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
	[Possible] Hearing Date: Aug. 24, 2011 at 9:30 a.m.
	Related Dkt. Nos. 6696, 6697, 6964, 7038

POST-HEARING MEMORANDUM OF LAW BY CLASS REPRESENTATIVES OF DIME LITIGATION TRACKING WARRANT HOLDERS IN OPPOSITION TO CONFIRMATION OF THE DEBTORS' MODIFIED SIXTH AMENDED JOINT PLAN

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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 "**Class Claimants**"), for themselves and as class representatives of the Dime Litigation Tracking Warrants ("**LTWs**"), by their undersigned counsel, submit this *Memorandum of Law in Opposition to Confirmation of the Modified Sixth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code* ("**Modified Plan**")[1] [Docket No. 6696] and in support thereof represent as follows:

PRELIMINARY STATEMENT

The hearing on confirmation ("**Confirmation Hearing**") clearly demonstrated the active participation of the Settlement Noteholders in the negotiation of the Global Settlement with JPMC.[2] At times, the Settlement Noteholders met with JPMC without informing the Debtors, and made their own settlement proposals to JPMC. The Settlement Noteholders were motivated to maximize the recovery on their claims. They were not fiduciaries for the Debtors' Estates, and were not concerned with maximizing the recovery of the Debtors' claims against JPMC. Aurelius' pleadings filed in connection with confirmation of the Modified Plan highlight that the focus of the Settlement Noteholders was on the recoveries to them, as contrasted to the value of the Debtors' claims against JPMC.

[1] This Memorandum of Law supplements the Class Claimants' (i) *Objection to Confirmation of the Modified Sixth Amended Plan of Affiliated Debtors by Class Representatives of Dime Litigation Tracking Warrants*, dated June 16, 2011 [Docket No. 7912]; and (ii) *Reply By Class Representatives Of Dime Litigation Tracking Warrant Holders To (I) Objection Of Aurelius Capital Management, LP To Confirmation Of The Debtors' Modified Sixth Amended Joint Plan, Or, In The Alternative, (II) For The Court To Consider Whether Conversion Of These Chapter 11 Cases To Chapter 7 Of The Bankruptcy Code Is Appropriate If, Assuming Arguendo, Aurelius' Position On Late-Filed Claims Is Correct (Which It Is Not), Or For Other Appropriate Reasons Resulting From The Confirmation Hearing*, dated July 1, 2011 [Docket No. 8067].

[2] Capitalized terms not otherwise defined hereon shall have the meanings ascribed to them in the Modified Plan.

The Settlement Noteholders acquired large positions in certain creditor classes and then, acting as an *ad hoc* group, strongly advised the Debtors of their "blocking" positions and the need to address their concerns. The Settlement Noteholders also exerted influence through the Creditors' Committee, which is comprised of four indenture trustees who owe duties to the Settlement Noteholders, as large holders of their debt instruments. The dominance of the Settlement Noteholders over the plan process left other creditor groups isolated and/or ignored by the Debtors. For example, the LTWs are entitled to receive 85% of the net recovery in the Anchor Litigation. The Global Settlement was structured as a Section 363 sale in order, among other things, to transfer the Anchor Litigation to JPMC free and clear of the liens and claims of the LTW holders. The Debtors never included the LTW holders in any discussions relating to the structure of the Global Settlement, and clearly intended to give other creditors (*e.g.*, the Settlement Noteholders) -- and not the LTW holders -- the value of the Anchor Litigation being sold to JPMC. The LTW holders objected, *inter alia*, to this aspect of the Debtors' prior plan, and the Confirmation Opinion (as defined below) properly protected the LTW holders' rights by holding that all liens and claims of the LTW holders would attach to the Global Settlement proceeds. *See In re Washington Mutual, Inc.*, 442 B.R. 314, 340-41 (Bankr. D. Del. 2011).

The Settlement Noteholders' dominance over the Debtors' prior plan was also manifested in the following provisions, which were stricken by the Court in the Confirmation Opinion: (a) certain improper third-party releases in favor of, among others, the Settlement Noteholders, (b) payment of postpetition interest to creditors such as the Settlement Noteholders ahead of late-filed claims, (c) improper skewing of the stock ownership of Reorganized WMI (and the benefits of the Debtors' substantial net operating losses ("**NOLs**")) to certain creditor groups (*e.g.*, the Settlement Noteholders) and not other creditors, and (d) payment of

professional fees of the Settlement Noteholders without disclosure of the amounts sought, or application and approval by the Court.

Although they are no longer signatories to the Global Settlement Agreement, the Settlement Noteholders' influence over the Debtors and the Creditors' Committee has not diminished, and there remain a number of provisions in the Modified Plan which, as demonstrated herein, make the Modified Plan unconfirmable. The offending provisions include:

> (a) Paying postpetition interest at the contract rate and not the federal judgment rate. Aurelius, as the alleged predominant holder of the PIERS (the alleged fulcrum security), advocates for the contract rate, and contends that somehow the contract rate was an integral part of the negotiations of the Global Settlement. The Debtors, for inexplicable reasons, hinge their Modified Plan on the contract rate being applied knowing that, if the federal judgment rate was held applicable, the Modified Plan would not be confirmable.
>
> (b) The PIERS are improperly being compensated for their equity warrant. The PIERS are also improperly receiving the benefit of payments made by the Debtors on account of the Debtors' holdings in the common securities of the PIERS.
>
> (c) The stock election for Reorganized WMI has been manipulated to discourage other creditors from participating therein. For example, if an LTW holder made a stock election, it would be prohibited (for no good reason) from trading its claim during the potentially lengthy time period before it received a distribution under the Modified Plan. Also, the Modified Plan was structured so that the PIERS holders would be the majority owner of Reorganized WMI. The Modified Plan removed the Rights Offering that was included in the prior plan, so a minority holder (*e.g.*, an LTW holder) would not have any knowledge, let alone influence, as to how Reorganized WMI would recapitalize itself (including the cost of the capital raised) to maximize the use of its large NOLs. The minority holder, at the time of the stock election, would not even know who would be managing Reorganized WMI -- a decision that will ultimately be made by the majority holders of the PIERS.
>
> (d) The value of Reorganized WMI and, in particular, the value of the NOLs, was set at an artificially low number which will provide an excessive distribution for the electing stockholders of Reorganized WMI (primarily, the PIERS).

Aside from the foregoing, the Debtors did not make their *prima facie* case for plan confirmation because, among other things, they did not disclose contemplated payments to

people who will be managing or overseeing the Liquidating Trust, and contemplated payments to people who will be managing Reorganized WMI. *See* Section 1129(a)(4) of the Bankruptcy Code.

