IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	Chapter 11
WASHINGTON MUTUAL, INC. *et al.*,	:	Case No. 08-12229 (MFW)
Debtors.	:	Jointly Administered
Black Horse Capital LP *et al.*,	:	
Plaintiffs,	:	Adversary Proceeding No. 10-51387 (MFW)
v.	:	
JPMorgan Chase Bank, N.A. *et al.*,	:	
Defendants.	:	

DEFENDANTS' JOINT REPLY IN SUPPORT OF THEIR MOTIONS FOR SUMMARY JUDGMENT AND OPPOSITION TO PLAINTIFFS' CROSS-MOTION FOR SUMMARY JUDGMENT

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Defendants Washington Mutual, Inc. ("WMI") and JPMorgan Chase Bank, N.A. ("JPMC") submit this joint reply and opposition brief in support of their respective motions for summary judgment and in opposition to Plaintiffs' cross-motion for summary judgment.[1]

PRELIMINARY STATEMENT

This entire case begins and ends with a single uncontroverted fact that Plaintiffs concede: The Office of Thrift Supervision ("OTS") determined that an Exchange Event had occurred and on September 25, 2008, directed that the Conditional Exchange be made. (*See* Mem. of Law in Supp. of Cross-Mot. for Summ. J. & Opp. to Defs.' Mot. For Partial Summ. J. ("Pls. Mem."), pp. 12-13 (D.I. 139).[2]) That fact alone dictates that the Conditional Exchange occurred at 8:00 a.m. Eastern time on September 26, 2008. From that point forward, all outstanding interests in Trust Preferred Securities ("TruPS") were, as the governing documents and offering circulars make clear, "deemed" to be interests in WMI preferred stock regardless of whether further steps were ever taken to *document* the exchange.

Faced with Plaintiffs' lengthy dissertation on how Washington Mutual might have better drafted its offering circulars and their desperate efforts to deconstruct an automatic and immediate exchange, one could overlook the fact that, with very limited

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1 Abbreviations and capitalized terms not defined in this brief have the same meaning as in the Defendants' opening briefs. (*See* Mem. of P. & A. in Supp. of Def. JPMC's Mot. for Partial Summ. J. ("JPMC Mem.") (D.I. 106); Opening Br. of WMI in Supp. of Mot. for Summ. J. ("WMI Mem.") (D.I. 109).) The Declaration of Brent J. McIntosh dated November 2, 2010 ("McIntosh Decl.") and its attached exhibits support this brief as well as the Defendants' opening briefs.

2 Plaintiffs make legal characterizations in their "Undisputed Facts" section (Pls. Mem., pp. 8-13) and in their Statement of Facts generally (*id.*, pp. 8-29), and Defendants do not accept these characterizations. (*See* JPMC Mem., pp. 5-14; WMI Mem., pp. 5-15.) However, these disagreements are not genuine factual disputes. (Pls. Mem., p. 2.)

exceptions, Plaintiffs here *did not even own* Trust Preferred Securities at the time of the Conditional Exchange. Instead, long after the exchange, and with full knowledge that the interests they purchased were deemed to be WMI equity, Plaintiffs purchased this stock for pennies on the dollar and have continued to do so throughout this action.

Having purchased highly distressed securities with full knowledge of the facts about which they complain, and having sat idly by for nearly two years as Defendants litigated over the TruPS in this bankruptcy proceeding, these sophisticated hedge fund plaintiffs now bring a separate lawsuit at the eleventh hour to assert that the "equities" require the Court to award them a billion-dollar windfall regardless of the impact on WMI's other creditors. Not only do their claims to ownership of TruPS lack any colorable basis, but they are themselves the height of inequity.

Nowhere do Plaintiffs offer a credible justification for invalidating an exchange that occurred years before they made their purchases—[redacted] Instead, page after page of Plaintiffs' prolix brief is devoted to belaboring the point that certain steps to record the effect of the Conditional Exchange have not been performed during the pendency of WMI's bankruptcy proceeding. These ministerial steps following the exchange have no bearing on the automatic transfer of all rights in the TruPS: The governing agreements state that even if these steps are never performed "*for any reason*," this transfer will still be effective "for all purposes" as of September 26, 2008. No one disputes that Plaintiffs are, and are entitled to be treated as, holders of WMI preferred shares. Neither the applicable agreements' plain language nor any applicable law supports Plaintiffs' position that delay in performing ministerial tasks vitiates the Conditional Exchange.

In Counts I-III of their Complaint ("Compl." (D.I. 1)), despite uncontroverted evidence that the OTS ordered the Conditional Exchange, Plaintiffs ask this Court to rule that it did not happen and that assets committed to protecting WMB's depositors belong to them. The parties agree there are no facts in dispute as to these counts. (Pls. Mem, p. 2.) In Counts IV-VI, which allege the perpetration of a fraud by, among others, a federal agency, Plaintiffs now claim that they are not required to prove that they or anyone else was in fact defrauded—a position they must take, given their concessions in depositions that they were not defrauded, particularly with regard to the preferred stock they acquired as recently as this month. These counts state no cognizable cause of action for fraud or anything else.[3] Neither the law nor the equities supports reforming the explicit bargain of the TruPS: that, in the event of financial trouble at WMB, the Trust Preferred Securities would convert automatically to preferred shares of WMI. That is what happened here, and Defendants are entitled to summary judgment on all counts as a matter of law because the Conditional Exchange occurred.

ARGUMENT

I. The Automatic Exchange Occurred and Allowed for the Record-Keeping Steps To Be Performed Upon Confirmation of the Debtors' Chapter 11 Plan.

