UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE
Case No. 08-12229(MFW)
Adv. Case No. 10-51387 (MFW)
Adv. Case No. 10-51297 (MFW)
- -x
In the Matter of:

WASHINGTON MUTUAL, INC., et al.,

Debtors.
- -x

- -x
BLACKHORSE CAPITAL LP, et al.,
Plaintiffs,
-against-
JPMORGAN CHASE BANK, N.A., et al.,
Defendants.
- -x

- -x

MICHAEL WILLINGHAM and ESOPUS CREEK VALUE LP,

Plaintiffs,

-against-

WASHINGTON MUTUAL, INC.,

Defendants.

- -x

United States Bankruptcy Court
824 North Market Street
Wilmington, Delaware

October 22, 2010
10:31 AM

B E F O R E:
HON. MARY F. WALRATH
U.S. BANKRUPTCY JUDGE
ECR OPERATOR: BRANDON MCCARTHY

HEARING re Debtors' Forty-Sixth Omnibus (Non-Substantive) Objection to Claims [Docket No. 5117; filed 7/21/10]

HEARING re Debtors' Objection to Proof of Claim of Tranquility Master Fund Ltd. (Claim No. 2206) [Docket No. 2531; filed 3/15/10]

HEARING re: Motion for Intervention of the Washington Mutual, Inc. Noteholders Group [Adversary Docket No. 21; filed 10/12/10]

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P R O C E E D I N G S

THE COURT: Good morning.

MR. JANG: Good morning, Your Honor. For the record, Chun Jang of Richards Layton & Finger on behalf of the debtors. With me on my right, Your Honor, we have Adam Strochak, Alex Levine and Jarrad Wright of Weil Gotshal & Manges. And they'll be handling the item with respect to the Tranquility objection.

Your Honor, that is kind of the main event of today but we do have two other matters still set to go forward and you wouldn't mind, we would just like to take care of those two items first.

THE COURT: What are they?

MR. JANG: They are the debtors' forty-sixth omnibus objection, that's item number thirty-two and the motion to intervene in the Blackhorse adversary by the WMI noteholders group.

THE COURT: Well, let's -- what's the second one?

MR. JANG: That's number thirty-six on the agenda.

THE COURT: Okay.

MR. JANG: All right. Your Honor, number thirty-two on the agenda is the debtor's forty-sixth omnibus objection to claims. Your Honor had previously entered an order with respect to most of the claims but if you recall at maybe three subsequent hearings, we've had Mr. Shore ask that his claim be heard. We've been continuing it from one objection to -- one

hearing to another based on his statements that he had information to provide and Your Honor had directed him at a couple of hearings to provide that information. At the last hearing, you directed him to provide that information by October 15 and we have not received anything from Mr. Shore.

THE COURT: All right. Is Mr. Shore on the phone?

MR. SHORE: Mr. Shore is present, Your Honor.

THE COURT: Did you file anything?

MR. SHORE: I haven't been able to file anything. I believe I've found an answer to your question that we were discussing at the last hearing. I apologize again for delaying this matter. I am currently seeking representation in my local area and am having someone at this very moment review it. If you would like me to disclose the name of the individual, I will. This person has over twenty-five years experience in this venue and even him himself says this is a complicated matter. I'd like to remind the Court that I am prosecuting this solely on behalf of myself at this moment, pro se and that I am asking for a little leniency on this matter, not that I haven't gotten it before but again, this is still a complicated matter that I am requiring assistance with. So --

THE COURT: Mr. Shore, you've been given several opportunities to file additional documents or information in support of your claim. And I have given you leeway because you are not represented but you haven't filed anything.

MR. SHORE: In the real world, Your Honor, I have notes. I have documentation. I'm very close to filing but I'm also not trying to clog the Court with a frivolous motion. I'm trying to be as diligent as I can and again, I'm not trying to insult the Court with motions that have nothing to do with the question.

THE COURT: Well so far --

MR. SHORE: I would like --

THE COURT: Mr. Shore, so far what you have filed has nothing to do with Washington Mutual, Inc. It deals solely with the bank.

MR. SHORE: May I add to that comment, ma'am?

THE COURT: Yes.

MR. SHORE: Your Honor, you asked me at our last hearing why WMI would be liable. I have found a federal regulation or rule that may apply. The regulation states that a company, a bank holding company and I believe it's in relation to the Bank Holding Company Act of 1956, it states that "A holding company who directly or indirectly owns in part of a depository institution is required to abide by the same rules as a savings association."

Now I might -- may not be citing this law correctly, but I would like --

THE COURT: Mr. Shore? Mr. Shore, you have filed nothing that shows that WMI took any action at all, whether

it's governed by the same regulations or not. Your evidence is all regarding the bank, not any WMI action. That's what I asked you to provide; facts, not just law, facts that show --

MR. SHORE: You're exactly right, Your Honor. The -- WMI hasn't took any action at all. They've known about my case. After their bankruptcy protection, I made another effort to give them an opportunity before I escalated my case to resolve this matter. They even disclosed that they have knowledge of my circumstances. Again, I'm not trying to clog up the time with a bunch of facts that may not be relevant at this time, however I am asking for a little bit more consideration for the Court. Again, I apologize for any --

THE COURT: Let me make this clear. I am going to give you some more time. If no pleading is filed in the next ten days, I will enter an order disallowing your claim. Do you understand? We will not have another hearing. I will enter an order.

MR. SHORE: Yes, ma'am, Your Honor.

THE COURT: All right.

MR. JANG: Your Honor, the next item is, as I stated, item number 36 on the agenda, it's the motion for intervention of the Washington Mutual Inc. noteholders group. And, Your Honor, the debtors have no position with respect to this motion. So I would just hand over the podium to the WMI noteholders group.

THE COURT: Well, just an aside, why am I having a hearing on a motion filed in an adversary? Under our local rules, I don't have hearings.

MR. STARNER: I think, Your Honor, what we were trying to do is basically tee up this issue so it doesn't clog up the Court on the November 9 hearing. I think the idea, Your Honor, is that we just want to clarify our right to be heard at the November 9 hearing.