Also, the Liquidating Trust structure which is part of the Modified Plan, but not relevant to the Chapter 7 scenario, has potentially significant tax issues relating thereto. Without disclosing the value of non-cash claims (*i.e.*, litigation claims) being assigned to the Liquidating Trust, it is unclear whether the Debtors have satisfied the "best interests of creditors" test of Section 1129(a)(7) of the Bankruptcy Code. The valuation of non-cash claims, and the anticipated timing of distributions of the proceeds relating to such non-cash assets, has significant tax ramifications to the holders of Liquidating Trust interests. In certain likely scenarios, taking account of tax considerations, Chapter 7 would be a better alternative to the Modified Plan because there will be no mismatch between earlier capital gains tax payable by creditors versus later receipts of Liquidating Trust distributions by creditors.

When the Court refused to confirm the Debtors' prior plan, the Debtors could have tried to broaden the consensus for their plan by negotiating with the parties who had been excluded from the process. Instead, the Debtors decided on the litigation route to try and achieve their confirmation goal. As shown below, they have missed the mark again.

ARGUMENT

I.

THE MODIFIED PLAN IS UNCONFIRMABLE

As explained below, the Modified Plan contains numerous infirmities that warrant denial of confirmation, including the following provisions discussed in this section: (i) the Postpetition Interest Claim is improperly calculated at the contract rate, and not at the federal

judgment rate, as is required under applicable law and the equities of this case; (ii) the Debtors have failed to satisfy the "best interests of creditors" test set forth in Section 1129(a)(7) of the Bankruptcy Code; and (iii) the Modified Plan proposes to make an improper distribution to holders of the PIERS class (Class XVI) and is, thus, not proposed in good faith (Section 1129(a)(3)) or in accordance with applicable law (Section 1129(a)(2)).

A. The Postpetition Interest Provision Renders the Modified Plan Unconfirmable

On January 7, 2011, this Court rendered its opinion denying confirmation of the Debtors' Sixth Amended Joint Plan ("**Confirmation Opinion**") [Docket No. 6528], finding, *inter alia*, that it is within the discretion of the Court to determine the appropriate rate of postpetition interest for unsecured creditors of a solvent debtor based on the equities of the case. *See Washington Mutual*, 442 B.R. at 359 (citing *In re Coram Healthcare Corp.*, 315 B.R. 321, 347, 357-359 (Bankr. D. Del. 2004)).

The Confirmation Opinion did not decide whether the Postpetition Interest Claim should accrue at the contract rate or the federal judgment rate. *Washington Mutual*, 442 B.R. at 359. The Court specifically noted that whether certain "conflicts of interest" existed in respect of the claims traded by the Settlement Noteholders may impact which interest rate should apply. The Court also noted that there may be other "equitable reasons" why the lower federal judgment rate should govern. *Id.*

Notwithstanding the variables discussed in the Confirmation Opinion as to which interest rate might govern in this case, the Debtors took the inflexible position in the Modified Plan that the contract rate applied to the Postpetition Interest Claim. Ignoring warnings by other creditors, including the LTW holders, the Debtors took an "all or nothing" approach on this issue. If the Debtors were wrong, and the federal judgment rate applied, the Modified Plan did

not simply adjust to the federal judgment rate; the Modified Plan failed. The Debtors' reckless approach to this issue has backfired on them. The equities of the case clearly demonstrate that the federal judgment rate should apply. Thus, confirmation of the Modified Plan cannot be granted.

The Equity Committee and others participated in the phase of the Confirmation Hearing dealing with the allegations regarding (a) whether the Settlement Noteholders traded claims with insider information, and (b) whether this alleged conduct impacted the validity of their claims, and/or the appropriateness of paying postpetition interest at the contract rate for their debt. The Class Claimants did not participate in this phase of the Confirmation Hearing, and the Class Claimants assume that the Equity Committee (and perhaps others) will include in their post-confirmation submissions how the evidence adduced at the Confirmation Hearing impacts the Court's consideration on the postpetition interest rate issue, and the validity of the Settlement Noteholders' claims.

Prior to the Confirmation Hearing, other parties-in-interest, including the Equity Committee, filed extensive briefs on the relevant law on the postpetition interest rate issue, and provided a litany of cases holding that the federal judgment rate should apply in this case. *See, e.g.*, *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 Class Claimants incorporate those legal arguments herein and believe they are dispositive of the issue.

The legal presumption is not that the contract rate applies to the Postpetition Interest Claim. Rather, the better interpretation of Section 726(a)(5) of the Bankruptcy Code is that the federal judgment rate applies to the Postpetition Interest Claim. *See In re Adelphia*

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Commc'ns Corp., 368 B.R. 140, 257 (Bankr. S.D.N.Y. 2007); *In re Best*, 365 B.R. 725, 727 (Bankr. W.D. Ky. 2007); *In re Garriock*, 373 B.R. 814, 816 (E.D. Va. 2007). Here, the equities of these cases do not dictate a different result.

At the Confirmation Hearing, the Debtors presented no testimony as to why the equities of the case dictate that the contract rate for postpetition interest should apply. Indeed, the Debtors acknowledged that, under their Modified Plan, there is disparate treatment among unsecured creditors on the interest rate issue. According to the Debtors' updated liquidation analysis dated July 6, 2011 ("**Liquidation Analysis**"),[3] only certain of the unsecured creditors will receive postpetition interest at the contract rate; others will receive interest at the federal judgment rate. *See* Liquidation Analysis, at p. 4.

Further, it is significant that none of the cases that the Debtors cited in support of paying postpetition interest at the contract rate involve a public company whose shareholders were innocent victims of the Debtors' blatant mismanagement. It is hard to conceive how the "equities of the case" would militate against paying something to these shareholder victims -- as contrasted to "topping off" certain of the unsecured creditors with an above-market interest rate for their Postpetition Interest Claim.

Moreover, there are two additional reasons why, at a minimum, the PIERS claims should not receive postpetition interest at the contract rate. **First**, in a pre-Confirmation Hearing submission, Aurelius stated that using the contract rate for the Postpetition Interest Claim was "a critical and material bargained-for element of the Global Settlement Agreement" and that Aurelius' support for the Global Settlement "was conditioned upon the payment of postpetition interest at the applicable contract rate." *See Response Of Aurelius Capital Management, LP To*

[3] The Liquidation Analysis was annexed as Exhibit "A" to the *Declaration of Jonathan Goulding in Support of Entry of an Order Confirming the Modified Sixth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code*, dated July 8, 2011 [Docket No. 8105].