As the Examiner noted, the automatic nature of the Conditional Exchange is a critical characteristic of the Trust Preferred Securities, allowing the TruPS to provide emergency loss-absorbing protection in the event of financial distress or receivership. (McIntosh Decl., Ex. 14K ("Final Exam. Rep."), p. 171.) Plaintiffs agree that the term "automatic" means the Conditional Exchange occurs "immediately" after all conditions

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[3] Plaintiffs bring Count V against WMI only and Count VI against JPMC only, and so the portions of this joint reply dealing with Counts V and VI are brought on behalf of WMI and JPMC, respectively.

precedent are satisfied (*see* Pls. Mem., p. 43); the only disagreement is whether the record-keeping acts in the Trust Agreements, §§ 4.08(a)(i)-(iii), are conditions precedent to this automatic exchange. The Trust Agreements' plain terms make clear they are not.[4]

The Trust Agreements (and the Exchange Agreements) define the Conditional Exchange according to one condition precedent:

> If the OTS so directs upon the occurrence of an Exchange Event, each Trust Security then outstanding *shall be* exchanged *automatically* for a Like Amount of newly issued [] Depositary Shares (the "Conditional Exchange").

(Trust Agr., § 4.08(a) (emphasis added); *see* JPMC Mem., pp. 15-16; WMI Mem., p. 19.) This is the *only* provision that states a condition explicitly, as required. (*See* JPMC Mem., p. 22.) *See also Co-Investor, AG* v. *Fonjax, Inc.*, No. C 08-1812 SBA, 2009 WL 2390227, at *2, 5 (N.D. Cal. Aug. 3, 2009) (upholding agreement providing for explicitly "automatic" conversion; conversion was "not dependent upon compliance" with other provisions of agreement). The record-keeping obligations that Plaintiffs cite arise "upon the occurrence" of the Conditional Exchange— *i.e.*, "with little or no interval *after*" the Conditional Exchange, *see* Bryan A. Garner, *A Dictionary of Modern Legal Usage*, 904 (2nd ed. 1995) (emphasis added)—and cannot be conditions *precedent to* the Conditional

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[4] Plaintiffs incorrectly assert that the Exchange Agreements govern the Conditional Exchange. (Pls. Mem., p. 15.) Securities and corporate actions like the Conditional Exchange are governed by the issuer's charter—in this case, the Trust Agreements. *See Matulich* v. *Aegis Comm'ns Group, Inc.*, 942 A.2d 596, 600 (Del. 2008) ("[T]he special rights and limitations of preferred stock are created by the corporate charter."). The trust certificates specify that the Trust Agreements control the "designations, rights, privileges, rights, preferences and other terms and provisions of the Trust Securities," and that § 4.08 governs the Conditional Exchange. (*E.g.* McIntosh Decl., Ex. 2I, p. 3.) The Exchange Agreements dictate the mechanics of ministerial steps *following* a Conditional Exchange (*see* Trust Agr., § 4.08(a)(iii)), and their description of the Conditional Exchange tracks § 4.08 of the Trust Agreements, including the provision deeming trust certificates to represent Depositary Shares. (*See* McIntosh Decl., Exs. 4A-4D; *id.*, Ex. 4D, § 2.)

Exchange.[5] Even if these acts are never performed "for any reason," the exchange is deemed effective. (Trust Agr., § 4.08(c).) This plain reading is confirmed in the offering memoranda, which state that once the OTS directs the Conditional Exchange, "no action will be required to be taken" by WMI or any other party to "effect the Conditional Exchange as of the time of the exchange." (McIntosh Decl., Ex. 1E, p. 92.)[6]

Plaintiffs try to confuse this simple issue. *First*, they attempt to cast the three record-keeping steps as "constructive conditions," even though Delaware law does not support such a reading. (Pls. Mem., p. 38.) *Second*, they claim that, because they have not received physical receipts representing WMI preferred equity, there was nothing to exchange the TruPS for (*see id.*, pp. 39-42), despite an explicit clause in the Trust Agreements providing for just such a situation, and despite WMI's continued recognition of their equity interests. These arguments fail as a matter of law.

A. The Record-Keeping Steps Are Not Implied Conditions.

Delaware law, which controls the Trust Agreements, disfavors implied or "constructive" conditions. "As a general proposition, for a court to add a limitation that is not found within the express language of the contract is untenable," *Alpine Invest. Partners* v. *LJM2 Cap. Mgmt., L.P.*, 794 A.2d 1276, 1286 (Del. Ch. 2002), and Delaware

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[5] Defendants do not dispute that the record-keeping steps must eventually be performed. Plaintiffs suggest that the failure to perform them "immediately"—here, during the pendency of the WMI bankruptcy and attendant litigation—forfeits the entire Conditional Exchange. (Pls. Mem., p. 37.) Defendants believe that deference to the judicial proceedings excuses the delay in recording ownership. But even if it were a technical *breach* of the Exchange Agreements, it would not be a failure of a *condition.*

[6] Although the offering memoranda are not controlling, the Trust Agreements should be read, if possible, in conformity with them, because they were drafted together as part of the same transaction. *See In re Northwestern Corp.*, 313 B.R. 595, 601 (Bankr. D. Del. 2004) ("Under Delaware law, all related documents and instruments in a single transaction together are harmonized to the extent possible.").

courts recognize only the "occasional necessity" to protect parties' expectations, *see id.*; *see also SLMSoft.Com, Inc.* v. *Cross Country Bank*, Civ. A. No. 00C09163JRJ, 2003 WL 1769770, *13 (Del. Super. Apr. 2, 2003) (no condition precedent where there was no explicit language creating one). This is because conditions precedent are generally disfavored, due to the severe consequences of their failure. *See Stoltz Realty Co.* v. *Paul*, Civ. A No. 94C-02-208, 1995 WL 654152, *9 (Del. Super. Sept. 20, 1995).

