sale and continuing its business. Here, WMI's subsidiary thrift was seized, not sold. WMI had no option to maintain control of WMB, and the change in WMI's "existence and purpose" was irreversible even before WMI began settlement negotiations.

Plaintiffs have to lump together the seizure of WMB, the GSA, and the distributions that will be made under the Plan in order to conjure up a sale of substantially all assets. The effect of their argument, however, would be to convert virtually every equity warrant to debt when the issuer files for bankruptcy, because anti-dilution adjustment provisions are common in equity warrants. Plaintiffs cannot credibly argue that boilerplate adjustment mechanisms in an equity warrant effectively immunize LTW holders from the effects of the Bankruptcy Code.

Finally, assuming *arguendo* that upon going effective the Plan and GSA did constitute a sale of substantially all of WMI's assets, the LTW holders would only be entitled to whatever WMI common shareholders receive in that transaction. *See* Ex. 4, § 4.2 (2003 Warrant Agmt.). Because WMI common shareholders will likely receive nothing in exchange for their common stock as a result of the seizure of WMB, FDIC's sale of its assets to JPMC, and consummation of the GSA and the Plan, the Dime LTWs have no value, and there are no damages for any purported breach.

2. Defendants Did Not Breach Sections 4.4 and 4.5 of the 2003 Warrant Agreement.

Section 4.4 of the 2003 Warrant Agreement states:

> If any event occurs as to which the foregoing provisions of this Article IV are not strictly applicable or, if strictly applicable, would not, in the good faith judgment of the Board, fairly and adequately protect the purchase rights of the Holders of the [LTWs] in accordance with the essential intent and principles of such provisions, then the Board ***may*** make, without the consent of the Holders, such adjustments to the terms of this Article IV, in accordance with such essential intent and principles, as will be reasonably necessary, in the good faith opinion of such Board, to protect such purchase rights as aforesaid.

(emphasis added). Emergence from bankruptcy is not an event requiring adjustment under Article IV of the 2003 Warrant Agreement, which refers only to "reclassification, redesignation or reorganization" described in Section 4.1 or any Combination described in Section 4.2. Ex. 4, § 4.1(a) & (b) (2003 Warrant Agmt.). The Plan does not effect any of these categories of change to the common stock of WMI. The kinds of "reclassification, redesignation or reorganization" mentioned are voluntary business deals and out-of-court restructurings, not a chapter 11 reorganization.

Further, section 4.4 *permits* adjustments to protect the "purchase rights" of the LTW holders, but does not require it, and thus cannot be breached by a decision not to

amend. *See, e.g., ASM Commc'ns Inc. v. Allen*, 656 F. Supp. 839, 839 (S.D.N.Y. 1987) ("In common usage and understanding, the word 'shall' signifies a command" whereas "[t]he word 'may' is permissive."); *Proyecfin de Venezuela, S.A. v. Banco Indus. De Venezuela, S.A.*, 760 F.2d 390, 396 (2d Cir. 1985) (holding that use of "may" in forum selection clauses is permissive, not mandatory). There is no merit to Plaintiffs' contention that interpreting section 4.4 as permissive deprives it of meaning. It means that, in circumstances where the specific language of sections 4.1, 4.2, and 4.3 does not apply, the Board has discretion to make an adjustment consistent with the general spirit of the anti-dilution provisions in order to protect the purchase rights of the holders. Under section 4.4, those adjustments can be made without the need to seek consent of the holders, and without regard to the standards for modification under section 7.2.

Section 4.4 does not impose any duty on WMI or its board to cause JPMC to assume responsibility for the Dime LTWs. As a matter of law, the FDIC succeeded to all rights of WMB. The Federal Deposit Insurance Act provides the powers and duties of the FDIC as receiver, and specifies that the FDIC as receiver may "take over the assets of . . . the insured depository institution" such as the rights to the Anchor Litigation. 12 U.S.C. § 1821(d)(2)(B)(i). WMI had no power to require JPMC to do anything in connection with its acquisition of WMB assets from the receivership. The risk that WMI common stock might prove worthless due to enforcement actions by banking regulators is exactly the risk Plaintiffs took when they acquired equity securities in a thrift holding company and was plainly disclosed in the Registration Statement. *See* Ex. 6, prospectus at 5 (Registration Statement) (noting that regulatory restrictions may prevent distribution of Anchor Litigation award to Dime). Because Plaintiffs apparently bought LTWs *after*