Certain Objections To Supplemental Disclosure Statement For The Modified Sixth Amended Joint Plan Of Affiliated Debtors Pursuant To Chapter 11 Of The United States Bankruptcy Code ("**Aurelius Response**"), dated March 16, 2011 [Docket No. 6957].[4]

It is hard to understand how a promise to pay interest at an inflated and inappropriate rate would be enforced. Nonetheless, assuming Aurelius' statement to be true, it literally means that the Debtors did not compromise their claims against JPMC under the Global Settlement based on the value of their claims against JPMC. Rather, the Debtors reached a compromise with JPMC to achieve a result predicated on a rate of return required by the Settlement Noteholders, who, as clearly established at the Confirmation Hearing, were actively negotiating the Global Settlement on behalf of the Debtors' Estates. Aside from whether Aurelius' allegation (made after the Confirmation Opinion was issued) raises a material issue as to the *bona fides* of the Global Settlement, it certainly raises a material issue as to whether the "equities of the case" should reward the Settlement Noteholders by paying them a contract rate of interest for their improper dominance over the settlement negotiations relating to the Global Settlement. That would be an additional, unfair burden on junior classes who failed to realize the benefit of the true potential of the Debtors' claims against JPMC.

It is, indeed, ironic and revealing that Aurelius now opposes the Global Settlement and objects to confirmation of the Modified Plan because the true value of the claims against JPMC have not been realized and now it (along with the junior classes) are suffering from this unfair compromise. Curiously, Aurelius presented no testimony on the Global

[4] Aurelius' position on the appropriate interest rate for the Postpetition Interest Claim highlights the materiality of this issue. According to Aurelius, if the federal judgment rate was found to apply, that would "significantly alter the economics of the Global Settlement Agreement and would cause certain creditors -- including Aurelius -- not only to vote to reject the Modified Plan, but to vigorously object to its confirmation as well." Aurelius Response, ¶ 9. Thus, if the Court determines that the federal judgment rate should apply to the Postpetition Interest Claim, the Modified Plan cannot simply be changed without further disclosure and a resolicitation of votes. *See* 11 U.S.C. § 1127; Rule 3019 of the Federal Rules of Bankruptcy Procedure.

Settlement at the Confirmation Hearing even though one of its principals testified extensively at the Confirmation Hearing.

Second, as discussed by the Debtors' treasurer, John Goulding ("**Goulding**"), at the Confirmation Hearing, the PIERS claims were structured so that they would "count as Tier 1 capital under the regulatory capital guidelines." Transcript of Confirmation Hearing, dated July 14, 2011 ("**July 14 Transcript**"), at 22:17 - 22:18. Items qualifying as regulatory capital are generally divided into Tier 1 and Tier 2. Tier 1 capital represents the highest quality of capital, such as common equity and some types of preferred stock. *See* Peter King and Heath Tarbert, *Banking & Financial Services Policy Report*, BASEL III: AN OVERVIEW, 30 No. 5 BNKFSPR 1, *2 (May 2011) ("**BASEL III**"). Sub debt is generally Tier 2 capital. *Id.*

The "equities of the case" do not militate in favor of paying an above market contract rate of interest to the PIERS; they had, at best, a quasi "debt" instrument, with a valuable equity warrant, and the PIERS instrument was designed to support the regulatory capital of a bank. Paying the PIERS instrument interest at the federal judgment rate should be more than sufficient. They do not deserve to be paid a higher rate than other general unsecured debt.

For all of the foregoing reasons, the "equities of the case" militate in favor of paying the Postpetition Interest Claim at the federal judgment rate and not the higher, above-market, contract rate of interest. And, based on the inflexible nature of the Modified Plan, since the federal judgment rate of interest applies, the Modified Plan cannot be confirmed.

B. The Debtors Have Failed to Satisfy the "Best Interests of Creditors" Test

Section 1129(a) of the Bankruptcy Code, which contains mandatory requirements that debtors must satisfy in order to confirm a Chapter 11 plan, provides in relevant part as follows:

> (7) With respect to each impaired class of claims or interests --
>
> (A) each holder of a claim or interest of such class --
>
> (i) has accepted the plan; or
>
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date . . . .

Section 1129(a)(7)(A)(ii) is commonly referred to as the "best interests of creditors" test. *See In re U.S. Wireless Data, Inc.*, 547 F.3d 484, 495 (2d Cir. 2008) ("A Chapter 11 reorganization plan may not be confirmed unless it satisfies a number of statutory requirements, including the 'best interests of creditors' test. *See* 11 U.S.C. §1129(a)(7)(A)."). Pursuant to the "best interests of creditors" test, each "holder of an impaired claim or interest either accepts the plan or receives under the plan not less than it would receive in a Chapter 7 liquidation." *Id.*

In this case, the Confirmation Hearing established that there is little difference between the Modified Plan, which is essentially a liquidating plan, and Chapter 7. The real issues are (a) which fiduciary should be winding down the Debtors, (b) whether the Debtors' assets are being properly realized and distributed, and (c) whether the Liquating Trust structure (which is a feature of the Modified Plan but not a Chapter 7 liquidation) is a tax efficient vehicle for the Debtors to wind down their business affairs.

Goulding stated at the Confirmation Hearing that, in his view, there were ***only*** two variables that impacted distributions under the Modified Plan versus a Chapter 7 liquidation. They were (i) the value of WMMRC (the non-filed, reinsurance, runoff subsidiary); and (ii) the incremental costs arising from the conversion to Chapter 7. *See* July 14 Transcript, at 124:12 -

124:18. All other asset/liability components under Goulding's Liquidation Analysis were the same.

1. The Value of Reorganized WMI

With respect to WMMRC, the Debtors used a forced sale number in the Chapter 7 scenario. *Id.* at 144:9 - 144:18. According to Goulding, this was based on the receipt of two unsolicited offers for WMMRC more than two years ago, during the height of the financial crisis in the first quarter of 2009. *Id.* at 46:6 - 46:20. Under cross-examination, Goulding acknowledged that the bids were deemed insufficient by the Debtors and, therefore, rejected, and neither the Debtors nor Blackstone (who was retained to eventually run a sale process for WMMRC) ever marketed this asset or sought to solicit bids for it. *Id.* at 88:13 - 91:7. Moreover, Goulding testified that the value of WMMRC actually increased since 2009, given that the passage of time brought WMMRC closer to the cash flow peak in its run-off rate, which starts around 2013. *See* July 14 Transcript, at 91:10 - 91:18.

Goulding could not explain why his Liquidation Analysis never was updated for this increased value of WMMRC. *Id.* at 89:13 - 89:21. Goulding also had no explanation as to why he did not adjust his liquidation number for WMMRC in light of the change in economic circumstances since early 2009. Goulding's analysis was artificially concocted based on faulty premises.

Moreover, and fundamentally, there was no basis for Goulding to conclude that a Chapter 7 trustee could not maximize the value of this asset in the same manner as that contemplated by the Debtors; that being, by allowing a runoff of the reinsurance business to occur. The Debtors' Chapter 11 scenario is actually a form of liquidation. The Debtors' Chapter 11 scenario assumes no operating business, no new business, and no independent employees. The assets of WMMRC are collected and disbursed as and when received. Accordingly, there

was no basis for the Debtors to present a difference in the value of WMMRC between the Modified Plan and Chapter 7.

