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)
	:	(Jointly Administered)
Debtors.	:	
	:	**Response Deadline: August 10, 2011 at 4:00 p.m.**
	:	
	:	**Re: Docket No. 7040**

POST-HEARING BRIEF OF WELLS FARGO BANK, N.A., IN ITS CAPACITY AS INDENTURE TRUSTEE AND GUARANTEE TRUSTEE, IN SUPPORT OF CONFIRMATION

Wells Fargo Bank, National Association, solely in its capacity as successor Indenture Trustee (the "**PIERS Trustee**") under the Indenture dated as of April 30, 2001 (the "**Base Indenture**"), between Debtor Washington Mutual, Inc. ("**WMI**") and The Bank of New York, as initial Trustee, as supplemented by the First Supplemental Indenture dated as of April 30, 2001 (the "**Supplemental Indenture**," and together with the Base Indenture, the "**PIERS Indenture**"), and under that certain Guarantee Agreement, dated as of April 30, 2001, between WMI as Guarantor, and Bank of New York as initial Guarantee Trustee, by and through its undersigned counsel, respectfully submits this Post-Hearing Brief in support of confirmation of the Modified Sixth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code (the "**Plan**").

PRELIMINARY STATEMENT

The PIERS Trustee previously filed its Statement in support of confirmation of the Plan [Docket No. 7939] (the "**Statement**") and its Response to certain objections to Plan confirmation

[Docket No. 8129] (the "**Response**").[1] The PIERS Trustee incorporates in full the arguments made in those submissions. Specifically, the PIERS Trustee addressed in Point II of its Response the objection of the WMB Noteholders to payment of post-petition interest ahead of 510(b) claims. This purely legal issue was not addressed at the confirmation hearing. Similarly, no evidence was presented at the confirmation hearing concerning the Stock Election mechanism that the WMI Noteholders contended runs afoul of the Senior Creditors' subordination rights (*see* Point III of the Response). This, too, is a purely legal issue that requires the Court to interpret the underlying trust indentures and Section 510(a) of the Bankruptcy Code. The PIERS Trustee therefore will address in this Post-Hearing Brief the two discreet issues of particular importance to the holders of the subordinated PIERS debt (the "**PIERS Creditors**") that were the subject of evidence adduced at the hearing: (1) the Plan's classification of the PIERS Claims as debt; and (2) the applicable post-petition interest rate.

In its Response, the PIERS Trustee established that the Debtors had appropriately and definitively addressed the one issue left unresolved in the Court's January 7, 2001 Opinion (the "**Opinion**") concerning the proper characterization of the PIERS Claims: whether or not Washington Mutual Capital Trust 2001 ("**WMCT 2001**") had merged into WMI. It appears that even the Equity Committee has now conceded that the PIERS Claims are properly classified as Unsecured Claims in Class 16. In any event, the evidence introduced at trial and Mr. Goulding's testimony on this subject confirm that no such merger occurred. Consequently, the PIERS Claims are appropriately classified and no Plan objector has come forth with any evidence to refute this fact. (See Point I below.)

The Plan provides for post-petition interest to be paid to WMI's creditors at their respective contract rates. However, the Equity Committee and certain Trust Preferred Holders

[1] Unless otherwise defined herein, capitalized terms shall have the meanings assigned to them in the Response.

(the "**TPS Consortium**") have argued for various reasons that a generally lower rate should be applied. As explained in Point II below, in deciding what rate of post-petition interest to apply, case law is clear that the Court must be guided primarily, if not exclusively, by the interests of creditors, while the consequences of that determination on recoveries to equity holders should be given little, if any, weight. In this case, as a result of the WMI capital structure, the impact of the Court's decision will be borne uniquely by the PIERS Creditors. The PIERS Trustee argued in its Statement that that impact might be mitigated if the Court were to conclude that the subordination provisions of the PIERS Supplemental Indenture must be interpreted to provide that the PIERS Creditors need only pay over to senior creditors at whatever rate the Court determines the Debtor is obligated to pay (the "**Allowed Rate**"), and no evidence was presented at the confirmation hearing to the contrary. However, if the Court were to disagree with that position, it must keep in mind the unintended consequences to the PIERS Creditors in determining the appropriate rate of post-petition interest to allow.