THE COURT: I know what you want to do but you didn't follow the local procedures. And I just want to caution everybody because the debtor does this in this case, as well. There are not hearings on adversary motions unless you have asked permission and the Court has granted permission. And this is true of discovery motions, as well. So I'm picking on you but the -- my admonition is to everybody in this case. But I will hear, why do you have an interest different from anybody else -- from the other parties in the proceeding that you need to be represented --

MR. STARNER: Thank you, Your Honor.

THE COURT: -- separately in an adversary?

MR. STARNER: Just to begin, this is Greg Starner from White & Case on behalf of the WMI bondholders -- sorry, the WMI noteholders group. I guess as context, as you know, we represent the largest and most senior creditor group here holding approximately 2.3 billion dollars of notes.

With respect to adequate representation, I think that's where the Court was going, what we're seeking to do is, taking a step back -- what we would really like to have is an opportunity to be heard at the hearing. We are seeking intervene under Rule 24(a)(1) and are basically standing as a party-in-interest under Section 1109(b) so the question of adequate representation does not necessarily play into that. That being said --

THE COURT: Well I think it does because the right to be heard in a bankruptcy case is different from the right to be heard in an adversary, it really is.

MR. STARNER: We'll go into that point then, Your Honor. I think we do have unique interests here. I think on the one hand we are the most senior creditors with a significant economic interest here. We would like to have the opportunity to be heard with respect to this relief that will have a material impact on our recoveries here.

THE COURT: How will it have any impact on your recoveries?

MR. STARNER: Well potentially what we're -- what the equity committee is seeking here is to compel a shareholders' meeting.

THE COURT: Okay.

MR. STARNER: And they've intentionally -- actually they've said publicly they're intent is to challenge, they do

not support the settlement. So the steps are they seek to compel a shareholders' meeting. Next step is they replace the board and then the natural progression is what they're seeking to do is overturn the settlement and basically derail the confirmation as planned.

THE COURT: Well whether they can or not achieve that goal if they get to the point where the board has been replaced and the debtor takes different action, then you can be heard. But do you have any interest, as a creditor, have any interest in corporate governance?

MR. STARNER: I think we have an interest in seeing the resolution of these cases. And seeing the settlement which I think we heard on Monday is a very fragile settlement that any further delay threatens. We have an interest in seeing that settlement in the confirmation go forward on an expedited basis -- on an expeditious basis. We have a hearing set now for December 1. The threat is if they -- they seek to compel and successfully compel a shareholders' meeting, then that puts at risk not only the settlement but also the December 1 confirmation date.

And I guess I would also note, Your Honor, we've also filed a motion to convert these cases to Chapter 7 and appoint a trustee. That's been adjourned a number of times but the point is, our interest in proceeding with that motion is directly impacted by whether or not the Court grants the relief

the committee is seeking here. We don't necessarily wish to proceed with that motion to convert. It's not necessarily the best outcome or something we want to see, we'd much rather proceed with the current plan but if the Court, you know, permits the equity committee to in effect take over these proceedings as out of the money constituents, then I think we have an interest in potentially going forward with that motion. And so I guess we would like to have the opportunity -- I mean we don't necessarily need to intervene in these actions.

THE COURT: I can't imagine what a creditor could say that is relevant to the corporate governance issue.

MR. STARNER: Well I guess the point is, Your Honor, we have an interest in whether or not --

THE COURT: You'll just say don't delay confirmation.

MR. STARNER: Well I mean in effect by granting them a shareholders motion -- a shareholders meeting, you're effectively putting at risk that December 1 confirmation, putting at risk the settlement.

THE COURT: Maybe or maybe not.

MR. STARNER: But I think maybe or maybe not, I think we have as the most senior kind of economic interest here, we have a right to be heard with respect to that.

THE COURT: Isn't the debtor representing your interest?

MR. STARNER: The debtor represents a number of

interests; they're fiduciaries of the estates. We have specific interests as senior creditors, Your Honor.

THE COURT: How is their position on proceeding with confirmation, opposing the shareholder meeting, enforcing the settlement, how is that any different from the positions you are espousing?

MR. STARNER: I'm not necessarily saying it is, Your Honor, with respect to that.

THE COURT: Then how are you not adequately represented by what they are doing?

MR. STARNER: But I don't think they necessarily would pursue -- just take our motion to convert, for instance, I mean that's obviously our motion. It's unique relief that we may be seeking or may be forced to seek if the relief is granted to the equity committee.

THE COURT: Okay. But that isn't an issue in the adversary.

MR. STARNER: Well it potentially may be at issue. If the adversary proceeding proceeds and they are granted the relief they seek, that will play a part in whether or not we're forced to go forward with that.

THE COURT: I understand there are dominos but it's not an issue in the adversary and I assume the debtor will be saying that if I grant the relief, terrible things will happen like you will insist on the appointment of a trustee or

conversion or other terrible things may happen. Why do I have to have two people telling me the same thing?

MR. STARNER: Well I mean keep in mind the creditors committee's also intervened in this action and so they have -- they're also involved.

THE COURT: They're also representing your interests.

MR. STARNER: Right. But I think specifically we have very specific interests that are unique to our position as the senior creditors here of the estate.

THE COURT: Like what? Like what?

MR. STARNER: Well in that the -- you know, basically we're not going to get paid out until the resolution of these cases.

THE COURT: Nobody is.

MR. STARNER: Right. But we have the largest economic stake in that regard.

THE COURT: That -- well, that makes you no different in kind from the person with the smallest economic claim, creditors claim.

MR. STARNER: Well except that we have the kind of financial interest to be -- you know, to basically -- to intervene and to make ourselves heard to understand that this largest creditor group feels very strongly about the relief sought by the equity committee. And it obviously plays into --

THE COURT: Well what percentage is necessary to

intervene?

MR. STARNER: I don't necessarily know what the percentage is, Your Honor.

THE COURT: You see where I'm going?

MR. STARNER: I do. I do. But I guess the point is that in taking a step back, just as a party-in-interest, this idea that by allowing us to intervene, you may open the floodgates to other parties, that's not necessarily I think a concern, certainly that the Third Circuit has been concerned about in the context of the Marin and Phar-Mor case in saying that parties in interest under 1109(b) have a right to intervene in adversary proceedings. I mean only a few parties are going to have the actual significant enough economic interest to intervene in an adversary proceeding.

