Docket #9235 Date Filed: 12/21/2011

IN THE UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re: WASHINGTON MUTUAL, INC., et al., Debtors.	Chapter 11 Case No. 08-12229 (MFW) Jointly Administered **Hearing Date: January 11, 2012 at 2:00 p.m. (EST)** **Related Dkt. Nos. : 9178, 9179, 9180, 9181**

OBJECTION TO THE DISCLOSURE STATEMENT FOR THE SEVENTH AMENDED PLAN BY CLASS REPRESENTATIVES OF THE DIME LITIGATION TRACKING WARRANTS

TO: THE HONORABLE MARY F. WALRATH,
UNITED STATES BANKRUPTCY JUDGE

Nantahala Capital Partners, LP, Blackwell Capital Partners, LLC, Axicon Partners LLC, Brennus Fund Limited, Costa Brava Partnership III, LP, and Sonterra Capital Master Fund, Ltd. (collectively, the "**Claimants**"), for themselves and as class representatives ("**Class Representatives**") of the Dime Litigation Tracking Warrants ("**LTWs**"), by their undersigned counsel, submit this objection ("**Objection**") to the *Disclosure Statement for the Seventh Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code* [Dkt. 9179] ("**Disclosure Statement**").[1] In support hereof, the Claimants represent as follows:

1. On January 7, 2011 and on September 13, 2011, the Court rendered Opinions denying confirmation of the Debtors' proposed plans of reorganization. In connection with the September 13 Opinion, the Court referred certain matters to mediation ("**Mediation**"), including various issues raised by the Equity Committee. The Mediation led to certain compromises which are reflected in the Plan.

[1] Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the *Seventh Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code* [Dkt. 9178] ("**Plan**").

2. In September 2011, the Court conducted a trial on whether the LTWs were claims against the Debtors or equity interests in the Debtors ("**Adversary Proceeding**"). The Class Representatives contend the LTWs are claims against the Debtors. The matter is *sub judice*.

3. In the Debtors' prior proposed plans of reorganization, equity security holders were not receiving a distribution, so the primary focus of the LTWs' dispute with the Debtors related to whether the Debtors' proposed plans properly treated LTWs in the event the Court determined they had claims against the Debtors. Based on objections successfully made by LTW Holders, the Court determined, among other things, that:

(a) Any liens or claims that the LTW Holders may have as a result of the sale of the Anchor Litigation to JPMC can be asserted against the proceeds of the Global Settlement.

(b) The LTW Holders, as a group (and not just Broadbill), are entitled to a Disputed Claims Reserve.

(c) The Disputed Claims Reserve is not $184 million (as the Debtors originally contended), but has been set by the Court after an evidentiary hearing at **$337 million**.

(d) The Debtors' Board of Directors will not be exculpated to the extent LTW Holders have asserted proper claims against them in the Adversary Proceeding.

4. The Claimants still have a few remaining issues with the Plan in the event the Court determines they hold claims against the Debtors, but the matter is not yet resolved by Final Order. Those issues primarily relate to whether (i) LTW Holders should be compelled to decide whether to give third-party releases before it is determined by Final Order whether they are creditors of the Debtors, and (ii) whether LTW Holders should be prohibited from trading their LTWs prior to it being determined by Final Order whether they are creditors of the Debtors.

5. Significantly, the Claimants have ***no*** material issues with the Plan in the event it was agreed that they were Class 12 creditors under the Plan. The Claimants believe that they should have Class 12 status, and that their rights thereto will ultimately be vindicated.

6. At this point, however, there is no agreement or judicial resolution that the LTW Holders are creditors of the Debtors.

7. In proffering the Plan, the Debtors are, for the first time, providing for a distribution to equity holders. Thus, the LTW Holders now need to consider their treatment under the Plan in the event they are deemed to hold equity interests in the Debtors. In that situation, as described below, the Disclosure Statement is inadequate.[2]

A. The Disclosure Relating to the Disputed Equity Escrow Is Inadequate and the Sharing Formula is Facially Wrong

8. The Disclosure Statement (page 40) states that until it is finally determined whether the LTWs are claims or equity, there will be a Disputed Equity Escrow set up for the LTW Holders. This equity escrow is ***in addition to*** the Disputed Claims Escrow of $337 million established for the LTW Holders.

9. The Debtors' formula in the Plan as to how the 30% of the Reorganized WMI Equity is to be allocated between the common stockholders (Class 22) and the LTW Holders (Class 21) is opaque at best, and appears to be facially wrong. Of course, the issue is rendered ***moot*** if the LTW Holders are determined to be creditors, and not holders of equity interests in the Debtor.

