

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:)	Chapter 11
)	
WASHINGTON MUTUAL, INC., <u>et al.</u> ,)	Case No. 08-12229 (MFW)
)	
Debtors.)	Jointly Administered
)	
)	Re: Docket No. 7040, 7475, 7747
)	
)	

**NORMANDY HILL CAPITAL L.P.’S SUR-REPLY TO LIMITED OBJECTION
TO CONFIRMATION OF THE MODIFIED SIXTH AMENDED
JOINT PLAN OF AFFILIATED DEBTORS PURSUANT TO CHAPTER 11
OF THE UNITED STATES BANKRUPTCY CODE**

Normandy Hill Capital L.P. (“Normandy Hill”), by and through its attorneys, Womble Carlyle Sandridge & Rice, PLLC and Halperin Battaglia Raicht, LLP, respectfully submits this Sur-Reply (the “Sur-Reply”) to its Limited Objection to confirmation of the above-captioned Debtors’ Modified Sixth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code (the “Plan”). In support of its Sur-Reply, Normandy Hill respectfully represents as follows:

1. Normandy Hill holds PIERS Claims and as a holder of PIERS Claims, it takes no position with regard to the assertions by the Equity Committee as to the alleged inequitable conduct of some or all of the Settlement Noteholders. However, as the Court recognized in its Memorandum Opinion on Confirmation dated January 7, 2011 (the “First Confirmation Decision”), one issue for the Court to consider and determine in connection with confirmation of the Plan is whether interest accrues on the claims of certain senior creditors at the Contract Rate or the Federal Rate. *In re Wash. Mut., Inc.*, 442 B.R. 314, 359 (Bankr. D. Del.

2011). Given the Court’s necessary determination as to the rate of accrual of post-petition interest, Normandy Hill respectfully requests that the Court consider the issues below.

A. The PIERS Indenture Requires Subordination to the Collection of Postpetition Interest by Senior Creditors at the Rate Determined by the Court

2. If the Court determines that the Debtors’ obligation to pay interest during the pendency of these chapter 11 cases is limited to the Federal Rate, the correct interpretation of the First Supplemental Indenture dated as of April 30, 2001 (the “Indenture”) is that the subordination of the recoveries of the holders of PIERS Claims to the holders of senior debt should likewise be limited to the Federal Rate.

3. The Indenture is clear that any distribution to the holders of PIERS claims is subordinate to “Senior Indebtedness.” *See* Indenture at Section 6.1. “Senior Indebtedness” is defined in the Indenture to include principal, premium (if any) and “all interest accruing subsequent to the commencement of any bankruptcy or similar proceeding, whether or not a claim for post-petition interest is allowable as a claim in any such proceeding...” Indenture at Section 1.1.

4. As this Court determined in the First Confirmation Decision, and as other courts have determined, the appropriate rate at which a creditor should accrue postpetition interest is an issue to be determined by the bankruptcy court in connection with confirmation.¹

See In re Wash. Mut., Inc., 442 B.R. at 357–60; *see also In re Coram Healthcare Corp.*, 315

¹ Despite assertions to the contrary at the hearing on confirmation of the Plan, if the Court determines that postpetition interest accrues at the Federal Judgment Rate on the claims of Senior Creditors, the Plan still provides for confirmation and modification of the Subordination Model by this Court. *See* Section 33.11 of the Plan at page 72. Pursuant to the plain language of the Plan, the Debtors and creditors supporting the Plan have submitted these issues to the Court for determination in connection with confirmation and have agreed that “if the decision of the Bankruptcy Court at the Confirmation Hearing differs from the Subordination Model, then all issues with respect to contractual subordination and subrogation shall be governed pursuant to such decision.” Hence, Normandy Hill submits that contrary to the assertions of some parties, it is not premature to raise its concerns. Indeed, Normandy Hill expects that these same parties would assert that Normandy Hill had waived its ability to raise the issue had it not done so now.

B.R. 321 (Bankr. D. Del. 2004); *In re Cardelucci*, 285 F. 3d 1231 (9th Cir. 2002). The term “interest” in the subordination provisions of the Indenture is not a defined term.

5. In its response to the Limited Objection, The Bank of New York Mellon Trust Company, N.A. (“BONY”), points out that the original PIERS Indenture was amended by a “First Supplemental Indenture” of the same date. The modification apparently replaced the following words in the definition of Senior Indebtedness:

(including any interest thereon accruing after the commencement of any such proceeding)

with the following words:

(including all interest accruing subsequent to the commencement of a bankruptcy or similar proceeding whether or not a claim for post-petition interest is allowable as a claim in any such proceeding).

6. BONY argues that this modification makes clear in the PIERS Indenture the parties’ intention to subordinate PIERS holders’ recoveries to the collection of the Contract Rate of interest by senior creditors. This argument is meritless. If, when amending the PIERS Indenture, there was an intention to clarify the rate of interest to which the subordination should apply, the drafter of the Indenture and the principals who agreed to the modification would have defined the term “interest.” They did not.

7. In fact, this record bolsters Normandy Hill’s interpretation. Despite two versions of defining the indebtedness to which the PIERS are subordinated in the Indenture, the term “interest” remains undefined – the parties could easily have defined it as the Contract Rate, but they did not. Thus, “interest” means what this Court ultimately says it means, and if the Court finds that “interest” accrues at the Federal Judgment Rate, then that is what it means in terms of the subordination provision.