THE COURT: But it is discretionary and it's only if it's necessary.

MR. STARNER: Well I think I might take --

THE COURT: It's not an absolute right in an adversary. It isn't the case.

MR. STARNER: Well I think I might take issue with that, Your Honor, because I think under the jurisprudence applying standing under 1109(b) as a party-in-interest, it is an absolute right to intervene under Rule 24(a)(1).

THE COURT: Well the party -- you're using part-in-interest and again, you're a party-in-interest in the

bankruptcy case but it's a factual issue as to whether you're a party-in-interest in the adversary.

MR. STARNER: I think --

THE COURT: And again, this is dealing with corporate governance, the issues. It really is not something --

MR. STARNER: Well I guess looking at a party-in-interest specifically with the adversary proceeding, that standard is relatively low. It deals with whether or not we have a sufficient stake in the outcome of the proceedings to warrant --

THE COURT: Right.

MR. STARNER: -- representation in that action. And I think given the amount and size of our stake, and our unique interest as senior creditors, we potentially may be forced to pursue a motion to convert or appoint a trustee, we have an interest to be heard with respect to the relief the equity committee seeks.

And I can address the other issues raised by the equity committee in terms of timing and prejudice if you would like, Your Honor.

THE COURT: No, I think the threshold of a party-in-interest in this adversary is what gives me trouble with your position.

MR. STARNER: Well I mean I guess --

THE COURT: This is different from an adversary where

it can directly impact, and I mean directly impact the economic interest, a large preference, a large fraudulent conveyance action where clearly you as a creditor would be recovering a large part of it.

MR. STARNER: Well I think that maybe --

THE COURT: And even in those cases, if you're adequately represented by the debtor or the creditors committee, the courts are reluctant to let an individual creditor intervene.

MR. STARNER: Just taking those separately, I guess, Your Honor, the first part in terms of the financial interest, you know, I think here the idea of trying to partition off the relief they were seeking to saying they're just seeking to compel a shareholders' meeting may be a little bit too narrow of an interpretation. They made it very clear that what they intend is not just to seek a shareholders' meeting. That in fact they intend to use that shareholders meeting to open the door to re-examine the settlement, re-examine the plan and, in fact, challenge the settlement and the plan which they have stated they do not support.

So the fact that the corporate governance piece may be on the front end, they're seeking to compel a shareholders' meeting, absolutely right but I think it's too narrow of an interpretation to say that that's the only thing they're seeking and, in fact, that we are limited in our ability to be

heard with respect to that relief because it's too speculative to say whether or not they're actually going to try to replace the board or whether in fact, they're going to try to challenge the settlement which, in fact, they have said explicitly that they intend to do.

And on the adequate representation piece, Your Honor, I guess this is not a situation where a number of other creditors are seeking to be heard here. I think we're in a unique position as the most senior creditors of the estate with a unique interest because of the size of our holdings and the fact that we may be forced to pursue this other relief to have an opportunity to be heard.

Again, just to stress, it's not necessarily a question of intervention, it's just a question of being -- the right to be heard. So if Your Honor tells me that --

THE COURT: Well but you're --

MR. STARNER: -- we're able to stand up on November 9 and be heard, I think we can withdraw our motion because that -- I think that would satisfy.

THE COURT: I don't think you even have that right because what you're going to say is exactly what the debtor -- the other parties to the case are going to say.

MR. STARNER: Well let me make clear on that point, it's not our intention to duplicate and take cumulative positions where the debtors or creditors committee's going to

take. It's certainly our intention to take, you know, positions that are unique to us and that, I think I can tell the Court right now, it's not our intention to file papers that mirror or echo exactly what the debtor will say.

THE COURT: Well what are you going to say? What are you going to say?

MR. STARNER: We're not -- Your Honor, we should have the opportunity to say something.

THE COURT: Well, typically you do attach the pleading that would say what your position and that's -- it's difficult to see what position you would have that is different from the parties that are already in there. So --

MR. STARNER: On that point, Your Honor, now we're talking about Rule 24(c). You know, that is a technical requirement. We have referenced the debtors answer and counterclaims. We've also laid out our position in opposition to their -- the relief they're seeking. And I would just note that it's not unique what we did and the equity committee did the same thing with intervening in the JPM adversary but nonetheless, I don't think it's credible to say they don't know what our position is going to be.

THE COURT: How is it --

MR. STARNER: We're going to oppose --

THE COURT: How is it different from the debtors and creditors committee's position?

MR. STARNER: I think we should have the opportunity to explain that to Your Honor.

THE COURT: Well explain it to me now.

MR. STARNER: Well we actually haven't been able to actually obtain any discovery in this matter. They've basically just produced documents to us yesterday or the day before that were heavily redacted. So we've been looking for the opportunity to participate and determine whether we need to have a voice. They haven't even given us that opportunity, Your Honor, and so it basically forces us to come into here.

THE COURT: Because you're not a party.

MR. STARNER: Well that's exactly why we're here, Your Honor, to clear that up. I mean again like I said, we don't necessarily need to be a party. We'd like to have the opportunity to participate in the discovery and determine whether or not we need to be heard with respect to the relief they seek on November 9.

THE COURT: Well I'm going to deny the motion. I think you're already adequately represented by both the debtor and the committee in the adversary. I've not heard that you have any position and cannot conceive of what position you would have that is different from the debtors and the committee's in the adversary and on the narrow issue in the adversary. You are a party-in-interest in the bankruptcy case and can be heard in the event that the consequences of the

adversary have any impact on the main case. But a creditor does not have any standing in my opinion to be heard on corporate governance issues which I think is the crux of the adversary.

MR. STARNER: Respectfully, Your Honor, I guess the connection between the corporate governance issues may have an impact on the administration of the estates and the ultimate recoveries by our clients.

THE COURT: Which is being stated by the parties already in the adversary.

MR. STARNER: I guess respectfully, Your Honor, can you reserve at least on the issue of allowing us to stand up on November 9 and say here are kind of our unique issues and here are issues that are -- you know, that are not necessarily raised by the debtors or the creditors committee with respect to the relief they seek?

THE COURT: I think not. In the event that the arguments -- if you can make a case that you're not adequately represented, file a motion then but right now I find that you're adequately represented and you cannot be heard at the adversary argument.