2. The Costs and Delay of a Chapter 7 Case

This leaves, as the only other variable presented by the Debtors, the costs of a Chapter 7 case, as compared to the Chapter 11 case. Goulding's testimony focused on the so-called delay factor allegedly attributable to a Chapter 7 conversion. Of course, Goulding's analysis assumed that the Debtors could confirm the Modified Plan, which, as demonstrated herein, is not possible.[5]

a. Costs of Chapter 7 Versus Chapter 11

Pursuant to the Liquidation Analysis, the Debtors assumed a five month delay for a Chapter 7 trustee to get up to speed. *See* Liquidation Analysis, at p. 6 (Note (e)). Goulding assumed that a Chapter 7 trustee would do nothing for two to four months (other than learn the case), and then take another two to four months to effectuate the distributions contemplated by the Modified Plan. He somehow averaged these two assumptions into a five month incremental delay. He further assumed that no Estate professional would assist the Chapter 7 trustee under a concocted theory that all Chapter 11 professionals would have a disabling "conflict" based on theoretical unpaid Chapter 11 professional fees. *See* July 14 Transcript, at 154:12 - 154:25.

Goulding testified that he calculated this additional cost by extrapolating a "burn rate" number from the Debtors recent monthly operating report. *Id.* at 125:17 - 126:19. This was obviously an unfair assumption. The professional fee burn rate in these cases, according to the Creditors' Committee, recently went up by $10 million a month.

[5] Failure to confirm the Modified Plan actually supports a conversion remedy as the best alternative for creditors and equity holders.

Goulding also apparently thought it was fair (it was not) to use recent professional fee numbers referable to a Debtors' attempt to confirm a plan as a basis for calculating the cost of a Chapter 7 trustee getting up to speed on the remaining tasks of an essentially liquidated bankruptcy estate.

Goulding thought it was appropriate (it was not) to include, in his base extrapolation number, the professional fees of ***both*** the Creditors' Committee and the Equity Committee. *See* July 14 Transcript, at 126:3 - 126:19. Committee professionals would not be retained in Chapter 7 and the inclusion of their fees in calculating potential Chapter 7 expenses by Goulding was just wrong.

Goulding also exaggerated the complexity of the work to be done in the Chapter 7 scenario in an effort to support his concocted five month "delay" estimate. His Liquidation Analysis assumed that the Global Settlement would be approved in Chapter 7. *See* Liquidation Analysis, at p. 1. It also assumed that substantially all of the Debtors' assets were liquidated or, like WMMRC, are in "wind down" mode. Thus, it was unclear what was driving Goulding's assertion that the case would be overly complex, other than his exaggerated presentation on unresolved claims.

Goulding stated that there was still $55 billion in disputed claims. However, under cross-examination he admitted that, assuming the Global Settlement was approved (which, as noted, is the assumption made in the Liquidation Analysis), and without regard to the LTW Holders' claims (which are being reserved for pursuant to Court order), there would only be $500 million of claims in dispute, which he expected to settle at approximately $375 million. *See* July 14 Transcript, at 116:8 - 117:11. Thus, much of the work regarding claims has been done in these cases already.

What Goulding did not account for, and which would militate in favor of the Chapter 7 scenario would be the elimination of the following professional fees which are present in the Modified Plan scenario only: (a) payment of fees for Section 503(b)(4) substantial contribution claims, which the Debtors have asserted would be millions of dollars; (b) payment of fees to counsel for the Liquidating Trust and for the members of the Liquidating Trust Board;[6] and (c) payment of fees for valuing non-cash assets to be transferred to the Liquidating Trust.

Moreover, in a Chapter 7 scenario, there would be notice to creditors and Court supervision of payment of professional fees. Under the Modified Plan, there would be no Court or full creditor scrutiny of such fees, or the expenses of the Liquidating Trust. *See* Liquidating Trust Agreement.

Goulding testified that he expected that the initial funding of the Liquidating Trust would be in the range of $75 million. *See* July 14 Transcript, at 123:12 - 123:16. When questioned why he thought it would be that much, he did not have an answer other than the residual amount would flow back to creditors. But, of course, that residual amount would be after the unsupervised payment of professional fees and expenses of the Liquidating Trust. *See generally* Liquidating Trust Agreement. Goulding concluded that a Chapter 7 trustee would be incrementally more expensive than a Liquidating Trustee by $37 million but never explained why that would be the case. *See* July 14 Transcript, at 45:10 - 45:18. When asked what would be the fees of the Liquidating Trust Advisory Board, Goulding said he did not know. *See* July 14 Transcript, at 113:25 - 114:6. William Kosturos ("**Kosturos**") testified but did not give that information. Making economic decisions about insider compensation after the Confirmation

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[6] When Goulding was asked what these fees were, he could not give an answer. *See* July 14 Transcript, at 113:25 - 114:6.

Hearing is not a proper response. It is also contrary to Section 1129(a)(4) of the Bankruptcy Code.

The professional fees incurred in this case have been huge. And, for the most part, the Estate professionals have never questioned each other's fees. That scenario would change in Chapter 7. A Chapter 7 trustee would not only scrutinize what was spent, but also would have a tighter reign on future costs and expenses.

As demonstrated above, the Debtors exaggerated the costs of a Chapter 7 case to drive their faulty Liquidation Analysis. There is absolutely no credible evidence that the cost of a Chapter 7 case would be more expensive then the cost of the Liquidating Trust. In fact, for the reasons state above and herein, the Debtors' Estates may very well be better off liquidating in Chapter 7 then in Chapter 11.

b. <u>Tax Cost Relating to Liquidating Trust Interests</u>

The Liquidating Trust structure, as embodied in the Modified Plan, has a tax cost; one that is not applicable to a Chapter 7 case. The creation of the Liquidating Trust, and the exchange of claims against the Debtors for interests in the Liquidating Trust, leads to a taxable event for creditors who are receiving an interest in the Liquidating Trust. In this case, because of the significant dividend to creditors, it could generally be a gain for creditors.

As part of setting up the Liquidating Trust, the trustee will need to value each asset in order to advise creditors of their new tax basis in the Liquidating Trust. *See* Disclosure Statement (dated October 6, 2010), at p. 166. However, Goulding testified that certain non-cash assets that are being transferred to the Liquidating Trust have not been valued yet. *See* July 14 Transcript, at 107:13 - 108:1.

Kosturos never supplemented Goulding's testimony in this regard. However, he did testify that the Debtors have entered into approximately 150 tolling agreements with the

Debtors' current and past officers and directors, and others. *See* Transcript of Confirmation Hearing, dated July 21, 2011 ("**July 21 Transcript**"), at 207:7 - 207:13. The Debtors have retained new counsel to investigate possible claims against some of these entities and, if warranted, commence litigation in connection therewith. *See id.* at 207:10 - 208:21.