ARGUMENT

I. THE PIERS CREDITORS ARE BONA FIDE CREDITORS HOLDING CLAIMS AGAINST WMI.

The PIERS Trustee demonstrated in its Response that, based on the Court's Opinion, and the law of the case doctrine, the only issue remaining to be addressed at confirmation concerning the classification of the PIERS Claims as debt was whether the special purpose trust that issued the PIERS securities, WMCT 2001, had merged into debtor Washington Mutual, Inc. ("**WMI**"). The evidence and testimony presented at the confirmation hearing leave no doubt that WMCT 2001 has not merged into WMI, and thus the Plan properly classifies the PIERS Claims as unsecured claims.

Mr. Goulding's testimony that WMCT 2001 did not merge into WMI was not challenged by any party.[2] Indeed, WMCT 2001 is still independently in existence, as reflected by its Delaware Certificate of Good Standing dated as of July12, 2011.[3] Based on the Court's findings in the Opinion, this is all that the Court need consider in concluding that the Plan properly classifies the PIERS Claims as general unsecured claims.

All the other evidence and testimony presented at the confirmation hearing with respect to the PIERS leads indisputably to the same conclusion. Mr. Goulding testified in great detail concerning the structure of the PIERS debt. WMCT 2001 raised money from outside investors who purchased PIERS Units for an aggregate of $1.15 billion, and WMI paid $35.6 million to purchase the common shares of the trust.[4] The only assets of WMCT 2001 are the junior subordinated debentures issued by WMI in the face amount of $1.1856 million.[5] As the holder of the junior subordinated debentures, WMCT 2001 is undeniably a creditor of WMI.[6] The PIERS Creditors, as holders of the PIERS Preferred Securities, in turn, are undeniably the beneficial owners of WMCT 2001.[7] Thus, the Plan could have provided for a distribution to

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[2] 7/14/2011 Hr'g Tr. 20: 22 – 23. It appears that even the Equity Committee has conceded that the Plan properly classifies the PIERS Claims. The Equity Committee did not cross-examine Mr. Goulding regarding this issue. Additionally, nowhere in in its submissions in connection with confirmation does the Equity Committee object to the classification of the PIERS Claims. To the contrary, in paragraph 24 of the Objection of the Official Committee of Equity Security Holders to Confirmation of the Modified Sixth Amended Plan of Reorganization, dated July 1, 2011 [Docket No. 8192], the Equity Committee refers to the PIERS as "debt securities." Similarly, in paragraph 50 of its Motion for an Order Authorizing the Official Committee of Equity Security Holders to Commence and Prosecute Certain Claims of Debtors' Estates, dated July 12, 2011 [Docket No. 8291; filed under seal], the PIERS are referred to as "debt securities." And at trial, counsel for the Equity Committee continued to refer to the PIERS as "bonds." *See, e.g.,* 7/20/01 Hr'g Tr. 303 – 304.

[3] 7/14/2011 Hr'g Tr. Tr. 21: 3 – 14; *see also,* DX-401 (Certificate of Good Standing).

[4] 7/14/2011 Hr'g Tr. Tr. 21: 20 – 25; 22: 1 – 2.

[5] 7/14/2011 Hr'g Tr. Tr. 22: 13 – 14.

[6] 7/14/2011 Hr'g Tr. Tr. 22: 12-14.; 23: 10 – 16; 26: 20 – 21.

[7] /14/2011 Hr'g Tr. 22: 17 – 25; 23: 1 – 10; 26: 22 – 24; DX 300 (junior subordinated debentures). *See also* DX-289 (WMCT 2001 Form S-3, filed June 27, 2001, at 1, disclosing that the PIERS Preferred Securities represent an undivided beneficial interest in the assets of WMCT 2001, whose assets in turn consist of the debentures issued by WMI.

WMCT 2001 on account of the debentures owned by WMCT 2001, which funds would then have been "distributed" to the PIERS Trustee for further distribution to PIERS Creditors. Simply because the Plan was structured to streamline the distribution process cannot change the nature of the PIERS Creditors' unsecured claims.