Here, were the courts to construe the record-keeping steps that follow "upon" a Conditional Exchange to be prerequisites to the Conditional Exchange, *contrary* to the issuer's representations in the offering circulars, this would *thwart* parties' expectations. Plaintiffs' reliance on Ohio and Utah law in support of their position does not change the fact that Delaware law does not recognize constructive conditions in these circumstances. (*See* Pls. Mem., p. 38 (citing *Henley* v. *Cuyahoga County Bd. of Mental Ret'n & Dev'l Disabs.*, 141 Fed. App'x 437, 444 (6th Cir. 2005) (constructive conditions apply where parties "neglect to expressly state the order in which their promises will be performed")).) Here, the Trust Agreements do define an order of events: *first*, the OTS directs the Conditional Exchange; *then* the Conditional Exchange occurs at 8:00 a.m. the next day; *then* the parties are obligated to surrender certificates, record the transfer, and issue depositary receipts. (Trust Agr., §§ 4.08(a)-(b).) And to ensure that courts do *not* construe these obligations as mutually conditional, each obligation is described as "unconditional" following the Conditional Exchange, and the TruPS are "deemed" exchanged even if these obligations are *never* performed. (*Id.*)

This may explain why Plaintiffs have abandoned the position they took in their Complaint, and now concede that the surrender of the certificates is *not* a condition

precedent of the Conditional Exchange. Plaintiffs state that after issuance of WMI preferred stock and recordation of transfer, "the Conditional Exchange would occur even if the holders of the [TruPS] failed to surrender the certificates." (Pls. Mem., p. 44; *contra* Compl. ¶ 204 (surrender of certificates was a condition precedent, failure of which prevented Conditional Exchange).) Under Plaintiffs' reading, then, § 4.08(a)(i) of the Trust Agreement (surrender of the certificates) is *not* a condition precedent, but §§ 4.08(a)(ii)-(iii) (recordation of transfer and delivery of depositary receipts) *are*, even though these three parallel obligations all arise identically "upon the occurrence" of the Conditional Exchange. Plaintiffs' reading of the agreements is plainly wrong.

B. Plaintiffs Are Deemed to Hold Interests in Duly Created WMI Preferred Equity under the Plain Terms of the Trust Agreements.

Plaintiffs go to great effort to twist the term "exchange" out of its ordinary usage in securities law, and into an exchange of tangible things—as if the Conditional Exchange were something like a hostage trade—and complain that because they have not received depositary receipts representing WMI preferred equity, there was no "exchange." (Pls. Mem., pp. 39-42.) But where intangible interests are involved, and specifically in Delaware corporate usage, "exchanges" of securities are interchangeable with "conversions." *See* 8 Del. C. § 151(e); *Bernstein* v. *Canet*, Civ. A. No. 13924, 1996 WL 342096, *6 (Del. Ch. Jun. 11, 1996); Fletcher Cyc. Corp. § 5306 (Perm. Ed.). The mechanism of a security automatically "morphing" (*see* Pls. Mem., p. 39) into another is not an "unprecedented proposition . . . defying logic" (*id.*, p. 49), but rather a "routine feature" used in a variety of securities transactions to ensure they take effect on a date certain. (*See* Declaration of Theodore A.B. McCombs ("McCombs Decl."), Ex. 5B

("Ferrell Rep."), ¶¶ 11, 16; *see generally id.*, ¶¶ 12-36 (discussing mergers, reverse stock splits, and other transactions involving automatic exchanges).)[7]

As is common in the corporate realm, the Conditional Exchange mechanism set the exchange at an enforceable date certain. Here, the OTS required such an automatic exchange so that the TruPS, serving as bank core capital, would be immediately available to support a struggling bank or receivership, without the risk of clerical delays or outside investors holding the TruPS hostage. [redacted] Final Exam. Rep., p. 171.) For this reason, the Trust Agreements expressly state that "[u]ntil certificates representing the Depositary Shares are delivered" *or if they are not delivered "for any reason,"* the TruPS certificates "shall be deemed *for all purposes* to represent Depositary Shares." (Trust Agr., § 4.08(c) (emphasis added).) Plaintiffs forget their own admonishment (*see* Pls. Mem., p. 37) not to read contract language as surplusage: If this provision *has any meaning whatsoever*, the physical receipt of Depositary Shares cannot be a prerequisite to the Conditional Exchange.

In a case squarely on point, *Co-Investor, AG* v. *Fonjax, Inc.*, the court upheld an automatic conversion where the issuer had failed to deliver new certificates. 2009 WL 2390227, at *5. There, the investor agreed to buy preferred shares in multiple

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[7] The Depository Trust Company ("DTC") allows up to three years after the transaction date for the "clean-up" of replacing certificates and CUSIP numbers. (Ferrell Rep., ¶¶ 40-42.) It is difficult to sympathize with Plaintiffs' complaint that "tracking ownership . . . by CUSIP numbers would be rendered impossible and meaningless" (Pls. Mem., p. 50) when Plaintiffs purchased [redacted] their interests *despite* WMI's press release and repeated filings stating that what those CUSIPs now represented was WMI preferred equity. (*See* McIntosh Decl., Ex. 6C; *id.*, 14B, p. 7.)

tranches, subject to a feature that would automatically convert the preferred shares into common if the investor failed to pay for a tranche. *Id.* at *2. The investor defaulted, triggering the conversion, but it claimed the conversion was ineffective because the company did not deliver certificates representing common shares, as the charter required. The Court rejected this argument, holding the automatic conversion did not depend on delivering the certificates, or other provisions to reflect the conversion, as nothing in the agreement made those acts "prerequisite[s]" to the automatic conversion feature. *Id.* at *5. Likewise, here, the Conditional Exchange is an "automatic" exchange and does not depend on the delivery of depositary receipts evidencing WMI preferred stock.

In this light, Plaintiffs' complaint that "the security for which the [TruPS] were purportedly 'exchanged' never existed" is nonsense. (*See* Pls. Mem., p. 5.)[8] The WMI Series I, J, L, M, and N preferred stock (the "REIT Series")—corresponding to the five TruPS issuances—certainly do exist. Before the TruPS even issued, the WMI Board of Directors established the REIT Series out of previously authorized preferred stock and authorized their issuance "if and only if a Conditional Exchange occurs." (McCombs Decl., Exs. 1A-1E (board resolutions); *id.*, Exs. 2A-2E (articles of amendment creating REIT Series); *id.*, Ex. 2E, p. 2 ("There is hereby *created* . . . a series of [WMI] preferred stock designated as the 'Series N . . . Preferred Stock'" (emphasis added)); *contra* Pls. Mem., p. 2 ("securities of WMI were never created").) Under the Washington Business Corporation Act, every corporate act necessary for issuance of the WMI preferred shares

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[8] Plaintiffs' brief cites several times to the report of their retained "expert," attorney Jack Williams. (*See* Pls. Mem., pp. 36, 42, 51.) The Williams report is not an expert report but a legal brief, and Defendants intend to move to exclude it. *See Suter* v. *General Acc. Ins. Co. of Am.*, 424 F. Supp. 2d 781, 791 (D.N.J. 2006) (Expert witnesses are "not allow[ed] to opine on what the law required.").

was duly approved by the Board of Directors.[9] *See* Wash. Rev. Code § 23B.06.210. As for the Depositary Shares, these are currently represented "for all purposes" by the global certificates.[10] (Trust Agr., § 4.08(c).) The Debtors' Chapter 11 Plan clearly places these equity interests in the WMI capital structure and affords them the same rank, rights, and waterfall recovery as the *pari passu* preferred Series K and Series R stock, with a $50 million release bonus from JPMC. (McIntosh Decl., Ex. 8A, § 23.1.)