[2] The Class Representatives did not know of the compromises with the Equity Committee, or the language of the Disclosure Statement, until the Plan and Disclosure Statement were filed with the Court. If they were given the opportunity, the LTW Holders would have highlighted the infirmities of the proposed Disclosure Statement and Plan before the compromise with the Equity Committee was reached, so that the issues raised herein could have been dealt with in a more timely and efficient manner. The LTW Holders had a similar concern of being "late to the party" when they were not consulted during the negotiation of the Global Settlement, and only became aware of the sale of the Anchor Litigation and the assumption by JPMC of certain of the Debtors' liabilities (just not the LTW obligations) when an earlier version of the plan was filed with the Court. The Settlement Noteholders participated in the Global Settlement negotiations, and their role in steering the parties to this unfavorable structure for the LTW Holders was well documented in the Adversary Proceeding.

10. At a minimum, the Disclosure Statement should have an example of how the sharing formula works in the event LTW Holders have a claim equal to the Disputed Claims Reserve of $337 million. Furthermore, the Plan should specify when the per share price of Common Equity Interests is determined, and how the market capitalization of the Common Equity Interests is determined, to the extent that these components are determined to be relevant for the sharing formula. With this information, equity holders will be able to see the full impact of the dilution in their distribution in the event LTW Holders are determined not to be creditors.

11. Moreover, the sharing formula in the Plan makes no sense. It appears to create a sharing formula based on converting $1 in Net Recovery (as herein defined) in the Anchor Litigation into $1 of the Debtors' common stock.

12. As demonstrated at the trial in the Adversary Proceeding, it was the clear intent and purpose of the LTWs to give their Holders 85% of the net recovery in the Anchor Litigation ("**Net Recovery**"). The Net Recovery was effectively "spun out" for the benefit of the Dime shareholders and was not to be given to a future acquirer (WMI) or the future acquirer's creditors. The LTW Agreement did not contemplate that there would be insufficient stock or other consideration to convey the Net Recovery to the LTW Holders. In other words, there was no concept of giving the LTW Holders a *pro rata* portion of the Net Recovery, in stock or anything else. Indeed, Section 4.4 of the LTW Agreement provides for a contrary result.

13. Barry Levine, the LTW expert who testified at the trial in the Adversary Proceeding, drove home the point that what made the LTWs a claim, and not an equity interest, was that it was intended to convey value (the Net Recovery) to the LTW Holders. This is the economic essence of the LTWs, this is their fundamental purpose, and this is what caused their appropriate accounting treatment to be a liability, and not an equity interest. Unlike equity warrants which deliver a fixed amount of shares with a variable value, LTWs deliver a **variable**

amount of shares for a fixed value (the Net Recovery). The LTW Agreement required WMI to give LTW Holders stock with a value equal to the Net Recovery. The Disclosure Statement at page 46 provides that the Common Equity Interests for common stockholders and LTW Holders will have an approximate value of $57 million. By definition, the Net Recovery will be far greater than the aggregate value of the Common Equity Interests. At a minimum, it is self-evident that there should be overwhelming dilution of the Common Equity Interests in favor of the LTW Holders.

14. The conversion formula in the LTW Agreement, which did not contemplate transferring less than full value of the Net Recovery to the LTW Holders, is a totally different formula than what is in the Plan. If the conversion formula in the LTW Agreement were followed, the following would result:

> (a) Assuming (i) a Net Recovery of $337 million, (ii) common shares of 1.7 billion (Disclosure Statement, p. 82), and (iii) a common stock price of 7 cents (closing trading price on December 19, 2011 was .067), LTW Holders would receive approximately 74% of the Common Equity Interests. This is computed by first dividing $337 million by .07 ("**LTW Share Amount**"), and then computing a percentage where the numerator is the LTW Share Amount, and the denominator is the LTW Share Amount plus 1.7 billion.
>
> (b) On the same assumptions but changing the common stock price to 3 cents, LTW Holders would receive approximately 87% of the Common Equity Interests, computed in the same manner as (a) above, subject to changing the share price variable. If there was proper disclosure made by the Debtors of the dilution, as well as the Reorganized Equity Value (*see* Section C hereof), the share price would be much less than 7 cents, and probably less than 3 cents.

15. Simply put, there is no basis for the sharing formula in the Plan, and the impact of the proper sharing formula and its resulting dilution on the Common Equity Interests must be properly disclosed. Moreover, the potential delay in making a distribution of the Common Equity Interests because of the unresolved LTW issue must be properly disclosed. Without such material information, the Disclosure Statement is inadequate and cannot be approved.

B. The Disclosure Relating to the Impact on the NOLs Based on the LTW Treatment Is Inadequate

16. On page 213 of the Disclosure Statement, the Debtors state that if the LTW Holders have a large equity interest in Reorganized WMI, at the time they get their distribution from the Disputed Equity Escrow, that could cause a subsequent ownership change, which in turn could substantially affect the unlimited usage of the NOLs. The Disclosure Statement needs to have a better description of this potential risk since the unlimited use of the NOLs is a significant component of the value of Reorganized WMI. Equity holders are voting on the Plan, and are required to give third-party releases in order to get a distribution under the Plan. As such, it is imperative to give proper disclosure of what they may or may not receive in exchange for their vote and giving such releases.