Indeed, the Plan also faithfully follows the internal subordination provisions of WMCT 2001 Trust Agreement pertaining to the PIERS Preferred Securities and the PIERS Common Securities. As Mr. Goulding testified, pursuant to the WMCT 2001 Trust Agreement, the PIERS Common Securities (owned by WMI) are subordinate to the PIERS Preferred Securities. The Plan properly accounts for this subordination in section 20.1 by providing that the PIERS Creditors (the holders of the PIERS Preferred Securities) receive all distributions that are to be made with respect to the interests of the PIERS Common Securities in WMCT 2001 until the Preferred Securities are fully paid.[8] Additionally, no distributions are being retained by the Debtors on account of the PIERS Common Securities. If and when the PIERS Preferred Securities are paid in full, any further distributions on account of the PIERS Common Securities

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[8] 7/14/2011 Hr'g Tr. 104: 14 – 23. *See also* WMCT 2001 Trust Agreement (DX – 295), at Section 6.1(e):

> Payment of Distributions on . . . the Securities shall be made on a Pro Rata basis based on the liquidation amount of such Securities; provided that if, on any date on which payment of a Distribution . . . is to be made, an Indenture Event of Default has occurred and is continuing, then such payment shall not be made on account of the Common Securities, and no other payment on account of the redemption, liquidation or other acquisition of such Common Securities shall be made, until all accumulated and unpaid Distributions . . . on all of the outstanding Preferred Securities for which Distributions are to be paid . . . are fully paid. All funds available to the Property Trustee shall first be applied to the payment in full in cash of all Distributions on . . . the Preferred Securities then due and payable.

See also the definition of Pro Rata in the WMCT 2001 Trust Agreement (DX -295) (emphasis added):

> pro rata to each Holder according to the aggregate stated liquidate amount of the Securities held by such Holder in relation to the aggregate stated liquidation amount of all Securities outstanding <u>unless, in relation to a payment, a Trust Enforcement Event has occurred and is continuing, in which case any funds available to make such payment shall be paid first to each Holder of the Preferred Securities pro rata according to the aggregate stated liquidation amount of Preferred Securities held by the relevant Holder relative to the aggregate stated liquidation amount of all Preferred Securities outstanding, and only after satisfaction of all amounts owed to the Holders of the Preferred Securities, to each Holder of Common Securities</u> pro rata according to the aggregate state liquidation amount of Common Securities held by the relevant Holder relative to the aggregate stated liquidation amount of all Common Securities outstanding."

would flow down to the lower classes in the Plan's waterfall, pursuant to section 20.1.[9] In addition, while the LTW Holders made much ado about the fact the PIERS Units also contained a warrant, the PIERS Preferred Securities and the warrants are two separate securities.[10] The OID implicit in the PIERS Preferred Securities is wholly unrelated to the value of the warrant.[11] In fact, no value is being distributed under the Plan on account of that warrant, and no evidence was adduced to the contrary, because none exists.

In sum, even were the Court to consider factors besides the unchallenged fact that WMCT 2001 never merged into WMI,[12] the record is clear that the PIERS holders are rightly classified as Creditors, and the PIERS Claims are properly treated under the Plan.

II. IN DETERMINING THE RATE AT WHICH DEBTORS PAY POST-PETITION INTEREST, THE CONSEQUENCES OF SUCH A RULING ON JUNIOR CREDITORS, SUCH AS THE PIERS CREDITORS, SHOULD BE THE COURT'S PARAMOUNT CONSIDERATION

The Equity Committee and the TPS Consortium[13] spent a considerable amount of time at the confirmation hearing advocating for a lower post-petition interest rate, presumably because

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[9] 7/14/2011 Hr'g Tr. 33: 10 – 22; 104: 18 – 23.

[10] 7/14/2011 Hr'g Tr. 100: 20 – 23.

[11] 7/14/2011 Hr'g Tr. 98: 25 – 99: 1-4; 100: 19 – 23.

[12] For instance, this Court entered an undisturbed final order declaring the PIERS Claims as general unsecured claims. *See* DX – 286 (Final Order liquidating the PIERS Claims as general unsecured claims).

[13] It does not appear that any unsecured creditor advocated for the FJR, although the position of the holders of the Litigation Tracking Warrants ("**LTWs**") with respect to this issue is not clear. The LTW's objection to Plan confirmation [Docket No. 7912] does not take issue with the contract rate except to suggest that the Debtors should have included a toggle to accommodate the FJR in the event the Court determined to award it. The LTWs have taken the position throughout this case that they are general unsecured creditors. Based on the Debtors' Updated Liquidation Analysis dated July 6, 2011 (DX-375), general unsecured creditors fare worse under a 1.95% FJR. 7/14/2011 Hr'g Tr. 172: 12-22. If the FJR were .25% then unsecured creditors would fare far worse. *Id.* at 173: 11-16. The PIERS Trustee thus assumes that the LTWs are not advocating against their economic interests and would prefer that the Court award the contract rate. The WMB Noteholders reserved their right to argue for the FJR in their confirmation objection [Docket No. 7483, fn, 7 yet did not question any witnesses or otherwise participate in the evidentiary portion of the confirmation hearing. In light of the wholly speculative nature of this unliquidated claim belonging to bondholders of Washington Mutual Bank, the Court should give little, if any, consideration to the interests of WMB Noteholders in assessing the appropriate post-petition rate of interest to award.