What Plaintiffs seem to be complaining about—the only thing that does not "exist" yet—are the "Receipts" to be issued by Mellon Investor Services LLC, the Depositary, under the Depositary Agreements. (*See* McCombs Decl., Exs. 3A-3D; *id.*, Ex. 3D, § 2.01.) In essence, Plaintiffs are attempting to invalidate a $4 billion transaction that occurred two years ago, and destroy the significant recoveries of WMI creditors senior to them, because they didn't get their receipt.

C. Section 365(c)(2) of the Bankruptcy Code Does Not Prevent WMI from Reflecting the Conditional Exchange in Its Plan.

Plaintiffs argue this Court cannot give effect to the Conditional Exchange because Section 365(c)(2) of the Bankruptcy Code prohibits a debtor from assuming an executory contract to issue a security. *See* 11 U.S.C. § 365(c)(2). This argument fails for three reasons. *First*, as explained above, the Conditional Exchange already is effective, even if WMI never issues the depositary receipts. (*See* Trust Agr., § 4.08(c).) *Second*,

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[9] The WMI board expressly authorized the issuance of the preferred shares in either certificated or uncertificated form. (*E.g.*, McCombs Decl., Ex. 2E, p. 11); *see* Wash. Rev. Code § 23B.06.260 (permitting corporations to issue shares in uncertificated form). Subsequent resolutions authorized officers of the company to take any action "necessary or advisable in connection with the issuance" of the preferred shares. (*E.g.*, McCombs Decl., Ex. 1D, p. 11.)

[10] "Depositary Shares" are a 1/1000th interest in the REIT Series preferred stock, with no greater or lesser rights than such a fractional interest carries. (*See* McIntosh Decl., Ex. 1E, p. 116.)

the transaction agreements are not executory because the only outstanding obligations are ministerial formalities. *Third*, neither the Exchange Agreements nor any other transaction documents constitute a contract "to issue" a security for new money, and § 365(c)(2) is therefore inapplicable.

The Trust Agreements and the Exchange Agreements are not executory contracts because all outstanding obligations are immaterial. *See In re Midwest Portland Cement Co.*, 174 Fed. App'x 34, 36 (3d Cir. 2006) ("[T]he contract here is not executory merely because the parties failed to perform various, non-material obligations."); *In re Streets & Beard Farm P'ship,* 882 F.2d 233, 235 (7th Cir. 1989) (land sale contract non-executory where only remaining obligation was to deliver legal title); *In re Federal-Mogul Global Inc.*, 385 B.R. 560, 575-76 (Bankr. D. Del. 2008) (insurance contract non-executory where premiums were already paid in full; remaining "ministerial obligations" did not transform the "otherwise non-executory" policy into executory contract). At the time of the Conditional Exchange on September 26, 2008, all *material* obligations of the parties were performed, because TruPS holders received the economic substance they had bargained for under these circumstances: WMI preferred equity interests. (*See supra* Part I.B.) *See also Ewell* v. *Those Certain Underwriters of Lloyd's, London*, C.A. No. S09C-07-031 RFS, 2010 WL 3447570, *6 (Del. Super. Aug. 27, 2010) (materiality judged in part by whether party received benefit of bargain). The governing agreements provide that TruPS certificates are "deemed for all purposes to represent" WMI equity interests after the OTS's declaration, confirming that the acts to *reflect* the Conditional Exchange are immaterial "clean-up." (*See* Trust Agr. §§ 4.08(b)-(c); Exchange Agr., § 2; McCombs Decl., Ex. 4 (notice from trustee stating that TruPS certificates represent WMI

preferred equity as of September 26, 2008).) As a matter of law, the former TruPS owners became owners of WMI preferred stock upon the Conditional Exchange even if WMI never issued new certificates. The Trust Agreements and Exchange Agreements are therefore non-executory, and 11 U.S.C. § 365(c)(2) does not apply.[11]

Even if the Exchange Agreements were executory contracts, § 365(c)(2) would still pose no bar to confirmation of the Plan, because WMI is not extending "new cash." *See In re Teligent, Inc.*, 268 B.R. 723, 737 (Bankr. S.D.N.Y. 2001) (contract to "issue a security of the debtor" refers to pre-petition agreement of non-debtor to advance "new cash or credit" in exchange for debtor's stock). The *Teligent* court examined the legislative history of § 365(c)(2) and concluded that Congress "intended to deal with a specific fear: forcing a lender to extend new cash . . . through the assumption of a pre-petition financial agreement," and determined that it "does not, however, apply to every contract involving . . . the issuance of a security." *Id.* Thus, in *Chase Manhattan Bank* v. *Iridium Africa Corp.*, No. 00-564 (JJF), 2004 WL 323178 (D. Del. Feb. 13, 2004), Judge Farnan found that § 365(c)(2) did not bar a contract to issue LLC interests where the consideration was "analogous to an old equity investment," rather than new money coming into the estate. 2004 WL 323178, at *4. Here, the Exchange Agreements contemplate only that WMI would deliver previously authorized and reserved preferred shares to Mellon, not in return for cash, but only so that Mellon could issue depositary receipts to former TruPS holders. (*See* Exchange Agr., § 2(b); McCombs Decl., Ex. 3D,

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[11] Plaintiffs exaggerate the importance of one ministerial step—issuance of the depositary receipts by Mellon—by focusing only on the Exchange Agreements. The Exchange Agreements must be read with the Trust Agreements, *see Kroblin Refrig'd Xpress, Inc.* v. *Pitterich*, 805 F.2d 96, 106 (3d Cir. 1986), which together establish the ministerial acts are non-material obligations meant to reflect the Conditional Exchange.