MR. STARNER: Thank you, Your Honor.

MR. STROCHAK: Good morning, Your Honor. Adam Strochak from Weil Gotshal & Manges for the debtors. We're here on our objection to the Tranquility proof of claim and let

me, if I may, set the table a little bit with a little discussion about what we think is appropriately before the Court today. Their claim, Your Honor --

THE COURT: Am I going to hear any testimony today or is this argument as suggested by the agenda?

MR. STROCHAK: No, Your Honor, it's just argument.

THE COURT: Okay.

MR. STROCHAK: And I think the parties are in agreement on that. We've put forward a very extensive objection and they've filed a very extensive reply and, you know, the parties have conferred and we've agreed that there are certain issues that the Court can consider as a matter of law and essentially deal with this in a bifurcated process where we have something that's akin to a motion to dismiss today. And then obviously if the Court agrees with us and some or all of the claims are dismissed, either will go away completely or the issues will be narrowed if we need to proceed further. So we're proceeding akin to a motion to dismiss on three legal issues.

The first, Your Honor, is whether there's any cause of action that can be asserted under Section 11 of the Securities Act. The second is whether various principles of preemption apply to foreclose any of the state law causes of action. And the third is our arguments regarding the effectiveness of the pleading under Rule 9(b) and the specificity required to assert

the claims that they're trying to assert against Washington Mutual, Inc., the parent company.

So what this relates to is a series of mortgage-backed securities and this kind of puts us right here on the leading issue of the whole housing crisis and the mortgage crisis over the last several years. That's really what this claim is all about is the crash of the housing market and the mortgage market.

Tranquility is an investor, a hedge fund, that purchased largely B certificates in a series of mortgage-backed securities issuances. The B certificates are quite clearly the very subordinate tranche of these securities and the vast majority of what they purchased were securities that were sold in private placement transactions that were not registered securities.

So we've gone back and looked at the damages that they've asserted. Their overall claim is for a little under fifty million dollars and we've gone back and looked at the various tranches of securities that they've purchased and this is attached in a fairly detailed exhibit to the proof of claim. And over forty-seven million dollars of the 49.6 that they're asserting relates to securities that they purchased through private placement transactions; that is, they purchased securities that were not registered under the Securities Act.

Their assertions, of course, are against the parent

company, Washington Mutual, Inc. but Washington Mutual, Inc. didn't issue any of these securities. It was simply the thrift holding company at the very top of the corporate pyramid. So what they are doing and I'll draw an analogy to a famous shipwreck, they're essentially asserting that somebody had a glass of water on the Titanic and the water spilled and the Titanic sunk as a result of hitting the iceberg. And the company, the White Star Line back in London or wherever it was that caused a porter to load the glass onto the ship is somehow responsible for the loss of the Titanic because of the water that spilled.

THE COURT: Well we're not here to talk about the facts.

MR. STROCHAK: Certainly not, Your Honor, and I don't suggest that that's related to the facts. What I am trying to do is simply put their claim in a context of what they're really asserting here. So the key issue on the federal claim, the Section 11 claim, Your Honor, is that you can only bring a Section 11 claim with respect to a registered security. You can't bring that cause of action under the Federal Securities law with respect to an unregistered security. And it's really as simple as that. You simply cannot assert that claim.

There might be other claims that could be asserted but they've made a very conscious and very deliberate choice here, Your Honor, to proceed under a statute that imposes effectively

a strict liability regime for false or misleading statements in a registration statement for a registered security.

THE COURT: Well are there any cases that support their argument that because the private placement memorandum referenced registration statements that it comes within the ambit of Section 11?

MR. STROCHAK: I don't believe that there are, Your Honor. We don't believe that providing the prospectus, the registration statement as attached to a private placement memorandum gives rise to a cause of action under Section 11. It might give rise to other causes of action. They might be able to assert some type of 10(b) claim or something else but it simply does not give rise to a cause of action under Section 11. And that's the fundamental failing.

The argument, Your Honor, that the prospectuses were somehow incorporated by reference into the private placement memorandum doesn't work. The private placement memorandum doesn't say that the prospectuses are incorporated by reference, thereby bootstrapping the registration requirement into the unregistered securities. And that's what they're trying to do.

For purposes of this proceeding, Your Honor, today we're not arguing about whether they got their prospectuses or whether they didn't get the prospectuses. We're not arguing about whether anything that was said in the prospectuses was

true or wasn't true. What we're simply saying, Your Honor, is that you can't bootstrap the fact that the private placement memorandum referenced the registration statements and said look, there's more information out there. If you want to go read it, go read it. In fact, we think you should read it. That doesn't create a registration requirement for the security through a private placement.

What they're trying to do is say that by virtue of the attachment, we effectively made these into registered securities but that's not at all what happened. They were sold very clearly in a private placement. The private placement memorandum indicates quite clearly that first of all, these securities are not registered period, full stop. You are buying unregistered securities.

It also indicates quite clearly that you're not buying securities from Washington Mutual, Inc. either these certificates nor the underlying mortgage loans are guaranteed by any -- excuse me, I read the wrong section -- the certificates -- excuse me. I just lost my place, Your Honor.

Yes, the certificates do not represent an obligation or interest in Washington Mutual Securities Corp. or any of its affiliates including Washington Mutual, Inc. So the private placement memorandum made it clear, first of all that they're not buying registered securities. Second of all, they're not buying anything that's issued by Washington Mutual, Inc.

That's the Section 11 argument, Your Honor.

And what they're trying to do with that is trying to bootstrap a very lenient requirement to establish liability. And we don't think that's appropriate and it should not be sustained under the case law under Section 11.

Let me turn to the preemption arguments, Your Honor, and that's the answer with respect to the state law claims. The state law claims, Your Honor, are preempted under the Homeowner's Loan Act because under that act, the OTS regulates the field of mortgage issuance. This is a highly regulated industry and the OTS regulates the field of the origination of home mortgages.

THE COURT: But this wasn't the issuance of a home mortgage.

MR. STROCHAK: Let me -- excuse me one second.