WMI filed for bankruptcy, they bought not just with knowledge of the risk factors, but with actual knowledge that the worst case scenario for WMI common stock had in fact *already occurred*. *See* Mack Dep. 20:22-21:5 (noting that LTWs were purchased in first or second quarter of 2010). Defendants therefore had no right (or power) to cause JPMC to assume the LTW liabilities in the GSA.

What WMI and its board did do was maximize the value of the estate, fulfilling their fiduciary duties to all stakeholders. They sought legal counsel on the requirements of the 2003 Warrant Agreement and appropriately treated the LTWs as equity interests. McQuade Dep. 137:15-138:20. Goulding testified that Debtors never asked JPMC to assume obligations to LTW holders because Debtors "always viewed" the LTW obligations as equity interests. Goulding, 9/20/11 Tr. 24:10-11. Assumption of the LTW obligations by JPMC would "catapult the LTW obligation from an equity interest to essentially a priority claim where JPMC would pay them a hundred cents, and that reduction would be a reduction in the value that would then get transferred back to WMI and, therefore, be value available for distribution to creditors." *Id.* at 24:14-21. Most ridiculous is Plaintiffs' assertion that WMI has breached an imagined "duty" to propose a plan that pays the LTWs in cash as a claim. The Warrant Agreement imposes no such duty, but even if it did, WMI has satisfied it because the Plan provides that the LTWs will be treated as claims if the Court decides they are not equity interests. *See* Ex. 249, at § 25.1 (Plan).

Section 4.5 is merely a notice provision which only requires notice to be given in the event of any of the transactions described in section 4.4. It imposes no independent affirmative duty of amendment that does not otherwise exist in Article IV.

3. Defendants Did Not Breach Section 6.3 of the 2003 Warrant Agreement.

Section 6.3 of the Warrant Agreement does not require Washington Mutual Bank or any successor to retain control over the Anchor Litigation. Plaintiffs' contention that it does (Pl. Br. at 44) contradicts the plain language of the 2003 Warrant Agreement and relevant case law. Section 6.3 states:

> The Bank will retain sole and exclusive control of the Litigation and will retain 100% of any recovery from the Litigation. *The Holders will not have* any right to control or manage the course or disposition of the Litigation or the proceeds of any recovery therefrom or *any rights against the Company for any decision regarding the conduct of the Litigation or disposition of the Litigation*[.]

Ex. 4, § 6.3 (2003 Warrant Agmt.) (emphasis added). This provision clearly states that the LTW holders have no right whatsoever with respect to how the litigation is or was pursued and who receives the actual recovery. No duty was imposed on either WMI or WMB with respect to the handling of the case or its proceeds, and Plaintiffs offered no extensive evidence to the contrary.

The purpose of section 6.3 is clear on its face; it states that the LTW holders will not have any control over the Anchor Litigation. Its purpose and intent is not to impose an affirmative duty on WMI to maintain WMB's control over the litigation, but rather to restrict the LTW holders from exercising such control. Accordingly, Plaintiffs have no standing to assert any claim for an alleged breach. *See Straughn v. Delta Air Lines, Inc.*, 170 F. Supp. 2d 133, 150 (D.N.H. 2000), *aff'd*, 250 F.3d 23 (1st Cir. 2001) (only an intended beneficiary of a contract provision may claim its breach). Although the plain language of the text alone makes this point clear, it also can be gleaned from the

surrounding sections, all of which protect WMI's rights.[21] Numerous comments in the registration statement likewise explain that section 6.3 acts as a restriction on the LTW holders' rights, not an affirmative covenant that WMB would forever retain control of the Anchor Litigation. Ex. 6, at 2, 4, 18-19, 22-23 (Registration Statement).