Aside from litigation claims, other non-cash assets which will not be collected immediately that will need to be valued include: (i) future income tax receivables; (ii) the equity in the Debtors' remaining subsidiaries; and (iii) certain BOLI/COLI policies**.** *See* July 14 Transcript, at 107:13 - 109:12.

Depending on a creditor's original tax basis in its claim, the computation of the Liquidating Trust interest for a creditor should generally lead to an immediate gain by a creditor based on the contemplated 100% dividend to creditors. The gain will be greater for creditors who bought at a discount (there are many creditors in this capacity).

Assuming there is a gain, there will not be a full corresponding distribution from the Liquidating Trust to pay the tax liability resulting from that gain because the non-cash assets (such as litigation claims) will not have been successfully prosecuted and collected as of the time the tax payments will be due. Also, the Debtors are reserving an excessive amount ($75 million) for future Liquidating Trust expenses that could never occur. This will lead to a gain realized by creditors, without a matching receipt of cash to pay the same. None of these important tax concerns have been disclosed to creditors. Many of these adverse tax consequences militate in favor of Chapter 7. In Chapter 7, creditors pay taxes as and when they actually receive distributions.

There should be heightened scrutiny over the valuation of these non-cash assets into the Liquidating Trust. Based on the Debtors' Liquidation Analysis, the PIERS debt actually

receives a higher recovery under the Modified Plan using the federal judgment rate of interest as opposed to the contract rate of interest. *Compare* Liquidation Analysis, p. 4 *with* Liquidation Analysis, p. 5. Despite this, Aurelius, a purported large holder of PIERS claims, has advocated using the contract rate of interest, and not the federal judgment rate of interest.

By Aurelius advocating the contract rate of interest, which is against its current economic interest, it must believe that the Liquidating Trust assets are undervalued. This is so because the federal judgment rate works as an overall cap on the PIERS claim. If the Debtors recover significant amounts on litigation claims (which were somehow never included by Goulding in the Liquidation Analysis) then having a higher capped claim based on the contractual rate of interest best serves the PIERS' overall recovery. Aurelius' witness testified at the Confirmation Hearing but did not discuss this subject.

In addition, the Debtors announced a potential seventh plan (which was never consummated) predicated on a deal with the Equity Committee. Under that deal, the Equity Committee would be given a $25 million war chest to sue third parties for the Debtors' Estates. Goulding did not know who the potential targets were (*see* July 14 Transcript, at 104:24 - 105:19), but it is fair to assume the Debtors would not have proposed to give $25 million to fund litigation against third parties unless there were viable claims to bring.

In short, without presenting the requisite tax information and the valuation of the non-cash assets, the Debtors did not present material information needed to assess whether the "best interests of creditors" test has been satisfied. For this reason alone, the Modified Plan cannot be confirmed.

3. <u>Conversion May be Appropriate</u>

If the Debtors are unsuccessful again in obtaining confirmation of the Modified Plan, serious consideration should be given to converting these Chapter 11 cases to Chapter 7 of

the Bankruptcy Code, and/or putting in place a new, independent fiduciary. The new, independent fiduciary will not be burdened by the Debtors' past failures to confirm a plan, and will be able to work towards successfully resolving the remaining issues associated with liquidating the Debtors' Estates. A new fiduciary would lead to a smaller role for the Committees and, in Chapter 7, the elimination of the Committees. At all times, professional fees would remain subject to Court scrutiny. The independent fiduciary should be better able to streamline these cases, reduce the "burn rate," resolve issues more expeditiously, and incur less in professional fees then the Debtors currently are incurring on a monthly basis.

The Class Claimants lack confidence in the Debtors' management and their aggressive and improper approach toward the LTW holders. As noted on other occasions, the Debtors and the Creditors' Committee have continuously tried to undermine the LTW position by, among other things, (a) first trying to set a claims reserve for only one LTW holder (Broadbill), (b) later trying to set an LTW claims reserve for approximately $150 million less than what the Court ultimately determined should be the proper claims reserve, (c) submitting a flawed summary judgment motion predicated on a draft document, (d) trying to file an expert report (while a summary judgment motion was pending) on the eve of the confirmation hearing respecting the prior plan, and (e) structuring the Global Settlement using a Section 363(f) mechanism in a way -- ultimately unsuccessful -- to disenfranchise the rights of the LTW holders.

Another illustration: the Debtors waited approximately two and one-half years to retain counsel to investigate claims against the Debtors' current and former officers and directors. Why the delay? Why did the Debtors retain new counsel as compared to the existing Estate professionals? Did existing Estate professionals have a disabling conflict? Why is the

new counsel only investigating the Debtors' old Board and not the current Board? Clearly, these claims have value. There was a recently announced shareholder settlement, where the WMI board (thru the D&O insurance carrier) is making a major payment to shareholders. The FDIC also sued the board and there were reports of settlement negotiations that broke down. Goulding had no adequate explanation as to why the Debtors waited so long to act in this regard, and neither did Kosturos. Kosturos was not even sure whether the Debtors had made a claim against the D&O policy for 2007/2008. *See* July 21 Transcript, at 205:23 - 205:25. Kosturos also testified that some of the tolling agreements with the WMI Board were entered into as late as the week before the Confirmation Hearing, after the Equity Committee sought authorization to prosecute claims against the WMI Board. *Id.* at 208:12 - 209:4.

Another example: Goulding's testimony that if the Debtors confirmed their plan before the end of last year, as was their original intention, it would have substantially impaired the Reorganized WMI's use of their NOLs. When asked why the Debtors did not wait a few weeks to preserve full usage of potentially $5 billion of NOLs, Goulding had no adequate response. *See* July 14 Transcript, at 121:21 - 122:15. Kosturos did not testify on this issue.

The Debtors failure to create a self-adjusting feature in the Modified Plan on the rate of interest for Postpetition Interest Claims also raises serious concerns. What was the downside for providing in the Modified Plan that the federal judgment rate would apply if determined by the Court to be appropriate?

The failure to provide answers on non-cash asset valuations, contemplated post-confirmation payments to insiders, and Court scrutiny over post-confirmation fees and expenses, is also all very troubling and revealing. It appears as if the Debtors are hiding the ball.

As noted, the Creditors' Committee, comprised of the four indenture trustees, doing the bidding for the Settlement Noteholders, have not provided the proper "watch dog" function over the Debtors.

For all of these reasons, if the Court denies confirmation of the Modified Plan, as it should, it also should carefully consider whether an independent fiduciary should be appointed, or the cases converted to Chapter 7.