§ 2.02.) To the extent this can be considered an equity issuance to TruPS holders at all, the consideration is their "old equity investment" in the TruPS, which converted into WMI equity automatically. *Chase Manhattan Bank*, 2004 WL 323178, at *4. Issuance of depositary receipts to Plaintiffs in order to reflect the Conditional Exchange does not require new cash or credit extended to the estate, and thus does not implicate § 365(c)(2).

Because the Conditional Exchange occurred, § 365(c)(2) is irrelevant. But even if performance of the tasks described in the Exchange Agreements were necessary to document Plaintiffs' status as WMI preferred shareholders, this can be done pursuant to Debtors' Chapter 11 Plan even without assumption of the Exchange Agreement or any other agreement. *See* 11 U.S.C. § 1142(b) (court may direct the debtor to "execute or deliver . . . any instrument required to effect a transfer of property" and perform "any other act . . . that is necessary" to consummate the plan).

II. The Conditional Exchange Validly Transferred Ownership of Securities Without Regard to Uniform Commercial Code Article 8.

Plaintiffs portray Article 8 of the UCC as a straightjacket that only allows securities to transfer in inflexible circumstances. But as WMI and JPMC both explained in their opening briefs, Article 8 is neither the exclusive means of transferring ownership of securities nor as inflexible as Plaintiffs portray. (*See* JPMC Mem., pp. 24-26; WMI Mem., pp. 21-28.) The drafters of the UCC made clear that securities transfers could occur outside the framework of Article 8. *See* UCC § 8-302, cmt. n.2 (2007) ("Article 8 is not a comprehensive codification of all of the law governing the creation or transfer of interest in securities"). The UCC drafters further provided that parties may contract to "change the legal consequences that would otherwise flow" from the UCC. UCC § 1-302, cmt. 1 (2007). The drafters of the Trust Agreements and Exchange Agreements

did exactly that. Indeed, the Supreme Court of Delaware has held that UCC Article 8 is not the exclusive means of transferring securities and that UCC provisions "are generally supplemented by principles of law and equity." *Kallop* v. *McAllister*, 678 A.2d 526, 529-31 (Del. 1996). Here, the transaction's governing documents and circumstances show that the Conditional Exchange effectively transferred the TruPS from the holders.

A. Article 8's Delivery Requirement Does Not Apply to an Involuntary Mass Transfer of Ownership in Securities Among Multiple Parties.

The UCC, by its own terms, makes clear that physical delivery is not the operative event in effecting the Conditional Exchange—an involuntary mass transfer of securities among multiple parties, which no one (neither WMI nor TruPS holders) had the power to block. To the contrary, the delivery requirement in UCC § 8-301 applies only to transfers to "purchasers," and a "purchase" is defined as a "voluntary transaction creating an interest in property." 6 Del. C. § 1-201(29). To the same effect, delivery is defined as a "voluntary transfer" of "control" or "possession." 6 Del. C. § 1-201(15).

Delaware courts have defined "voluntary" as "proceeding from the will," "produced in or by an act of choice," "done by design or intention," and "not constrained, impelled, or influenced by another." *Haft* v. *Dart Group Corp.*, 841 F. Supp. 549, 565 (D. Del. 1993) (quoting Webster's New Int'l Dictionary 2564 (3d ed. 1971)). It is difficult to imagine a less voluntary transaction than a Conditional Exchange, because neither WMI nor TruPS holders had the power to initiate it or to stop it—even if they *tried*, the exchange would be deemed effective. Only the OTS, a federal regulator not party to either agreement, could direct a Conditional Exchange. (Trust Agr., § 4.08; Exchange Agr., §§ 1, 2.)

The "proper focus" is not, as Plaintiffs argue,[12] on the underlying agreements, but on "the immediate mechanism by which the transfer is made effective." *United States* v. *Seattle First Nat. Bank*, 321 U.S. 583, 587-89 (1944) (transfer of securities upon consolidation of two banks was involuntary, even though banks had voluntarily entered into consolidation agreement). Likewise, where parties contract to buy securities in installments, subsequent transfers of securities are not considered "purchases," because there is no new investment decision. *Helman* v. *Murry's Steaks, Inc.*, 742 F. Supp. 860, 870-71 (D. Del. 1990). Here, the Conditional Exchange was a mandatory event directed by the federal government, and both WMI and the TruPS holders had no ability to avoid that event. The OTS's directive is much like the court order in *In re Interstate Stores, Inc.*, 830 F.2d 16, 19 (2d Cir. 1987), a command by governmental authority that WMI could not resist.[13]

B. The Declaration of a Conditional Exchange, Not "Delivery," Was the Operative Event to Transfer Ownership of the Securities.

Plaintiffs acknowledge that parties may agree to modify the application of the UCC in their contracts but argue that the parties to these transactions did not agree to "opt out" of Article 8, because the Trust Agreements and Exchange Agreements still refer

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12 *See* Pls. Mem., p. 70. The only case Plaintiffs cite for this proposition, *King Foods* v. *Erie Farms*, 21 Pa. D. & C.3d 434, 1981 WL 137978 (Pa. Com. Pl. Nov. 18, 1981), is not binding precedent and has nothing to do with securities, but rather deals with lienholders under Article 9 and their status as bona fide purchasers.