D. The WMI Directors Are Not Liable.

1. Plaintiffs Offered No Evidence That the WMI Directors Were Personally Bound Under the 2003 Warrant Agreement.

During the trial, Plaintiffs put on no evidence that the WMI Directors were liable for the breach of contract claims in the Complaint.[22] Plaintiffs concede none of the WMI Directors are signatories to, or expressed an intent to be personally bound by, the 2003 Warrant Agreement, upon which they base their only causes of action against the WMI Directors. *See* Compl. 2d & 3d Causes of Action ¶¶ 71-89. It is axiomatic that only parties to a contract can be bound by its terms. *See Pac. Carlton Dev. Corp. v. 752 Pac., LLC*, 878 N.Y.S.2d 421, 422 (N.Y. App. Div. 2d Dep't 2009) (holding that because defendant was "not a party to the contract alleged to have been breached[,]" he "cannot be bound by the contract"); *Nat'l Survival Game of N.Y. v. NSG of LI Corp.*, 169 A.D.2d 760, 761 (N.Y. App. Div. 2d Dep't 1991) (same). Moreover, it is well settled that "[a] director is not personally liable for his corporation's contractual breaches unless he assumed personal liability, acted in bad faith or committed a tort in connection with the

[21] As a whole, Article VI of the 2003 Warrant Agreement protects WMI's rights and not those of LTW holders: section 6.1 prohibits LTW holders from exercising any rights conferred to stockholders, section 6.2 sets forth prerequisites that LTW holders must satisfy before enforcing any alleged LTW-related rights, and section 6.4 restricts LTW holders from challenging any determination by WMI or its board of directors regarding the number of shares of stock issuable to LTW holders upon occurrence of the trigger events. *See* Ex. 4, at Article VI (2003 Warrant Agmt.).

[22] Defendants incorporate by reference the legal arguments asserted in the Motion of the WMI Director Defendants to Dismiss Plaintiffs' Second Amended Class Complaint [Adv. Dkt. No. 180], and the Reply of the WMI Director Defendants to Plaintiffs' Opposition to WMI Director Defendants' Motion to Dismiss Plaintiffs' Second Amended Class Complaint [Adv. Dkt. No. 198].

performance of the contract." *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1177 (2d Cir. 1993); *see also Liang v. Sollecito*, No. 097990 CVN 2010, 2010 WL 4668334, at *1-2 (N.Y. Civ. Ct. Nov. 18, 2010) ("officers of a corporation . . . cannot be held personally liable on contracts provided that they did not bind themselves individually").[23]

Plaintiffs failed to prove that the WMI Directors did *anything* to manifest an intent to be personally bound. Indeed, the 2003 Warrant Agreement contains only limited references to the WMI Board as a collective institution, and the majority of named WMI Directors first served as WMI directors *after* the 2003 Warrant Agreement was executed.

2. The 2003 Warrant Agreement Imposes No Fiduciary Duty on the WMI Directors.

The 2003 Warrant Agreement does not refer to any fiduciary duty, nor do the WMI Directors occupy a fiduciary position with respect to the LTW holders. *See* Ex. 5 (2003 Warrant Agmt.). Plaintiffs argue that sections 4.4 and 5.1 of the 2003 Warrant Agreement create a duty on behalf of the WMI Directors to protect the rights of LTW holders if an event occurred for which an adjustment was required and that the WMI Directors had a fiduciary duty to protect the LTW holders in 2010 when the GSA was reached because the original LTW holders in 2000 were also Dime shareholders. Pl. Br. at 51. Thus, after arguing for 50 pages that they *are not* equity holders, Plaintiffs flip flop and claim that they have the *rights* of equity holders simply because the original owners

[23] In addition, although none of the WMI Directors signed any of the Warrant Agreements, even if they had, there is a "presumption against individual liability" under New York law when an individual signs a contract in his or her corporate capacity as an officer or director of a corporation, as opposed to a personal capacity. *Lerner v. Amalgamated Clothing & Textile Workers Union*, 938 F.2d 2, 3 (2d Cir. 1991) (noting the absence of evidence of "the signatory's explicit intent to assume personal liability" where a corporation's president signed contract in his corporate capacity as president).

of their instruments were shareholders. Not surprisingly, Plaintiffs cite no case law to support this proposition.