equity holders are more likely to be "in the money" if the lower rate were applied. Indeed, after the record was closed, the TPS Consortium improperly filed its "Submission for Inclusion in the Record," dated July 26, 2011 [Docket No. 8315]. Presumably, the purpose of this misleading submission is to demonstrate the purported benefit to equity holders were the Court to direct the Debtors to pay to creditors only a lower federal judgment rate (the "**FJR**"). The Debtors and the Official Committee of Unsecured Creditors have appropriately objected to this misleading submission because, among its many other infirmities, the exhibit fails to account for the consequences of intercreditor subordination on recoveries to junior creditors – were the Court to apply only the lower rate. The PIERS Trustee agrees with the Debtors and the Creditors Committee that Exhibit 301-B should not be admitted. But even if it were, the Court should give that exhibit little, if any, weight in assessing the appropriate rate of post-petition interest, because the Court's paramount concern in setting the post-petition interest rate should be the consequences that such a determination would have on recoveries of unsecured creditors and not equity holders. *See, e.g.*, *Urban Communicators PCS LP v. Gabriel Capital, L.P.*, 394 B.R. 325, 340 (S.D.N.Y. 2008)("[I]t is not inequitable to cut down the interest of Debtors' shareholders by interest at the default rate to which the Debtors contractually agreed.")

In *Urban Communicators*, the Bankruptcy Court awarded a lower rate of interest to a secured creditor of a solvent debtor because Judge Gerber thought it inequitable to allow full recovery to the creditor at the expense of equity holders. District Judge Sweet overturned Judge Gerber's decision to award a lower rate of interest and directed that post-petition interest be increased "to the highest amount that still permits [debtor] to repay its unsecured creditors in full." *Id.* The same result obtained in *In re Int'l Hydro-Electric Systems*, where the District Court held that in assessing the appropriate rate of post-petition interest, the court's paramount concern should be the consequence of that determination on recoveries to creditors, and not equity holders. 101 F. Supp. 222, 224 - 225 (D. Mass. 1951):

> The burden of this [interest] payment will fall entirely on the interest of stockholders. They cannot complain that they are treated inequitably when their interest is cut down by the payment of a sum to which the debenture holders are clearly entitled by the express provisions of the trust indenture. . . . Fairness requires that debenture holders who were compelled to wait for their interest payments should receive the compensation which the indenture provided they should be paid in such an eventuality.

It is undisputed that the ultimate recoveries of PIERS Creditors will be impacted by the subordination provisions of the PIERS Supplemental Indenture, and as a result, could be further impaired by the Court's determination of the appropriate post-petition interest rate. Thus, the Court cannot lose sight of the consequences of its interest rate ruling on the recoveries to PIERS Creditors, which should be given substantial weight in assessing the equities of the case here. Because the Court's determination concerning the post-petition rate at which PIERS Creditors subordinate to senior creditors will greatly impact recoveries to PIERS Creditors under the FJR scenario, the Court's consideration of the appropriate rate of post-petition interest must also be guided by its determination of the intercreditor subordination issue addressed in the PIERS Trustee's Statement.[14]

The record is clear that PIERS Creditors would be severely harmed by any decision to limit the debtor's payment obligations to the FJR, if the Court were also to rule that PIERS Creditors must nevertheless subordinate to the contractual interest rates of the senior

[14] In its Statement, the PIERS Trustee argued that in the event the Court determines that the Debtor should not pay post-petition interest at the contract rate, whether to all or just certain of the senior creditors, then PIERS Creditors should only be subordinate to the post-petition interest of such senior creditors at the Allowed Rate. Under that scenario, PIERS Creditors would pay up at the lower rate awarded by the Court. Furthermore, in the event the Court determines that Debtors are not required to pay certain senior creditors amounts to which those senior creditors are contractually entitled because of alleged misconduct, the PIERS Trustee established in its Statement that PIERS Creditors should not be required to make up the difference. No evidence was presented and no testimony was elicited in connection with these subordination issues during the confirmation hearing, and thus the PIERS Trustee rests on its previously filed papers.