C. Holders of the PIERS Claims Are Receiving More Than They Should Under the Modified Plan

According to Goulding, approximately 77% of Reorganized WMI will be owned by the PIERS if the Modified Plan is confirmed. *See* July 14 Transcript, at 39:15 - 39:17. The remaining stock interest in Reorganized WMI will be held by: (i) the senior notes - 15%; (ii) the senior subordinated notes - 8%; and (iii) general unsecured claims (including LTWs)- less than 1%. *Id.* at 38:24 - 39:14. As explained *infra*, the Modified Plan was structured to discourage general unsecured creditors, including the LTWs, from electing the stock alternative.

When asked why someone would elect to receive stock, instead of cash, Goulding responded as follows: "You would elect to take stock in lieu of cash if you believe that the company was undervalued, so you believe that making a swap of a dollar of cash for a dollar of stock was a good trade. So people who elected stock believe that they had -- it had more value than the value Blackstone was placing on it." *Id.* at 39:22 - 40:2.

While some of the holders of PIERS will obtain stock in Reorganized WMI by default pursuant to the terms of the Modified Plan, many of the holders of PIERS actually elected to take the stock interest. *See id.* at 96:23 - 97:1. Moreover, the structure of the Modified Plan -- including the default provisions for Reorganized WMI stock -- was created with the participation of the PIERS holders and the indenture trustee representing the PIERS holders,

through their role on the Creditors' Committee. If the PIERS holders believed that the valuation of Reorganized WMI was too high, and that cash was worth more than Reorganized WMI stock, they would have objected to the default treatment under the Modified Plan. The fact that they did not suggests that the PIERS holders always wanted Reorganized WMI stock instead of cash.

Further, the fact that the largest holder of the stock of Reorganized WMI would be the PIERS should also come as no surprise since the Debtors prior plan was structured so that only certain creditors, including the PIERS, could participate in the Rights Offering. Nothing has changed between the Debtors prior plan and the Modified Plan to cause the PIERS group to re-evaluate its estimated value of Reorganized WMI.

As noted, Reorganized WMI's only tangible asset will be the wind-down insurance portfolio (WMRRC). The experts who testified at the Confirmation Hearing did not disagree as to the range of value of WMMRC (assuming a wind-down mode). The basis of their disagreement, and the potential large swing in value for Reorganized WMI, is the potential usage of the Debtors $5.5 billion in NOLs.

Steve Zelin ("**Zelin**") of Blackstone Advisory Partners testified on behalf of the Debtors and valued the NOLs at $20-$45 million. Of that amount, $10-$20 million was referable to offsetting the income from the windown of WMMRC. The experts agreed on the valuation of this component of the NOLs.

The remaining $10-$25 million was referred to by Zelin as the "corporate opportunity." *See* Transcript of Confirmation Hearing, dated July 13, 2011 ("**July 13 Transcript**"), at 298:20 - 298:22. The Debtors' low valuation of the so-called "corporate opportunity" was based in part on expressed concerns over Section 269 of the Internal Revenue Code ("**IRC**"). Zelin explained his valuation of the "corporate opportunity" was predicated on

the testimony of Richard Reinhold ("**Reinhold**") -- a tax partner from Willkie Farr & Gallagher. Reinhold, in turn, testified that because of the limited size of WMMRC, any attempt to raise capital for Reorganized WMI above the value of WMMRC today would raise Section 269 concerns. *Id.* at 196-25 - 197:20. Thus, because Reinhold put a limit on the capital to be raised by Reorganized WMI due to concerns regarding the application of Section 269 of the IRC, there was, according to the Debtors, a limited amount of NOLs that could ever be used by Reorganized WMI.

Reinhold, in nuanced testimony, said that there was no Section 269 issue caused by Reorganized WMI raising capital in any amount. *Id.* at 217:19 - 217:23. Rather, he testified that if there was a large amount of capital raised by Reorganized WMI in the future, the IRS may revisit what happened ***at the plan confirmation stage*** and challenge the original debt to stock conversion contained in the Modified Plan, on the basis that the Modified Plan structure was crafted, at inception, with the principal purpose of the avoidance of taxes. *Id.* at 200:1 - 202:6; 216:16 - 217:15.

The Debtors' Section 269 concern appears to be a clear exaggeration. At present, there is no limit on how much capital Reorganized WMI can raise in the future. The Section 269 concern -- principal purpose of the plan is the avoidance of taxes -- is the same concern expressed in Section 1129(d) of the Bankruptcy Code. The IRS, with notice of the Modified Plan, did not challenge the Modified Plan on those grounds. The Section 269 issue, if advocated by the IRS, would seem far-fetched, since it is self-evident that the principal purpose of the Modified Plan is the effectuation of the Global Settlement.

Zelin also discounted the NOL corporate opportunity for the risk factor in raising capital for Reorganized WMI. *Id.* at 339:18 - 340:2. Significantly, the Debtors prior plan did

not have this risk factor because there was a Rights Offering as part of that plan. Moreover, the Debtors' contemplated seventh plan also featured a capital raise for Reorganized WMI of $100 million, and would not have had this risk factor. As explained *infra*, the Debtors should have addressed the fund raising issue for Reorganized WMI as part of the Modified Plan so that there would have been meaningful information provided to creditors as part of the stock election. Instead, the Debtors failed to include any information as to fund raising, and who would run Reorganized WMI. The failure to include this information artificially depressed the value of Reorganized WMI. Moreover, it chilled the stock election for a minority holder, such as an LTW holder. By contrast, the failure to disclose this information did not deter the large PIERS holder who will control Reorganized WMI and how these critical issues will be addressed.

In any event, the Debtors have overemphasized the Section 269 risk and thus undervalued the NOL usage; this, in turn, caused the Debtors to undervalue Reorganized WMI. If the Debtors truly believed there was a Section 269 risk, they would have capped future capital raises by Reorganized WMI. By not doing so, they knew that such a capital raising limitation was not required for them to defeat any Section 1129(d) challenge as to the principal purpose of the Modified Plan.

Accordingly, the Court should reset the value of Reorganized WMI. If not, the Debtors have undervalued Reorganized WMI, and holders of PIERS claims (and senior note claims) will receive more from the Debtors' Estates on account of their claims than they are legally entitled to, thus making the Modified Plan contrary to law, not proposed in good faith, and not confirmable.