It is well-established that a corporation's directors do *not* owe any fiduciary duty to holders of warrants. *Helvering v. Sw. Consol. Corp.*, 315 U.S. 194, 200-01 (1942) ("Whatever rights a warrant holder may have to require the obligor corporation to maintain the integrity of the shares covered by the warrants . . . he is not a shareholder . . . His rights are wholly contractual. . . . And he cannot assert the rights of a shareholder") (citation omitted); *MCG Capital Corp. v. Maginn*, No. 4521-CC, 2010 Del. Ch. LEXIS 87, at *54 (Del. Ch. May 5, 2010) ("Under Delaware law, directors do not owe fiduciary duties to warrant holders under any circumstances. The rights of warrant holders are governed exclusively by the terms of their warrants."). As a matter of law, the WMI Directors owed no fiduciary duties to Plaintiffs, but even if the Warrant Agreement did impose duties on the individual board members, they satisfied their obligations by maximizing the value of the estate for all constituents. No fiduciary duty requires the board to favor one equity constituency over every other stakeholder.

E. No Constructive Trust Is Appropriate.

In their post-trial brief, Plaintiffs for the first time ask the Court to impose a constructive trust. The argument is meritless as well as untimely.[24] The argument is frivolous. Claimants bear the burden of proof of a constructive trust, and bankruptcy courts are "reluctant to impose constructive trusts without a substantial reason to do so," *XL/Datacomp, Inc. v. Wilson* (*In re Omegas Grp., Inc.*), 16 F.3d 1443, 1451 (6th Cir. 1994), because it wreaks "havoc with the priority system ordained by the Bankruptcy

[24] Having failed to assert this theory in either their complaint or the pre-trial order, it is barred under Local Rule 16.3(d)(4).

Code." *In re Haber Oil*, 12 F.3d 426, 436 (5th Cir. 1994). Plaintiffs have not come close to meeting their burden of proof here. Their sole argument is that WMI purportedly pledged the LTW holders the value of the Anchor Litigation, but it is well-established that "[t]he right to have a demand satisfied from specific property does not give rise to a constructive trust." *The Cadle Co. v. Mangan*, 316 B.R. 11, 21 (D. Conn. 2004).

Constructive trust is only available when contractual remedies are not, *In re First Cent. Fin. Corp.*, 377 F.3d 209 (2d Cir. 2004), and the mere existence of a written agreement may bar a constructive trust. *Briggs v. Goodyear Tire & Rubber Co.*, 79 F. Supp. 2d 228, 236-37 (W.D.N.Y. 1999). At bare minimum, "[w]here there exists a valid and enforceable written contract governing a particular subject matter, quasi-contractual claims, including claims for unjust enrichment and constructive trust are not allowed." *In re Stylesite Mktg., Inc.*, 253 B.R. 503, 507-508 (Bankr. S.D.N.Y. 2000); *Cherno v. Dutch Am. Mercantile Corp.*, 353 F.2d 147, 154 (2d Cir. 1965) ("breach of a contract concerning payment of a debt furnishes no basis for the finding of a constructive trust").

Plaintiffs also argue that the WMI estate holds no equitable interest in the Anchor Litigation proceeds and they are therefore not property of the estate under section 541(d) of the Bankruptcy Code. This is true insofar as WMI has no separate assets traceable to the Anchor Litigation, a proposition that defeats their own constructive trust theory, which requires that assets be traceable. But it is false insofar as Plaintiffs claim that any interest in cash generated by an eventual resolution of the Anchor Litigation belongs to them. Their own expert conceded that, under the LTW structure, the proceeds of the litigation would belong to the issuer of the LTWs, not the holders. *See* Levine, 9/12/11 Tr. 132:22-134:1. The only interest Plaintiffs have is an equity interest in WMI.

F. Even If the Court Finds A Breach of Contract, Plaintiffs' Breach of Contract Claim Is Subject To Subordination Under Section 510(b).