13 As noted in WMI's opening brief, the Conditional Exchange was a transfer by operation of law, and Article 8 does not apply to transfers by operation of law. *See* UCC § 8-302, cmt. 2 (2007). In *Pioneer Nat'l Title Ins Co.* v. *Child, Inc.*, 401 A.2d 68, 70-71 (Del. 1979), a case cited by Plaintiffs, Delaware's Supreme Court described transfer "by operation of law" as "refer[ring] to situations in which rights, and sometimes liabilities, are created without action by the parties." This is precisely the circumstance here: Upon the declaration of a Conditional Exchange by OTS, both WMI and the TruPS holders acquired rights and obligations without any action on their part.

to the "delivery" of the securities. This argument misses the point: These agreements provide that, unlike in commercial purchases under Article 8, "delivery" would *not* be the operative event to transfer title to the securities. Indeed, even if delivery *never* occurs, the exchange is deemed effective. Both sets of agreements state that ownership transfers upon declaration of a Conditional Exchange, and that "delivery" of certificates is to occur *after* ownership rights have already transferred. These provisions show an unmistakable intent to "change the legal consequences that would otherwise flow" from the UCC by making "delivery" an act that has no weight in determining ownership.[14]

Under § 4.08 of the Trust Agreements, the OTS directive is the controlling event as to when the Conditional Exchange occurs. Section 4.08(b) provides that "[t]he Conditional Exchange shall occur as of 8:00 A.M. New York time on the date set forth in the OTS directive" or, if no date is set forth in the directive, at 8:00 A.M. "on the earliest possible date." Thus, the Trust Agreements specify that the Conditional Exchange would occur at a specific instant in time. At that moment, TruPS holders "shall be, for all purposes, solely holders of . . . Depositary Shares, and WMI shall be the holder of all outstanding Trust Securities." (Trust Agr., § 4.08(b).) By contrast, § 4.08(c) provides

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[14] As explained in the opening briefs, the Conditional Exchange satisfies the common-law standard of "constructive delivery" under *Kallop* v. *McAllister*, 678 A.2d at 530-31. (*See* JPMC Mem., p. 26; WMI Mem., pp. 24-25.) Plaintiffs wrongly argue that constructive delivery only applies to gifts of securities. (*See* Pls. Mem., p. 66 (citing South Dakota law).) The Delaware Supreme Court allows constructive delivery in any case where actual delivery is "impractical," *Kallop*, 678 A.2d at 531, such as here, where the need for an urgent, simultaneous transfer *en masse* on short notice makes physical exchange of certificates impractical. Nor does Delaware require the magic words or special acts that Plaintiffs would require. (*See* Pls. Mem., p. 67.) All that is required is an "unmistakable intention to transfer title without transferring possession." *Kallop*, 678 A.2d at 531. WMI clearly showed such an unmistakable intention when it issued a press release on September 26, 2008, announcing that "the Conditional Exchange of Securities will occur on Friday, 8:00 A.M. New York time" and that the TruPS "will be exchanged automatically" for preferred stock. (*See* McIntosh Decl., Ex. 6C.)

that delivery of certificates and depositary receipts are to occur "[w]ithin 30 days" *after* the OTS directive. Even if depositary receipts are *never* delivered, the transfer of rights will be "deemed" to have occurred. (Trust Agr., § 4.08(c).) In unambiguous language, § 4.08 provides that the operative event to transfer ownership is the OTS's declaration of a Conditional Exchange, not delivery of certificates as in routine Article 8 transactions.[15]

The use of these contractual provisions to de-select delivery as the event transferring ownership is understandable in the context of these transactions. The TruPS were designed so that the OTS's declaration of the Conditional Exchange would convert TruPS holders into WMI preferred shareholders without delay, and neither the holders nor WMI could stop the conversion:

> The OTS wanted to make sure that when they ordered a conditional exchange that there would be no actions that the company could take to delay . . . essentially they wanted to have the documents reflect that when a conditional exchange is ordered, it is automatic. There's no optionality left.

(Freilinger Tr. 41:10-16.) Unlike the ordinary situation under Article 8 in which a single seller would transfer ownership to a single buyer, these transactions were designed to change the ownership rights of many different parties at a single point in time. This required that the transfer be automatic and immediate, not dependent on trailing record-keeping steps that could delay the effectiveness of the exchange by weeks or more.

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[15] The Exchange Agreement is to the same effect. Section 2 provides that, following the OTS directive, the Conditional Exchange is to occur at a specific "date and time," upon which the ownership rights are exchanged. Section 2(c) further provides that the physical substitution of securities will occur after the Conditional Exchange, and "until receipts evidencing the . . . Depositary Shares are delivered or in the event such replacement receipts are not delivered, any certificates previously representing [Trust] Securities shall be deemed for all purposes to represent Depositary Shares."

III. Plaintiffs Have Withdrawn Count III.

Plaintiffs did not oppose Defendants' motions for summary judgment as to Count III and instead have withdrawn it. (Pls. Mem., p. 2 n.3.)

IV. Count IV Fails Because Plaintiffs Cannot Prove Fraud.

Plaintiffs argue that they do not assert fraud claims in Counts IV-VI of the Complaint and therefore do not need to prove fraud (Pls. Mem., pp. 71, 98), but each of these counts is premised on, and *does* in fact assert, fraud. The Complaint seeks a declaratory judgment that WMI "perpetrated a fraud on investors" (Compl. ¶ 245 (Count V)), that the OTS "aided and abetted a fraud on investors" (Compl. ¶ 242 (Count IV)), and that JPMC had knowledge of or even "participation" in the fraud (Compl. ¶ 257 (Count VI)). But having trumpeted "fraud" throughout these counts, Plaintiffs now argue that proving fraud is not an element of their claims. (Pls. Mem., p. 71.) Rather, they claim only to allege "unclean hands" on the part of WMI, OTS and JPMC. *Id.* This is an odd semantic game, because Plaintiffs' Complaint makes indisputably clear that Plaintiffs' basis for asserting "unclean hands" *is* fraud. (Compl. ¶¶ 242, 245, 257.) Unable to establish the elements of fraud—and with no standing to assert fraud claims in any event—Plaintiffs now ask the Court to relieve them of the burden of proving what they have alleged.[16]

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[16] It is axiomatic that an omission must be material for it to be actionable as fraud. *See BMW of North America, Inc.* v. *Gore*, 517 U.S. 559, 579 (1996). Yet, despite this requirement, Plaintiffs did not respond to WMI's arguments regarding the immateriality of their alleged omission, effectively conceding this point. *See D'Angio* v. *Borough of Nescopeck*, 34 F. Supp. 2d 256, 265 (M.D. Pa. 1999) (holding that the non-moving party waived argument he failed to address in a responsive brief).