C. The Disclosure Statement Should Contain a Valuation of that Portion of Reorganized WMI to be Allocated to Common Equity Interests

17. As noted, page 46 of the Disclosure Statement states that 30% of the Common Equity Interest in Reorganized WMI is equal to $57 million. Therefore, 100% of the Common Equity Interest in Reorganized WMI should be at least $190 million. It is not clear whether the $10 million allocable to the Common Stock Allotment is additive to this amount so that the Common Equity Interest for Reorganized WMI is $200 million. The Disclosure Statement should be amended to clarify this point.

18. In any event, it is not clear how the $190 million for the Common Equity Interest in Reorganized WMI is derived. The Disclosure Statement needs to contain this valuation with specificity as to the key components thereof. Without this information, parties in interest receiving the Disclosure Statement have no idea whether the Debtors' valuation numbers are fairly estimated or misleading.

19. This concern is exacerbated by the misleading and/or incomplete information relating to Reorganized WMI actually contained in the Disclosure Statement. For example, the balance sheet for Reorganized WMI set forth on page 201 of the Disclosure Statement appears to be wrong. The Runoff Notes are non-recourse and therefore in year 2019, after the Reinsurance Premium Receivable is eliminated, so should the corresponding liability for Runoff Notes.

20. In addition, there needs to be a separate cash flow statement for Reorganized WMI (*see* Disclosure Statement at pages 202-203) and a balance sheet statement for Reorganized WMI (Disclosure Statement at page 201) which do not contain WMMRC assets/liabilities/expenses. WMMRC and the Runoff Notes are intended primarily for the benefit of creditors. The other assets of Reorganized WMI (such as the $75 million capital contribution, the $10 million relating to the Reorganized Stock Election, a portion of the Litigation Proceeds, and a residual interest in the Liquidating Trust) are intended for the benefit of Common Equity Interests. Parties in interest need to see a clear presentation of what each constituency is supposed to receive. Based on the combined presentation contained in the Disclosure Statement (pages 201-203), it appears that value intended for the Common Equity Interests is being used to "prop up" the operations of WMMRC and the shortfall in the Runoff Notes.

21. The Disclosure Statement does not say what Reorganized WMI can expect to receive from Litigation Proceeds. If the amount is **capped** at $5 million, or some other sum, the Disclosure Statement should say so.

22. The Disclosure Statement does not say how much is needed to be paid to creditors before the residual interest in the Liquidating Trust is distributed to holders of the Common Equity Interests. The Disclosure Statement should give a range for this number so that holders of contingent value rights in the Liquidating Trust have a better idea of the likelihood of realizing any amount on account of this asset.

23. The Court has determined that all creditors accrue post-petition interest at the federal judgment rate. The Disclosure Statement should explain why holders of Runoff Notes are accruing interest at 13% per annum instead of 1.9% per annum. Using the lower federal judgment rate would potentially put the Common Equity Interest Holders "in the money" on the residual interest of this asset at a much earlier stage. The difference in recovery appears to be in excess of $75 million.

D. The Tax Disclosure Relating to Receiving a Contingent Right to a Liquidating Trust Interest Is Inadequate

24. The Debtors state on page 16 of the Disclosure Statement that receiving a contingent right to a Liquidating Trust Interest should be of no moment since there is "little or no current market value" thereto and thus no real tax risk. The Debtors should be more specific and confirm that there will be no tax income for receiving a contingent right to a Liquidating Trust Interest, or, if there will be tax income, what it will be.

25. There is an interesting contrast between Professor Pomp's testimony in the Adversary Proceeding and this tax disclosure in the Disclosure Statement. Unlike the Adversary Proceeding, the Disclosure Statement emphasizes that the contingent aspect of the recovery generates no current taxable income. The Disclosure Statement also reaches the general conclusion that the business objectives of the Liquidating Trust trump any theoretical tax concerns for the holders of contingent rights therein.

E. The Disclosure Statement Should Disclose What Rights, if any, LTW Holders Are Losing By Not Voting on the Plan

26. The Plan provides that, other than "Deemed to Accept Classes," the only Class under the Plan that is not entitled to vote is Class 21 -- the LTW Holders. The Disclosure Statement should explain why that makes sense and what rights, if any, the LTW Holders are losing by not being given the opportunity to vote on the Plan.

F. <u>Reservation of Rights</u>

27. The Claimants reserve the right to supplement this Objection.

WHEREFORE, the Claimants request that the Court deny approval of the Disclosure Statement until the infirmities raised by the Objection are adequately addressed, and that they be granted such other and further relief as is just under the circumstances.

Dated: December 21, 2011
Wilmington, Delaware

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FOR THE DISTRICT OF DELAWARE

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

CERTIFICATE OF SERVICE

On this 21st day of December 2011, I, Scott J. Leonhardt, served a true and correct copy of the *Objection to the Disclosure Statement for the Seventh Amended Plan by Class Representatives of the Dime Litigation Tracking Warrants* upon the parties and in the manner listed below:

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