If the Court concludes the Dime LTWs are equity interests, it need not reach WMI's subordination counterclaim. Even if the Court sustains Plaintiffs' breach of contract theories, however, any resulting claim is subject to mandatory subordination under section 510(b). Section 101(49) of the Bankruptcy Code defines "security" to include notes, stocks, debentures, any other "claim or interest commonly known as a 'security,'" and any "certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase or sell, a security." 11 U.S.C. § 101(49) (xiv)-(xv). There is no question that the LTWs are securities, and Plaintiffs concede this. Pl. Br. at 14 (discussing features of "securities like the LTWs"). Indeed, the Dime LTWs are securities on two levels. They are equity warrants themselves; and as derivatives, they represent a contractual right to acquire common stock.

The Third Circuit has broadly held that a claim "arises from the purchase or sale" of a security, and is therefore subject to section 510(b) subordination, so long as there exists "some nexus or causal relationship between the claims and the purchase of the securities[.]" *Baroda Hill Invs., Ltd v. Telegroup, Inc.* (*In re Telegroup, Inc.*), 281 F.3d 133, 138 (3d Cir. 2002) (holding shareholder claims for breach of a provision in a stock purchase agreement properly subordinated); *In re Int'l Wireless Comm's Holdings, Inc.*, 257 B.R. 739, 743 (Bankr. D. Del. 2001) (Walrath, J.) (subordinating claim arising out of debtor's breach of agreement to repurchase stock it had issued to claimants if it failed to make an initial public offering of its stock by a certain date), *aff'd*, 279 B.R. 463 (D. Del. 2002), *aff'd*, 68 F. App'x 275 (3d Cir. 2003); *see also In re Touch Am. Holdings Inc.*, 381

B.R. 95, 103-106 (Bankr. D. Del. 2008) (indemnification claims subordinated because claims would not exist but for underlying lawsuit based on purchase of the debtor's stock).

Because the LTWs represent the right to acquire common stock, Plaintiffs' breach of contract claims arise from the purchase of a security and are subordinated to the level of common stock under section 510(b). As this Court has held, section 510(b) applies to breach of contract claims similar to those asserted here. *See Int'l Wireless*, 257 B.R. at 743 (subordinating claim arising out of debtor's breach of agreement to repurchase stock it had issued to claimants if it failed to make an initial public offering of its stock by a certain date); *see also In re Public Serv. Co. of N.H.*, 129 B.R. 3, 5 (Bankr. D.N.H. 1991) (holding that "the language of 510(b) is broad enough to include breach of contract and related actions as well"). The LTW holders would not have claims *but for* their ownership of LTWs, which are nothing more than contingent rights to *acquire* WMI stock. The very language Plaintiffs rely upon in asserting breach of contract confirms that their claims arise from the purchase of common stock. For example, section 4.4 of the Warrant Agreement speaks of adjustments to protect the "purchase rights" of the LTW holders. Furthermore, the LTWs were originally awarded to LTW holders based on their ownership of Dime stock.[25] Ex. 4, § 2.1(a) (2003 Warrant Agmt.). Any claim that LTW holders might have would not exist *but for* their interests in ownership Dime and WMI stock.

[25] The fact that the LTW holders received the LTWs as a dividend based on their ownership of Dime stock, rather than purchasing the LTWs, is irrelevant for the purposes of 510(b) subordination. *See In re Betacom of Phoenix, Inc.*, 240 F.3d 823, 831 (9th Cir. 2001) (subordinating claim for breach of merger agreement, even though merger agreement provided for payment in cash and stock, and holding that "an actual purchase or sale [of securities] is not required for mandatory subordination").

Plaintiffs' argument that the LTW holders are entitled to "delivery of a fixed amount of value, *i.e.*, 85% of the net litigation proceeds," does not save the LTW holders' claims from the broad reach of section 510(b) subordination. Pl. Br. at 3. In *International Wireless*, the Third Circuit held that a claimant's contract right to an "amount certain" did not prevent subordination where the claim arose from the purchase or sale of a security. *Int'l Wireless*, 68 F. App'x at 278 ("Thus, F & W's claim is really one for nondelivery of an equity security-a claim 'arising from . . . a purchase . . . of a security of the debtor.'") (quoting 11 U.S.C. § 510(b)).