(Pause)

MR. STROCHAK: Where we get to the preemption argument, Your Honor, is you have to dig a little bit deeper than the surface of their claims, I think, in order to understand why preemption is necessary here. They've asserted their claims, of course, as securities claims; misrepresentation claims, omission claims. But what they've done, Your Honor, is they've taken the allegations from the New York Attorney General's complaint against the appraisal companies. It was filed, I believe in November of 2007. And

in that complaint which is attached as an exhibit to the proof of claim and essentially incorporated in whole as the substantive allegations that they're making, everything they're saying about the appraisal practices and all the flaws that they allege in the appraisal practices comes from the New York Attorney General's complaint.

THE COURT: But can't the -- one set of facts create two different legal claims?

MR. STROCHAK: I think it could, Your Honor, but I think the important point here is to look at what this court would have to do in order to adjudicate their claims. In order to adjudicate their claims, this court is going to have to go back and look at every single allegation they make regarding the appraisal practices and whether they're appropriate and whether they complied with applicable laws.

This is not a case where, for example, the representation alleged as being misleading is one, for example, that says well you know, we told our investors that we were doing appraisals for each mortgage but, in fact, we didn't do them. We were lying. We didn't appraisals at all. That's simple; right? That doesn't require the Court to inquire as to any of the underlying substantive regulatory principles. Either the appraisals were done or they weren't done. You said they were done. If they weren't done, it was a lie. and it's a misrepresentation.

What they're alleging is that the way the appraisal processes work, everything that was done was faulty. So in order to determine whether any single thing that they allege was a misrepresentation or a material omission, the Court is going to have to go back and we are going to have to unpack and present evidence to determine, you know, what actually happened with the appraisal practices and were they, in fact, flawed in any way.

But because OTS is the regulator of the mortgage origination process, including the appraisal process, that is preempted. So the effect --

THE COURT: Well, let me ask you a question. Again, once set of facts could create more than one legal claim. And just because a claim is complicated doesn't mean it has no validity. And whether or not they're correct and that it does create a legal claim, I'm not sure what they're saying is you -- is the same as the violation that would give rise to an action under the Homeowner's statute.

MR. STROCHAK: I --

THE COURT: Why can't it be two different claims based on the same set of facts?

MR. STROCHAK: I certainly understand your concerns, Your Honor. And I'm not suggesting here that I have a case that I can point you to that says here, controlling authority, these claims are absolutely preempted. I recognize that this

case is a little bit different than the ones that have preceded it and we've cited Your Honor to the Indian Act case decided by Judge Koeltl in the Southern District of New York and the Spero case which was in fact a Washington Mutual matter.

You know, we don't argue that those cases are the same but we think that the underlying principles there demonstrate why having this court sit and have to unpack all these substantive allegations, the same substantive allegations that the New York Attorney General was asserting against the appraisers, effectively means that the only result that can come out of this is a series of rulings that the appraisal processes and practices either complied or didn't comply with the underlying legal requirements.

THE COURT: Well let me posit this. Let's assume that they didn't comply. If they didn't comply, which is the factual predicate of their claim, would it not create two different claims? Could they not assert a claim on their own behalf that as a result of all of that, you know, we have a claim?

MR. STROCHAK: I think it could result in two claims but the --

THE COURT: Why is it preempted?

MR. STROCHAK: -- conflict and the reason is that because Congress wanted and the agencies wanted to insure that there wouldn't be conflicting standards for the mortgage

industry. Right? There has to be one standard for the mortgage industry. We have a national mortgage market where --

THE COURT: Well if, in fact, it is determined that they complied with the standard, the one standard, wouldn't that defeat their claim?

MR. STROCHAK: I think it would because it would probably prove truth; right, Your Honor?

THE COURT: So then --

MR. STROCHAK: It would prove truth.

THE COURT: -- how can I at this stage dismiss their claim without knowing that?

MR. STROCHAK: Well I think, Your Honor, I think the problem is that in considering preemption matters, you know, there's always two possible results; right? There's one possible result that says well, everything's fine. Whatever ruling the bankruptcy court might reach is perfectly consistent with everything else that's going on. There's no inconsistency, therefore you know, the problem that was tried -- that Congress was trying to address in preempting doesn't exist.

THE COURT: Right.

MR. STROCHAK: But the other outcome, of course, is a conflict. And you can't tell --

THE COURT: How? How would there be a conflict?

MR. STROCHAK: There could be a conflict, Your Honor,

if this court concludes, for example, that the appraisal practices challenged in the proof of claim are -- well let's put it this way -- let's say this court finds that everything was fine. I don't see any problem, the appraisal practices conformed with whatever the applicable rules were and while the appraisals might have been wrong, you know, that's just with the benefit of hindsight. An appraisal is obviously a subjective matter and there's no misrepresentation.

Well, if every court is going to look at these practices, we're going to have a hodgepodge of different rulings from different courts saying well this practice was okay here. You know, Judge Walrath in Bankruptcy Court in Wilmington found that this was all okay but some other judge in some other court looked at the same practices, came to a different conclusion and decided that they were impermissible in some way.

THE COURT: Well maybe the suggestion should be that I abstain from determining the legal issue but not dismiss the claim. I mean, to the extent that there was not compliance, and that is determined by the appropriate authority in the appropriate forum, they may have a claim.

I mean preemption is that you can't have a claim because the area of law has been preempted by this statute. So therefore you have to go under that statute. But I mean they're not claiming under the statute. They're not claiming

I'm a homeowner, and therefore I was harmed because of this appraisal practice. They're suggesting that the systemic violation of the law created other problems and we know that, you know, there may be claims.

MR. STROCHAK: I certainly understand that argument, Your Honor, and I see that there's a degree of attenuation between the preemption arguments here and the ones that have been considered in prior cases. But I think that the key driver here is when you look at what they've incorporated into their complaint.

The New York Attorney General action was asserted in addition to some other authority under Section 349 of the General Business Law in New York. That's exactly the same section that was asserted in the IndyMac case where Judge Koeltl found preemption. I'm not going to consider under these circumstances whether the appraisal practices that had been challenged in that case -- and that case was about appraisals, very, very similar circumstances although from a little different perspective.

THE COURT: Yes.

MR. STROCHAK: So I think that, you know, if what they're saying is look, we're just taking the New York Attorney General's complaint and incorporating it and that's the basis for our claim of liability here, we think that they have to live by the same preemption standards because of adjudication

of that claim would create exactly the same problems that preemption is intended to alleviate.