As explained in the opening briefs, all the ultimate risks of the Conditional Exchange were disclosed. (JPMC Mem., App'x B; WMI Mem., pp. 38-41.) But in any event, Plaintiffs, all sophisticated hedge funds, almost exclusively purchased after all of

A. Plaintiffs Cannot Buy Standing to Assert a Fraud.

As explained in the opening briefs, most Plaintiffs lack standing to bring the Count IV fraud allegations because in the aggregate they purchased [redacted] their interests in 2010, long after the alleged injury.[17] (*See* JPMC Mem., pp. 29-30.) For the majority of Plaintiffs, who did not own TruPS before the Conditional Exchange, their sole theory of standing is that when they bought their interests in 2010, they also bought the right to assert the alleged fraud injury of prior TruPS owners before them.[18] (Pls. Mem., pp. 72-73.) This is plainly wrong.

Delaware law requires stockholder plaintiffs to have held stock at the time of the complained-of injury, due to a "longstanding . . . public policy against the 'evil' of purchasing stock in order to attack a transaction which occurred prior to the purchase of the stock." *Omnicare, Inc.* v. *NCS Healthcare, Inc.*, 809 A.2d 1163, 1169 (Del. Ch. 2002). Delaware courts have applied this clear rule to suits over material omissions. *See id.* at 1169 n.17 (Plaintiffs "have no direct right to be awarded judicial relief for acts that

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the relevant events had taken place and with full knowledge of them. Even the two Plaintiffs that held nominal amounts of TruPS before the Conditional Exchange should have understood that securities issued as *bank* core capital would support the *bank* in times of distress. (*See* McCombs Decl., Ex. 5A ("James Rep."), ¶¶ 53-66.)

17 [redacted]

18 [redacted]

occurred before they purchased stock."). Likewise, under New York's anti-champerty statute, it is a *crime* to purchase certain securities with the primary purpose of bringing a lawsuit on them. N.Y. Jud. L. § 489; *Semi-Tech Litig., LLC* v. *Bankers Trust Co.*, 272 F. Supp. 2d 319, 331 (S.D.N.Y. 2003). [redacted]

Plaintiffs misleadingly cite UCC § 8-302(a) and *Consolidated Edison, Inc.* v. *Northeast Utilities*, 318 F. Supp. 2d 181 (S.D.N.Y. 2004), for the proposition that the right to assert fraud travels with the security. (Pls. Mem., p. 72.) The *ConEd* case states that the "rights" that travel with a security under UCC § 8-302(a) are the contract rights against the issuer in the issuer's charter, such as voting rights or dividends, but *not* "fraud claims against third parties." *ConEd*, 318 F. Supp. 2d at 192-93, *rev'd on other grounds*, 426 F.3d 524 (2d Cir. 2005); *accord Fraternity Fund Ltd.* v. *Beacon Hill Asset Mgmt., LLC*, 479 F. Supp. 2d 349, 373 n.126 (S.D.N.Y. 2007). Plaintiffs have no standing to assert Counts IV-VI, which depend on establishing that third parties other than the issuer—specifically, WMI, JPMC, and the OTS—committed or aided and abetted fraud. *See Fraternity Fund*, 479 F. Supp. 2d at 373 n.126; *ConEd*, 318 F. Supp. 2d at 192-93.

[redacted]

B. Plaintiffs Cannot Pursue Count IV Without Suing the OTS.

In Count IV, Plaintiffs allege that OTS "acted in excess of its authority" in aiding and abetting a "fraud," and ask this Court to declare an OTS directive "null, void and without effect." (Compl. ¶¶ 231, 238, 243.) They have further told this Court that "Count IV of the Complaint focuses *solely* on the conduct of OTS." (*See* Pls. Opp. to Defs. Joint Mot. to Compel (D.I. 77), p. 7 (emphasis in original).) Yet, in their brief, Plaintiffs argue that they do not have to sue OTS directly, or meet the substantive and procedural requirements established by the Constitution and Congress for challenging the actions of federal agencies, because they have chosen to sue private parties instead. (Pls. Mem., pp. 83-93.) Plaintiffs cannot have it both ways.

Plaintiffs contend that they can sue WMI and JPMC because they relied upon the OTS directive. (Pls. Mem., p. 77.) But under Article III of the Constitution, if their complaint is that the OTS exceeded its authority, then Plaintiffs must sue the OTS directly. *See Simon* v. *E. Kentucky Welfare Rights Org.*, 426 U.S. 26, 41-42 (1975) (to have standing plaintiffs must sue persons to whose actions their alleged injuries are traceable). Because Count IV "depends on the unfettered choices made by independent actors not before the courts," *Lujan* v. *Defenders of Wildlife*, 504 U.S. 555, 562 (1992), Plaintiffs cannot bring that claim without suing the OTS. As the OTS is not a party to this action, this Court cannot redress the alleged injury. *See id.* at 561, 571 n.5. Accordingly, this Court lacks jurisdiction to hear Count IV.

C. Even If the OTS Colluded in Fraud, Its Directive Would Not Be Void.

Plaintiffs spend 12 pages rebutting a supposed sovereign immunity argument that Defendants have not made. (Pls. Mem., pp. 77-89.) Defendants do not claim that sovereign immunity shields them; indeed, the concept of sovereign immunity

appears nowhere in Defendants' briefs. Rather, Defendants have merely pointed out that even if Plaintiffs could prove every wild, potboiler allegation in Count IV—that WMI tricked (other) investors and that venal federal regulators helped them do so—it would not undo the Conditional Exchange or give Plaintiffs their windfall, because even torts of the U.S. government are not *ultra vires* and void. (JPMC Mem., pp. 32-33.)