The existence of anti-dilution language that, in certain circumstances, could make the LTWs exercisable for consideration other than stock, does not prevent subordination. As this Court has held, an agreement that provides for compensation partially in the issuer's stock, and partially in another currency, remains an agreement for the purchase of stock of the issuer, and thus any claims arising from the agreement must be subordinated pursuant to section 510(b). *Int'l Wireless*, 257 B.R. at 743 ("The Share Purchase Agreement, as ultimately executed, provided for the transfer of IWCH stock *as partial compensation* for the Pakistan Mobile stock. Thus, there was a 'purchase' of stock of one of the Debtors, IWCH.") (emphasis added).

Similarly, Plaintiffs' mistaken belief that the LTW holders are entitled to payment in cash does not save their claim from subordination. In *In re Enron Corp*, 341 B.R. 141 (Bankr. S.D.N.Y. 2006), former Enron employees filed claims based on stock options they received as compensation and opposed subordination claiming they were entitled to receive cash upon the exercise of their options. *Id.* at 166-67. The bankruptcy court held that section 510(b) mandated subordination of the claims:

> Because employee stock options are designed to be exercisable in the normal course of business, employees do not recognize that options merely grant them the right to purchase and do not represent a promise to pay . . . .
>
> Nonetheless, these mistaken impressions, however justifiable they may be, do not change the nature of the instrument. Employee stock options are simple "rights" contracts, and while they have a value relative to the demand for that right, they do not have an absolute minimum value intrinsically.
>
> . . . .
>
> [H]owever [claimants] might have understood the options they held, employee stock options are securities, and section 510(b) reflects the Congressional judgment that securityholders should bear the risk of insolvency and securities fraud.

Id. at 168-89. Like the securities at issue in *Enron,* the LTWs are simple rights contracts—they are securities that convey the right to acquire stock upon the occurrence of the Trigger.

Even if the Court concludes that the LTWs do represent a "promise to pay" and that the LTWs are not equity securities, the LTW holders' claims must still be subordinated. Section 510(b) subordination applies to all claims arising from the purchase or sale of securities—including debt securities. *See In re Mid-American Waste Sys., Inc*., 228 B.R. 816, 825 (D. Del. 1999) ("The Bankruptcy Code defines the term 'security' to include a 'note,' 'bond,' or 'debenture' . . . . Thus, by its plain terms § 510(b) is intended to apply to both debtholders and equityholders.") (citations omitted); *In re Geneva Steel Co.,* 281 F.3d 1173 (10th Cir. 2002) (subordinating fraudulent retention claim arising from retention of debt securities); *In re Vista Eyecare, Inc*., 283 B.R. 613 (Bankr. N.D. Ga. 2002) (finding that claim arising out of a put option agreement, even if representing a contingent claim, must be subordinated under section 510(b)); *In re NAL Fin. Grp., Inc.*, 237 B.R. 225, 231 (Bankr. S.D. Fla. 1999) (holding

that claim for breach of contract based on failure to register debentures must be subordinated under section 510(b) because claim arose from the purchase of a security in that the debtor "would not have failed to register the Debentures and thus [claimant] would not have incurred any damages if [claimant] did not purchase the Debentures in the first place."). Whether the LTWs are equity securities affects only the level of subordination, not the fact that subordination is mandated.[26]

CONCLUSION

For the foregoing reasons, the Court should enter judgment denying Plaintiffs relief on all counts of the Third Amended Complaint.

Dated: November 3, 2011
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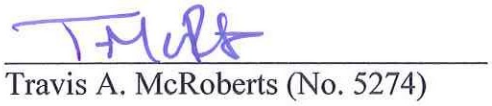
[26] If the Court finds that the LTWs are equity then the LTW holders have claims in Class 21. If the Court finds in favor of Plaintiffs on their breach of contract claim, and finds that the LTWs are not equity securities, then the LTW holders have claims in Class 18.

CERTIFICATE OF SERVICE

I, Travis A. McRoberts, do hereby certify that on November 3, 2011, I caused copies of the ***Defendants' Post-Trial Brief*** to be served on counsel in the manner indicated on the attached service list.



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