And, you know, like I said I fully understand Your Honor's skepticism about it and we do think that it does, in fact -- it is, in fact, required by the same principles of uniformity of regulation of the mortgage markets.

Let me just mention very briefly the other preemption argument that we made under the National Securities Market Improvement Act. I think if you walk through definitionally how it works, we have covered securities and these securities are not subject to the exemption for state law enforcement actions for fraud or deceit. This is not a state enforcement action. This is a private securities cause of action. And the same ideas about creating a national market for securities require enforcement of the preemption provisions here.

If we're going to have a national mortgage market, we can't have separate standards -- separate standards of liability under the state laws and under the federal laws. It has to be a uniform national standard.

Let me turn a little bit to the 9(b) arguments and try and simplify our position if I can because there's been a lot of discussion of this in the papers. You know our argument is focused on what have they told us in the pleadings that actually relate to their specific claims. and there's kind of two elements to their claims. The first is a broader one and

it says look, they're challenging all of these appraisal practices but there's nothing in the pleading at all that says look, the losses that were incurred with respect to the securities that they bought had anything to do with the appraisal practices that they've challenged. There simply is no nexus pleaded.

There's not even an allegation that any one of the particular mortgages in any of the pools that they bought into was, in fact, affected by what they claim to be flawed appraisal practices.

And this gets back to my Titanic analogy and the glass on the boat and the ship and everything else. You know, we had a colossal crisis in the housing market. People couldn't pay their mortgages. That's why these securities are under water because people can't pay. A lot of them, they can't pay because they don't have jobs anymore and they can't make their mortgage payments. A lot of them can't pay for other reasons.

I'm sure that appraisals are important in the sense that if you had an appraisal for a home and the appraiser said it was worth 200 thousand dollars and two years later it's only worth 100 thousand dollars, well was there a problem with the appraisal? Maybe there was. Maybe it was flawed. Maybe it was flawed due to some external reason or maybe it was just wrong because people get it wrong sometimes. And maybe it was just right. Maybe it was worth 200 thousand dollars when the

appraisal was done and now that we're, you know, three, four years into the housing crisis, it probably shouldn't come as a dramatic surprise to anybody that the value of the property has gone down.

So really what we're saying with respect to the particularity argument is where's in the pleading any nexus that the problems that they allege in the origination of the loans and the appraisals had anything to do with the losses that have been suffered in these pools of mortgages.

The other point, the more narrow point goes to why we're standing here, Your Honor. I represent the parent company, of course. The parent company didn't issue the securities. So they've made these control allegations in very, very general form, very similar to what Ms. Eucklesohn (ph.) alleged with respect to her piercing the veil arguments and we don't think that the allegations set forth here are sufficient to demonstrate control person liability or aiding and abetting liability under the California statute.

They've made a lot of assertions that well the New York Attorney General's complaint says WMI did X or Y. If you read that complaint, it simply doesn't make those allegations. It just defines WMI, it defines WaMu to include WMI and everybody else in the corporate family. And the complaint goes on to say WaMu did this and WaMu did that and WaMu did everything else. There's no particularized allegations

regarding the types of control that you would need to demonstrate control person liability under the securities laws, under the California -- under the federal securities laws or the California securities laws.

There are a handful of allegations at the beginning of the complaint, kind of bolted on to the allegations that are cribbed from the New York Attorney General's complaint. But they simply don't suffice, Your Honor. And let me just turn to them for one second.

Paragraph 33, for example, of the proof of claim says "On information and belief, WaMu Inc. designed and approved the mortgage-backed securities securitization strategy employed by WaMu for the origination, securitization and sale of WaMu mortgage loans." It's just a generalized allegation that really does nothing more than assert the legal standard. Where are the facts? What did the parent company do other than own the stock of its subsidiaries, either directly or indirectly. There's really nothing.

There's one allegation that they had overlapping executives. That's shouldn't come as a surprise to anybody and if that's the standard, Your Honor, if that's all you have to plead in order to assert a claim of control person liability is that they were overlapping people within the structure, then you would eviscerate any semblance of the corporate forum anymore. You would always have securities claims against every

parent company in every case because the reality is that corporate America is organized that way. They're often are overlapping people. That doesn't mean that they're not wearing different hats in different roles. That's just standard corporate law.

The only mention one individual, Mr. Beck, as being someone in these dual roles. And everything else that they say is just its status as the parent company. It's just -- it was a shareholder. It was the ultimate shareholder of the enterprise and therefore it should be liable. Everything else is perfunctory and insufficient to establish control Peron liability and certainly insufficiently to establish aiding and abetting, materially assisting in the language of the California statute.

What else is there? Well WaMu, Inc. authorized and designed WaMu's strategy scheme to finance WaMu's operations and earned profits from the sale of the certificates. It's just a generalized allegation that the parent company authorized things; insufficient to establish control person liability under the case law which requires some showing of culpable conduct in some way. Just being the parent company isn't enough and they really have not alleged anything more than that here.

Let me just look at my notes for one moment, Your Honor.

(Pause)

MR. STROCHAK: Let me just follow up on a couple of points. They did, of course, purchase some securities that were, in fact, registered. It's a tiny portion as I've indicated and one of the reasons why we thought it appropriate to move forward on this argument in particular, even though it wouldn't affect, you know, every single aspect of your claim, was really just our desire to continue to move the claim process forward to the extent we can to narrow issues. If Your Honor agrees with us and this becomes, you know, a two million dollar claim rather than a forty-nine or fifty million dollar claim, that's substantial progress and that's why we thought it appropriate to bring this forward now.

The other issue is that many of their purchases are in the secondary market and secondary market purchases simply, you know, can't be actionable under either Section 11 or under the California law because we didn't sell it to them. So you know, even if you disagrees with my Section 11 arguments for some reason, anything they bought in the secondary market simply can't be actionable because they didn't buy it from even the issuer much less from Washington Mutual, Inc. So those should go away.

I'll stop there, Your Honor. If you have any questions, I'm happy to address them. Otherwise, I'll let the claimant's counsel proceed and reserve some time for rebuttal.

THE COURT: Thank you.