8. As stated in the Limited Objection, when reading an indenture to

subordinate junior creditors to the recovery of post-petition interest by the senior lenders, the Third Circuit requires that the indenture explicitly provide for such an outcome. Absent explicitness in the indenture, consent of the junior creditors to such extreme subordination should not be inferred. This principle is commonly known as the “Rule of Explicitness.” *See In re Time Sales Finance Corp.*, 491 F.2d 841 (3d Cir. 1974); *In re Ionosphere Clubs Inc.*, 134 B.R. 528 (Bankr. S.D.N.Y. 1991). The holders of PIERS Claims agreed to a certain subordination of their claims to Senior Indebtedness; however, nowhere, and in no event, did the PIERS claimants agree to subordinate recoveries on their claims in order to overcompensate parties for their own inequitable conduct. There was no intent by holders of PIERS Claims to subordinate their claims to protect against the bad acts of senior claimants. Such an intent – to the extent not void as against public policy -- would have to have been express.

9. Normandy Hill asserts that the subordination provision of the Indenture is clear on its face. For example, if inequitable conduct on the part of holders of Senior Indebtedness were not the issue and, thus interest accrued at the Contract Rate, yet the holders of PIERS Claims were poised to recover ahead of a senior secured class due to a (hypothetical) defective perfection of a security interest in collateral, the subordination provision would apply. However, the holders of PIERS Claims did not agree to compensate holders of Senior Indebtedness on account of an interest rate that the Court holds does not accrue due to the very actions of such holders.

10. BONY’s strained interpretation attempts to avoid the consequences of a potential decision by this Court applying the Federal Judgment Rate of interest by casting the issue as one of allowance or disallowance of a portion of its claim rather than what the issue truly is – the rate at which this Court determines post-petition interest accrues on claims. They do this

as an attempt to shoehorn the potential adverse consequences of a Federal Judgment Rate ruling into the language of the Indenture, and thereby foisting the economic consequences of alleged bad acts of senior creditors onto the backs of junior creditors.

B. General Principals of Equity Also Require that the Subordination of the PIERS Recoveries Mirror the Interest Rate Granted to Senior Creditors

11. If the Court determines to fix the senior creditors' postpetition interest rate at the Federal Judgment Rate, but subordinates the PIERS' recovery to the collection of the contract rate by those same senior creditors, virtually the entire cost of that decision would be imposed on the holders of the PIERS. The demonstrative attached to this Sur-Reply as Exhibit A (the "Exhibit") highlights the inequitable outcome.

12. The Exhibit compares the recoveries that each applicable class would receive in two different scenarios. In the first scenario, the Court hypothetically determines that (a) the Debtors' obligation to pay senior creditors postpetition interest is calculated using the Federal Judgment rate, and (b) the junior creditors' recoveries are subordinate to a claim that includes postpetition interest also calculated at the Federal Judgment rate.

13. In the second scenario, the Court hypothetically determines that (a) the Debtors' obligation to pay senior creditors postpetition interest is calculated using the Federal Judgment rate, but (b) the junior creditors' recoveries are subordinate to a claim that includes postpetition interest calculated at the contract rates specified in the senior creditors' indentures.

14. As the Exhibit shows, in the first scenario, senior creditors bear the cost of their alleged actions and receive a smaller recovery on their senior claims as a consequence of the use of the Federal Judgment rate. In the second scenario, that cost imposed due to their alleged actions is borne solely by the holders of PIERS.

15. Should this Court determine that the facts and circumstances of this case justify that application of the Federal Judgment rate, the Court should also ensure that the economic impact of such a decision affects the intended parties (senior creditors), and not innocent bystanders (holders of PIERS). Thus, Normandy Hill respectfully requests that, to the extent the equities of the cases mandate accrual of interest at the Federal Rate, the Court specify in its Order confirming the Plan, and direct the Debtors and holders of senior claims accordingly, that the subordination provision in the Indenture cannot be used to afford recoveries on senior claims at a rate higher than the Federal Rate.

Dated: August 10, 2011

**WOMBLE CARLYLE SANDRIDGE
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Exhibit A

				Hypothetical Distributions if the Court Applies the Federal Judgment Rate in Awarding Postpetition Interest and The Federal Judgment Rate is Used to Determine the Appropriate Contractual Subordination of the PIERS Recoveries	Hypothetical Distributions if the Court Applies the Federal Judgment Rate in Awarding Postpetition Interest and The Contract Rate is Used to Determine the Appropriate Contractual Subordination of the PIERS Recoveries	Recovery Difference
	Contract Rate	Federal Judgment Rate	Diference Between Contract Rate and Federal Judgment Rate			
Total Property Distributed (Normandy Hill Estimated)				8,070	8,070	
Bank Exp, Priority Claims & Convenience Class				(90)	(90)	
Net Proceeds				7,980	7,980	
<u>Unsecured Claims</u>						
Senior Notes						
Prepetition	4,132	4,132		4,132	4,132	
Post-Petition	452	241		241	241	
Difference in Post-Petition Interest between Contract and Fed. Jdgmt. Rates			211		211	
Total Recovery				4,373	4,584	211
Senior Subordinated Notes						
Prepetition	1,666	1,666		1,666	1,666	
Post-Petition	341	97		97	97	
Difference in Post-Petition Interest between Contract and Fed. Jdgmt. Rates			244		244	
Total Recovery				1,763	2,007	244
General Unsecured Claims						
Prepetition				375	375	
Post-Petition				82	82	
Total Recovery				457	457	-
CCB Guarantees						
Prepetition				70	70	
Post-Petition				10	10	
Total Recovery				80	80	-
PIERS						
Total Recovery				1,000	545	(455)
Recovery %				100%	54%	
Recovery for Equity Interest Holders						
				307	307	-
				-	-	

CERTIFICATE OF SERVICE

I, Kathleen Lytle, certify that I am not less than 18 years of age, and that on August 10, 2011, I caused a copy of the foregoing to be served upon the parties below by first class mail.

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