indebtedness, as is assumed in the Debtors' liquidation analysis. [15] As that analysis makes clear, in such a case potential recoveries to the PIERS Creditors would be capped and they could never recover the full amount to which they are contractually entitled if an FJR of 1.95% were to be applied, although the senior bondholders would still receive the full benefit of their contract rate by taking the lion's share of the PIERS Creditors' recovery.[16] And if the Court were to award the .25% (or now .16%) FJR advocated by equity holders, the impact on the PIERS Creditors would be even worse.[17] In fact, even the CCB's would be impaired under that scenario.[18]

It would be grossly inequitable to punish the entire PIERS class in order to enhance recoveries of junior stakeholders who should not be entitled to a distribution under the Bankruptcy Code until PIERS Creditors are paid in full, including post-petition interest. As the PIERS Trustee highlighted in its Statement, the PIERS Trustee has consistently advocated for a speedy resolution of the case, as have virtually all creditors.[19] Despite their continued protestation to the contrary, equity holders have done just the opposite in their attempts to extract value to which they are not otherwise entitled, knowing full well the consequences of delay on recoveries to PIERS Creditors. They now seek to ratchet up the pain to PIERS Creditors so as perhaps to eliminate most of the PIERS Creditors' recoveries so that equity may potentially

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[15] DX-375, p.5, fn. 4.

[16] *See, e.g.,* 7/14/2011 Hr'g Tr. at 49 – 50 and 62:14 – 22 (testimony of Mr. Goulding that recoveries to PIERS Creditors would be capped if the Court awarded the FJR and thus "the brunt of the delay and change in value is borne almost exclusively by the PIERS."); *Id.* at 172: 19-22 (testifying that general unsecured creditors would do about $7 million worse in the aggregate if the FJR were awarded.) *See also* DX-375 (Debtors' Updated Liquidation Analysis dated July 6, 2011), p.5, fn. 9.

[17] Mr. Goulding testified that PIERS Creditors would be "very badly affected" by such a determination. 7/14/2011 Hr'g Tr. at 173: 17 – 19.

[18] 7/14/2011 Hr'g Tr. at 173: 20 – 24.

[19] Indeed, if the Court were to determine, as some parties have argued, that the Plan must fail if a rate other than the contract rate is awarded, the further damage to the PIERS resulting from the expense and delay required to solicit a new Plan while post-petition interest continues to accrue could be devastating, and potentially would wipe out the PIERS recoveries entirely. *See* 7/14/2011 Hr'g Tr. at 172:1-11.

receive a distribution.[20] Even if the equity holders' efforts in this regard were successful, the potential for a distribution to them becoming a reality is extremely remote. Indeed, a distribution to equity could only be realized if the Debtors hit a grand slam in litigation, the Debtors' estimate of the allowed unsecured claim pool ultimately proves to be accurate, the 510(b) claims were eliminated and the Equity Committee could establish that WMMRC is worth far more than Blackstone and even their own expert has opined.[21] Any such potential upside should flow to PIERS Creditors until they recover the full amount of their claims, and that could never happen were the Court to determine that PIERS Creditors must subordinate at the contract rate while the Debtors pay post-petition interest at the FJR.

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[20] To the extent the Equity Committee and the TPS Consortium argue that the Court should award the FJR due to alleged misconduct of the Settlement Noteholders, they have failed to demonstrate why such purported misconduct should affect in any way recoveries of all other PIERS Creditors, and it of course should not.

[21] In fact, Mr. Maxwell put a lower value on reorganized WMI then even Blackstone in concluding that, for purposes of determining distributions under the Plan, the stock is worth between $130 million to $135 million. 7/15/2011 Hr'g Tr. at 68: 9 13. Mr. Maxwell, however, did not even prepare his own valuation report, despite being retained by the Equity Committee in February 2010. *Id.* 71: 1 – 2; 72: 18 – 23 and 73 :13 – 15 "Q: And your report is also not a valuation of the type normally relied upon the a Court, correct? A: That is correct."

CONCLUSION

WHEREFORE, the PIERS Trustee respectfully requests that the Court confirm the Plan in a manner consistent with the PIERS Trustee's submissions in support of confirmation and that it grant the PIERS Trustee such other and further relief as is just and proper.

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