MR. STROCHAK: Thank you, Your Honor.

MS. CULVER: Good morning, Your Honor. For the record, Donald Culver of Morris, Nichols, Arsht & Tunnell on behalf of Tranquility Master Fund. I would like to introduce co-counsel in this matter, Scott Meyers of Ulmer Berne firm. He has been admitted pro hac vice in this matter and will e presenting argument for Tranquility.

THE COURT: Thank you.

MR. MEYERS: Good morning, Your Honor. Scott Meyers of Ulmer & Berne representing Tranquility and Master Fund.

I'm happy to report that at last Tranquility agrees with the debtors on one thing; the sale of these mortgage-backed securities was, in fact, a Titanic shipwreck. However we're more inclined to view this as a situation of pilot error rather than blaming the iceberg.

This case is fundamentally about the disconnect between what the debtors say and what they actually do. What the debtors said when they sold seventy million plus worth of mortgage-backed securities through --

THE COURT: Did the debtor sell them?

MR. MEYERS: Yes, Your Honor, through a conglomeration of controlled subsidiaries which we've identified with particularity in the complaint, with a very complicated chart explaining exactly the interrelationships and the various

functions of the various entities.

To take a step back, what the debtors did here is to create an entire network for the origination, securitization and sale or mortgage-backed securities from soup to nuts, start to finish. And to pick up on the issues that counsel was mentioning with respect to the 9(b) control issues, what we have alleged as is required by applicable standards, is that the debtors here were in fact responsible for the downstream conduct by virtue of not just interlocking boards of directors and officer and directors but also by virtue of their ownership of these underlying companies. And, in fact, in their SEC filings they publicly state that, for example, Washington Mutual Bank one of the key players here as we explained in the papers was under their control. There is no dispute, they've never run from the fact that they control their wholly-owned subsidiaries. And from a pleading stand point, that's more than sufficient.

Using this controlled group of subsidiaries, they directed the issuance of mortgage-backed securities which were eventually sold to Tranquility for more than seventy million dollar. What they said when they sold those securities to Tranquility was that the underlying mortgages complied with a standard that they themselves adopted, the USPAP, the Uniformed Standards of Professional Appraisal Practices.

They weren't obligated to say that. They weren't

obligated to use that standard. They weren't obligated to adopt any underwriting standard but what they told Tranquility was we are representing that the underlying mortgages that you are purchasing through the mortgage-backed securities comply with this appraisal standard.

As we now know, that wasn't true. What they said was very different from what they did based on the facts in the complaint, particularly relying on the New York Attorney General and independent investigation we now know that these appraisals did not comply with USPAP. And it was not just an isolated --

THE COURT: Has there been a judicial ruling on that point?

MR. MEYERS: There's not been a final determination of liability yet, Your Honor.

THE COURT: Okay.

MR. MEYERS: The mortgages at issue because they did not comply with USPAP violated the representations that are in the offering documents that were provided to Tranquility. Those offering documents were of two forms; five of the fifty-six securities at issue were bought in the open market pursuant to a registration statement prospectus and prospectus supplement. There's no doubt about that. Thus, with respect to our Section 11 claim which I'll get to in a moment, there's no dispute we've adequately pled that with respect to at least

five of our claims.

THE COURT: Did you buy them from whom?

MR. MEYERS: A majority of them were purchased directly on the open market as an initial issuance. The balance were purchased in a secondary market but we've limited the claim as is reflected on our Exhibit 1 to only those securities we've bought in the secondary market that were traceable to the registration statements at issue. And, in fact, that we purchased from the WaMu captive underwriter, WaMu Capital Corp.

There were other securities that we purchased outside of that underwriting process we have not sought to recover those in this bankruptcy. We've also provided the Court as an exhibit in our response brief the tracing of our purchases to the various registration statements.

Now the nature of the offering documents is important here for purposes of the Section 11 claim because as we've pointed out in the papers, these were not mere private placement memoranda. What they have done in these PPMs is to take a fourteen page PPM and use it essentially as a wrapper around three hundred plus pages of prospectus and prospectus supplements.

They now say that that does not give rise to actionable misconduct under the federal securities law. In fact, that position's consistent with this whole notion that

there is a very large chasm between what the debtors say and what they do with respect to all of the arguments we'll be talking about today.

For example, here and we'll talk about Section 11, they say that even though they availed themselves of the federal and state securities laws and markets to sell billions of dollars in securities, they are now not responsible for any of those under the federal securities laws.

THE COURT: Well they are not saying that. They're saying they're simply not liable under Section 11. They're not saying they're completely free of liability. But you're bound by the law that applies to private placement memorandum, unregistered securities.

MR. MEYERS: Yes, Your Honor. What they are saying is that the strict liability that attaches under Section 11 does not apply to them, even though they sold us these securities pursuant to these registration statements.

THE COURT: Well they didn't sell them pursuant to the registration statements. They sold them pursuant to a private placement memorandum.

MR. MEYERS: Your Honor, it may be helpful for purposes of this conversation to look at the actual or at least examples of the actual documents we're dealing with. I brought several demonstrative exhibits if I could approach.

THE COURT: You may.

MR. MEYERS: Thank you.

THE COURT: It will save me searching through the binders.

MR. MEYERS: Your Honor, this is the form of the private placement as Tranquility actually received it. As you'll see on the cover letter -- I'm sorry, and the reason there are two of them, one has -- is an example from the WaMu class of mortgage-backed securities and the other is from the WaMalt (sic) class. They're effectively the same.

THE COURT: Okay.

MR. MEYERS: But just for purposes of consistency, I wanted you to be able to see both. If you'll note the cover page -- the cover letter, excuse me, we can look at the WaMu Series 2006 AR-1. It says, "Enclosed please find two private placement memorandums for the above-referenced transaction, each consistent of the private placement memorandum, Exhibit A, prospectus supplement and prospectus and Exhibit B, the form of the pooling and servicing agreement with the exhibits."

That's also carried over under the first page of the private placement memorandum where it says, "This memorandum must be read together with the prospectus dated January 6, 2006."

THE COURT: Where are you on page 2?

MR. MEYERS: I'm sorry, it's the first, second, third -- fourth full paragraph of text.

THE COURT: Thank you.