D. The Improper Distribution in Connection With a Component of the PIERS Claims

The Preferred PIERS securities contain two components, a preferred security reflecting the capital paid and an equity warrant to purchase stock in WMI. The Disclosure Statement (at page 9) stated that the value of the equity warrant was reflected in the original issue discount ("OID") related to the issuance of the PIERS. The Disclosure Statement also stated that the Preferred Securities piece of the PIERS increased in value since the issuance of the PIERS in 2001 (for the seven year period through 2008) based on the reduction of the OID. The initial purchase price of the Preferred Securities piece of the PIERS was between $730 million and $743 million. Yet, the claims based on the Preferred Securities piece of the PIERS, as of September 2008, was approximately $756 million in principal amount; this reflected the reduced OID. Goulding testified at the Confirmation Hearing that in addition to accretion of the OID, the Preferred Securities were being paid current interest at a rate of 5 3/8%. *See* July 14 Transcript, at 101:13 - 101:20. Thus, a component of the PIERS claim being paid under the Modified Plan is the equity warrant, and a component of the Postpetition Interest Claim for the PIERS is interest on the equity component of the PIERS prepetition claim. This amount is approximately $13 million to $30 million and should be disallowed. To the extent the Modified Plan seeks to pay this amount, it provides the PIERS debt with more than they are entitled to and thus the Modified Plan is not proposed in good faith and is contrary to law.

At the Confirmation Hearing, Goulding had no response to this contention other than the accretion of OID enhanced the return on the Preferred PIERS security. *Id.* at 98:25 - 100:23. However, that response does not convert an equity warrant component to debt. It merely reflects an overall rate of return on the investment for the PIERS. The Settlement Noteholders, who hold PIERS debt, did not testify on this subject, and neither did Kosturos.

The Disclosure Statement (at page 12) also stated that the holder of the Common Securities of the PIERS is WMI, and there will be no distribution on this aspect of the PIERS claim, **except** to the extent such distribution is made to the Preferred Securities holders of the PIERS on account of a contractual subordination provision. *See* Modified Plan, § 20.1. Goulding confirmed this at the Confirmation Hearing, stating as follows:

> There is a claim for the junior subordinated debentures that's allowed. If the claim were to pay -- my understanding is there's a liquidation preference within the trust to pay the preferred securities and their interest associated with the preferred securities, ahead of the common securities. If there were any value then remaining at the trust, and that value would then be to the common securities, that value would flow further down the waterfall. WMI is not retaining any of that interest, and it would essentially go to the liquidating trust to flow further down the waterfall.

July 14 Transcript, 104:14 - 104:23.

Translated, this means that the PIERS Preferred Security is receiving a distribution on account of WMI paying ***itself*** for its piece of the PIERS debt. That amount, inclusive of postpetition interest on such amount, is approximately $24 to $ 30 million, and constitutes an improper distribution on the PIERS debt. Since the Modified Plan makes an improper distribution to the PIERS, the Modified Plan is not proposed in good faith and is contrary to law, and therefore may not be confirmed.

Wells Fargo Bank, N.A. (the PIERS Trustee) ("**Wells Fargo**"), apparently recognized the improper structure in the Modified Plan, stating in its confirmation response that the Debtors could have structured the payment to the PIERS differently: "The Plan was structured to bypass for distribution purposes WMCT 2001, a non-operating, non-debtor special purpose entity, and confer on the PIERS Creditors direct claims against the estate. The Plan could have just as easily given WMCT 2001 itself the claim under the Subordinated Debentures, and simply then allowed WMCT 2001 to pass through the distributions to the owners of WMCT

2001 - the PIERS Creditors." *See Response Of Wells Fargo Bank, N.A., In Its Capacity As Indenture Trustee And Guarantee Trustee, To Certain Objections Filed With Respect To The Modified Sixth Amended Plan Of Affiliated Debtors Pursuant To Chapter 11 Of The United States Bankruptcy* Code [Docket No. 8128], dated July 11, 2011, at p. 8. However, the Modified Plan was not structured this way and the Debtors should not be permitted to adjust the Modified Plan to correct another infirmity.

It is interesting to note Wells Fargo's description of WMCT 2001 -- as a non-operating, non-debtor special purpose entity. In this regard, the Court stated in the Confirmation Opinion that "[i]f WMCT 2001 was merged into WMI, then the PIERS claims could be viewed as equity." *Washington Mutual*, 442 B.R. at 362. While there may not have been a technical merger of WMCT 2001 and WMI, there was something akin to a merger of the two entities. Typically, subordinated debt is considered Tier 2 capital. Tier 1 capital is generally considered regulatory capital consisting of common equity and some types of preferred stock. *See* BASEL III, at *2 ("Tier 2 capital on the other hand, largely comprises a range of lower-quality instruments often dubbed as "supplementary" capital. Examples of Tier 2 capital include subordinated term debt and certain hybrid instruments."). The PIERS securities were considered Tier 1 capital, which is primarily equity. Based on the foregoing treatment of PIERS as regulatory capital and not Tier 2 sub-debt, a credible argument can be made that the PIERS claims are, in fact, equity and not debt.

II.

OTHER INFIRMITIES CONTAINED IN THE MODIFIED PLAN

A. The Definition of Late-Filed Claims is Incorrect

The pleadings filed by the Debtors and the Creditors' Committee in support of confirmation of the Modified Plan have clarified that the claims held by the LTW Holders would

either fall within Class 12 or Class 21, and not within Class 12A (Late-Filed Claims). *See Debtors' Omnibus Response To Objections To Confirmation Of The Modified Sixth Amended Joint Plan Of Affiliated Debtors Pursuant To Chapter 11 Of The United States Bankruptcy* Code ("**Debtors' Omnibus Response**"), dated July 8, 2011 [Docket No. 8186], Exhibit "A," p. 1; *Memorandum Of Law Of The Official Committee Of Unsecured Creditors Of Washington Mutual, Inc., et al., In Response To Certain Objections To Confirmation Of The Debtors' Modified Sixth Amended Plan Of Reorganization*, dated July 11, 2011 [Docket No. 8140], at ¶ 30. In addition, the Debtors have acknowledged that Late-Filed Claims do not include claims filed late because of excusable neglect. *See Debtors' Omnibus Response*, Exhibit "A," p. 3 (in response to an argument raised in Class Claimants' objection to confirmation regarding the definition of Late-Filed Claims, the Debtors stated that "the Bankruptcy Court deems any late-filed Claim to be timely filed based upon the excusable neglect standard, then such claim would not be a Late-Filed Claim. Instead, such Claim would be an allowed, timely-filed claim in whichever Class such Claim belongs (e.g., Class 12 (General Unsecured Claims)).").

However, this is not what the Modified Plan provides. It defines Late-Filed Claims as:

> A Claim against any of the Debtors or the Debtors estates, (i) proof of which was filed subsequent to the date designated by the Bankruptcy Court as the last date for filing such proof of claim against any such Debtor or such Debtors' estate, but prior to the commencement of the Confirmation Hearing, and which is not merely amending or superseding a Claim that was filed prior to such date, and (ii) which has not been listed by such Debtor in its Schedules as liquidated in amount and not disputed or contingent.

Modified Plan, § 1.123.