Plaintiffs and Defendants apparently agree that "acts taken by agency officials . . . are not *per se ultra vires* just because the act is unlawful or tortious." (Pls. Mem., p. 91.) Indeed, the *only* question in deciding whether an action is *ultra vires* is whether the acts are done pursuant to statutory authority. *See Larson* v. *Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 695 (1949); *Centennial Assoc. L.P.* v. *FDIC*, 927 F. Supp. 806, 812 (D.N.J. 1996).

The Home Owners Loan Act authorizes the OTS to use "any methods" to ensure adequate capital at thrifts, *United Liberty Life Ins. Co.* v. *Ryan*, 985 F.2d 1320, 1326 (6th Cir. 1993); 12 U.S.C. § 1464(s)(1)(B)—which clearly includes the OTS's requirement of an exchange mechanism in the TruPS and subsequent action to trigger that mechanism. (*Cf.* McIntosh Decl., Ex. 9D (OTS letter requiring exchange mechanism to qualify hybrid securities as Tier 1 capital).) Plaintiffs attempt to limit the OTS's power to ensure capital maintenance to situations in which a thrift is *already* undercapitalized. (Pls. Mem., pp. 84-88.) This would be a sorry regulatory regime indeed, and it finds no support in law. The OTS's requirement to include the Conditional Exchange mechanism was authorized as "necessary" or "appropriate" to ensure adequate capital *before* WMB fell into crisis. *See* 12 U.S.C. § 1462a(b)(2); 12 U.S.C. § 1464(s)(1)(B) (authorizing capital directives "*or other such methods* as the Director determines to be appropriate"

(emphasis added)). Acts performed pursuant to that mechanism are similarly authorized, and so Count IV fails as a matter of law even if Plaintiffs could prove fraud.[20]

V. The Balance of the Equities Favors Defendants and Plan Confirmation.

Plaintiffs consistently ignore the rule that "unclean hands" is an equitable *defense*, not an offensive weapon that late entrants to bankruptcy proceedings can use to disrupt a debtor's Chapter 11 plan. "[I]n determining the issue of clean hands, we look solely at the conduct of the plaintiff . . . and not the conduct of the defendant." *Salomon Smith Barney Inc.* v. *Vockel*, 137 F. Supp. 2d 599, 603 (E.D. Pa. 2000); *accord Karpenko* v. *Leendertz*, 619 F.3d 259, 265 (3d Cir. 2010). Count V turns this doctrine upside-down by asking the Court to look solely to the conduct of defendants and not the conduct of plaintiffs. Count V thus fails at the threshold as a matter of law.

Even if the Court chooses to examine the equities, the balance overwhelmingly favors the Debtors such that no reasonable fact-finder could rule in favor of Plaintiffs. *See Johnson & Johnson Assoc., Inc.* v. *R.E. Service Co., Inc.*, No. C 03-2549 SBA, 2005 WL 289978, *7 (N.D. Cal. Feb. 4, 2005) (granting summary judgment on unclean hands defense because "no reasonable trier of fact" could find party had acted in bad faith). Plaintiffs ask the Court to void a Plan that would provide the true creditors of WMI's estate with substantial recovery, to destroy the global settlement underpinning that recovery, and to award the TruPS' $4 billion par value to ten speculators who

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[20] As explained in the opening briefs, capital is important even if the bank fails: Loss-absorbing capital protects depositors and other creditors in a receivership. (JPMC Mem., p. 6; WMI Mem., p. 6.) In a Conditional Exchange, the TruPS could provide high-value assets to pay deposits in an FDIC liquidation or—as was the case here—incentivize another bank to assume deposits and increase its bid, to the benefit of bank creditors. (*See* James Rep., ¶¶ 38, 46; Final Exam. Rep., p. 161 (TruPS were "integral part in [JPMC's] decision regarding the amount of JPMC's bid for WMB's assets.").)

purchased TruPS for pennies on the dollar *after* the Conditional Exchange occurred and *after* WMI filed its Chapter 11 petition. This would completely upset the priority regime favoring creditors that Congress adopted in 11 U.S.C. § 507.

Plaintiffs ignore the inequity that their requested windfall would decimate the recoveries of creditors ahead of them. Plaintiffs also ignore the inequity of reneging on the explicit bargain of the TruPS: that in the event of financial trouble at WMB, the TruPS would convert automatically into preferred shares of WMI. Litigation over the TruPS has been pending since JPMC's adversary complaint in March 2009; while that action was pending, Plaintiffs speculated in the market, buying [redacted] their interests in 2010 at discounts of up to 99%. [redacted] The Court should reject their last-minute attempt to cash in on their lottery-ticket strategy and upend the order of priority of payment based on their incorrect, opportunistic and inequitable interpretation of the governing documents.

Moreover, regardless of what allegations Plaintiffs raise about WMI's conduct, this case is not about rewarding or punishing WMI. *See In re Bean*, 251 B.R. 456, 203 (E.D.N.Y. 2000) ("The trustee's duty to act in the best interest of the bankruptcy estate does not include an obligation to punish debtors, let alone others, for punishment's sake."). Rather, this case is about equitably distributing WMI's estate among legitimate creditors. These creditors have no involvement in the supposed inequities Plaintiffs claim, and their rights should be respected. Count V should be rejected.

VI. Count VI Is Irrelevant to the Conditional Exchange's Effectiveness.

Because the Conditional Exchange was effective, there is no reason to litigate JPMC's status as a *bona fide* purchaser. Plaintiffs' ownership claims fail on the effectiveness of the Conditional Exchange (*see* JPMC Mem., pp. 3, 5), and the stayed

fraud claims (Counts VII-IX) will be eliminated by the Chapter 11 Plan's confirmation (*id.*, p. 5). Only if the Court rules that the Conditional Exchange did not occur or the Court rejects the Plan does Count VI become relevant.[21] JPMC is fully prepared to rebut Plaintiffs' baseless allegations in Count VI if the occasion arises but at this time Count VI does not raise a genuine triable issue.

CONCLUSION

For the foregoing reasons, the Court should grant summary judgment on Counts I-VI on the basis that the Conditional Exchange occurred as a matter of law.

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[21] JPMC reserves its rights to defend Count VI or any other claim on jurisdictional grounds, including the FIRREA bar, at the proper time. (*See* JPMC Mem., p. 31 n.27.)