The definition of Late-Filed Claims in the Modified Plan needed to be revised, consistent with the Debtors' statements in the Debtors' Omnibus Response, to make clear that

claims filed late based on excusable neglect will be treated as timely-filed claims. The Modified Plan should also clearly state that LTW claims are not to be considered "late filed" for any purpose. This clarification as to the LTW status would be consistent with the Debtors' assumptions in the Liquidation Analysis, which states that the Debtors believe that the amount of Late-Filed Claims will eventually be zero.

Moreover, as required by the Confirmation Opinion, the Modified Plan provides that Late-Filed Claims get paid ahead of Postpetition Interest Claims. Since the Modified Plan contemplates payment of postpetition interest, then, as a practical matter, there should be no issue relative to whether any of the LTW claims were late-filed or not.

B. The Election Regarding a Third Party Release is Unfair

In the Confirmation Opinion, the Court noted that a failure to make an election should not be viewed as consent to a third party release. *Washington Mutual*, 442 B.R. at 355. The Court also noted that it was unfair to ask parties in interest to elect whether to give a third party release when it was unclear if such party in interest would be receiving a distribution under the plan. *Id.* Representatives of the LTW Holders and the Debtors are currently litigating the class action adversary proceeding which will determine, among other things, whether the LTW holders have claims against the Debtors. It is not clear when a Final Order will be rendered on this issue.

Section 32.6(c) of the Modified Plan provides that if a creditor does not elect to give a third party release within a year of the Effective Date of the Plan, it forfeits its distribution. That provision is unfair to the LTW holders since (a) they don't know whether they will be receiving a distribution under the Modified Plan until the adversary proceeding is decided by Final Order, and (b) they don't know whether such Final Order will be issued before the time period specified in Section 32.6 will expire. There was absolutely no testimony or any other

evidence presented at the Confirmation Hearing that would demonstrate why Section 32.6(c) is needed or fair with respect to the LTW holders.

Moreover, it is not clear why entities who did not give a release to JPMC should be prohibited from sharing in recoveries from third parties other than JPMC.

Accordingly, the election provision with respect to the LTW holders is contrary to the Confirmation Opinion and must be stricken. LTW holders should have the later of one year after the Effective Date of the Modified Plan, or 90 days after the entry of a Final Order in the adversary proceeding, whichever is greater, to decide whether to grant the third party release under the Modified Plan.

C. The Trading Restriction Provisions, as They Relate to LTW Holders, Should be Stricken From the Modified Plan

The Disclosure Statement contained various provisions regarding the returning of securities and/or trading restrictions.[7] However, these provisions should not apply to the LTW holders since it is not clear whether the Modified Plan will provide for a distribution to them, and the adversary proceeding may not be decided by Final Order until years after confirmation.

The referenced provisions -- as they relate to the LTW Holders -- were not included for any meaningful administrative convenience of the Debtors. Rather, Class Claimants believe that they were merely added to discourage LTW holders from taking a stock election, and to disrupt the trading market for LTWs. Such provisions: (a) created serious confusion

[7] For example, *see* (i) Disclosure Statement, pp. 36-37, which contains a provision for returning securities in order "to ensure accurate identification of the Entities entitled to receive distributions pursuant to the Modified Plan…" Once the securities are returned, there can be no further trading in such security; (ii) Disclosure Statement, p. 37, which contains a provision relating to LTW holders making an election to take stock in Reorganized WMI instead of cash with respect to their potential Class 12 distribution under the Modified Plan. If a stock election is made by the LTW holders, LTWs must be tendered, and there can be no further trading of that LTW security; and (iii) Disclosure Statement, p. 37, which contains a provision that provides that once an LTW holder elects to give a Third Party Release, it has to tender the LTW, and there can be no further trading of that LTW security.

among many LTW holders, and (b) undermined the relief provided to LTW holders under the Confirmation Opinion.

In contrast to LTW holders, other holders of public securities will know what they will be getting under the Modified Plan and will only be prohibited from trading for a short period of time. The LTW holders, on the other hand, will not know what they are getting until the adversary proceeding is finally determined -- through the transfer restrictions, their trading may be restricted for a much longer period of time.

While there are over 110 million LTWs, it is clear from the testimony adduced at the Confirmation Hearing that only a small number of LTW holders made elections. *See* July 13 Transcript, at 72:4 - 72:8 (Robert Klamser testified that only a small number of LTW holders took the stock election); and 87:12 - 87:18 (David Sharp testified that a "fairly low" percentage of LTW Holders elected to grant a release). The vast majority of LTW holders were disincentivized to make any elections, and did not respond to the elections.

It is also interesting to note that there was no trading restriction imposed on holders of unsecured claims, but they were entitled to make a stock election. *See id*. at 73:18 - 74:9 (testimony of Robert Klamser -- confirmed that unsecured creditors could take a stock election but were not restricted in their trading activities). The reason given for this difference in treatment was that it was not difficult for the Debtors to keep track of the holders of unsecured claims if they traded their claims. *See id.* at 74:10 - 74:18. However, at least with respect to the registered holders of LTWs (approximately 15,000 in number), it would not be difficult to keep track of trades since the warrant agent maintains records of such activities. *See id.* at 90:2 - 90:10 (testimony of David Sharp). Moreover, Robert Klamser testified that he did not believe that the trading restrictions were done for administrative convenience; he believed they were

done for legal reasons (although he did not elaborate on this point and no legal reason was ever identified). *See id.* at 74:19 - 75:12. Accordingly, whatever convenience the Debtors are obtaining by having these restrictive provisions in the Modified Plan is clearly overridden by the harm to LTW holders.

D. <u>The LTW Holders Were Improperly Deprived of Their Stock Election</u>

As noted above, the Confirmation Opinion required all creditors to have a stock election for Reorganized WMI. This would have allowed such electing creditors to get the benefit of the value of the Debtors' huge NOLs. The Modified Plan addressed this concern in an improper way by: (a) creating artificial obstacles for the LTW holders to make the stock election (*i.e.*, as noted above, by imposing improper trading restrictions), (b) removing the Registration Rights agreement which would have infused capital into Reorganized WMI in order to maximize the usage of the Debtors' NOLs, and (c) not providing critical information as to (i) how Reorganized WMI would obtain capital to maximize the value of the NOLs, (ii) the anticipated cost of such capital, (iii) who will run Reorganized WMI, and (iv) how the rights of minority holders of Reorganized WMI will be protected.

The failure to include such information made it impossible for parties to evaluate the benefits of the stock election, and chilled a small holder's decision to elect to take stock. By doing this, the Debtors made an improper end-run around the Court's previous ruling that all entities were entitled to make a stock election.

CONCLUSION

Based on all of the foregoing, the Modified Plan cannot be confirmed. The Class Claimants seek such other and further relief as the Court deems just and proper under the circumstances.

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Wilmington, Delaware

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