MR. MEYERS: " This memorandum must be read together with the prospectus dated January 6, 2006 and the prospectus supplement dated January 26, 2006." Then both attached as Exhibit A and the pooling and servicing agreement attached as Exhibit B.

It goes on to say that "Investors interested in purchasing the class of securities need to read these documents to understand the certificates they're evaluating. Capitalized terms not defined herein are used as defined in the prospectus supplement or in the pooling agreement."

So this is a far different situation than that portrayed by debtor's counsel who suggested that they were simply offered to Tranquility and said hey, you might want to take a look at these. To the contrary, they were told they must and they need to look at these publicly filed documents that are unquestionably part of the registration statement.

Under these types of circumstances, it is appropriate to apply Section 11 liability to test the representations that were included in these offering materials, these publicly filed materials that were provided to Tranquility. These materials were used to sell the securities at issue and these securities were sold pursuant to these registered documents at issue.

This case is very similar to the Steed case which we cite in our papers which there is a very, almost identically

situated purchaser of securities in a mortgage-backed context who bought the -- through a private placement that attached similar to this, the prospectus and prospectus supplement. And in that case, the Court permitted the claim to go forward recognizing that resolution and dismissal of these issues at this stage would be inappropriate. It's also reflected in the Anagatta (ph.) case that we've discussed at length in our materials.

I would also point out that even if the Court were inclined to disallow the Section 11 claim with respect to the 51 of the 56 securities, to which they object, would have no impact to our proceeding on our California claims because unlike the Section 11 statute, the California statute applies to any misrepresentation or omission in connection with the securities offering. It's not limited to public or private. It's not limited to registration statements. It's a far broader statute and there's no reason to apply the Section 11 analysis that we just went through to the California statute. In fact cases that we cite to you have explained exactly why that's not necessary or appropriate.

The next issue is preemption which I would submit to you, Your Honor, is unnecessary ab initio because as we point out, the debtors are not subject to HOLA as prior bank holding companies. There is a separate statute that governs them and it does not contain a preemption provision.

So regardless of what you may or may not think of their arguments which I'll address in a moment, it's irrelevant because it doesn't apply here. In fact, that's also consistent with what the debtors have told us and again, the disconnect between what they say and what they do with respect to their actual banking activities.

Understanding that the purpose of HOLA is to preserve and protect the integrity of the national banking system, debtors have nonetheless told us in their papers that they are no longer engaged in banking, they don't own a bank, they have no banking activities whatsoever. So even if the Court were inclined to apply HOLA that does not apply on its face, there would be no reason to apply it in this particular situation to a debtor that admits it has no impact on the banking system going forward.

It's also significant, Your Honor, that despite the lengthy briefing on this issue, the debtor have not been able to identify for you one case in any jurisdiction anywhere that is preempted a federal -- excuse me, a state securities statute like the one that's at issue here. It has never happened.

And the reason for that is that even as the OTS, the agency to which they ask you to defer has recognized, these types of state statutes do not interfere with banking. In fact, they are consistent with the purposes of banking which is truthfulness. The OTS has outlined a three step analysis for

determining whether or not to apply whole or preemption. The first step is to determine whether the statute at issue falls within a list of thirteen enumerated types of activities that are per say preempted. As you heard, the debtors are not arguing that the statute falls within that and it clearly does not.

THE COURT: Right.

MR. MEYERS: The second analysis is does the statute affect banking. For the reasons that you discussed with debtor's counsel, clearly it does not. All we are asking here is for the Court to determine the truth of what the debtors have told us as part of the offering process, whether or not they actually met the representations that they made. We're not telling them what underwriting standards they have to use. We're not telling them what loan to value ratios they have to have. There's nothing in our papers that suggest that. They voluntarily in order to sell the mortgage-backed securities said we will comply with USPAP. Fine. We are entitled to test that and if it turns out to be false, they're subject to liability for that misrepresentation.

And the OTS in their own writings as early as 1996 has recognized that there is a presumption that federal thrifts will act truthfully. This is not imposing a requirement on the banks that does not already exist. The OTS found that in upholding the Indiana Deceptive Practices Statute and expressly

recognized because banks are expected to act truthfully, then applying these types of statutes particularly in these contexts does not in any way impinge upon banking.

And then finally as we pointed out in your paper -- in our papers, Your Honor, even if the Court were to find that this had some impact on banking which it does not, the California statute at issue would still be exempt under at least three of the express exemptions set forth in Section C of the HOLA statute at issue. It is exempt as a commercial and contract law. It is exempt as a criminal law and it is exempt under the saving clause, the last broad category of being consistent with the purposes of HOLA and not otherwise materially adversely impacting banking. So for that reason alone, there's no reason to preempt the claims at this stage.

The other argument they put forward is NSMIA and again I would make the same observation. There is no court anywhere that has ever preempted a California -- a (a) state security statute like the one at issue here on the basis of NSMIA. And tellingly, there's no case law that they point to in any of their papers to the contrary.

And the reason for that is that NSMIA is not intended to reach these types of statutes. What NSMIA does is to prevent states from putting substantive disclosure requirements on issuers. In other words, what NSMIA does is it prevents states from saying what issuers have to do. It does not

prevent states from making sure that issuers do what they say. It may be that California could not require them to claim that they complied with USPAP or to impose the USPAP standard. It's irrelevant. They've already told us they did it. All we are doing is testing it under the California fraud statutes and related securities statutes. There is no way that falls within the contours of NSMIA.

That's also consistent with the findings of virtually every court, excuse me, that have looked at this issue, not just the Houston court but at least the other two cases that we also cited to you from different jurisdictions, all of which reaching the same conclusion; NSMIA doesn't apply here. It's not intended to address these types of statutes at issue, both on its face and based on its clear legislative history.

Finally, let me turn to the issue of 9(b). We touched on it a bit earlier with respect to control. I would clarify something the debtor's counsel said that we had not alleged enough to pierce the corporate veil. I want to clarify, this is not a piercing the corporate veil analysis by any stretch of the imagination. This turns entirely on whether or not Washington Mutual, Inc. could control its wholly owned subsidiaries that had interlocking boards of directors and executive offers.

We believe we have certainly at the pleading stage, alleged enough to satisfy that much softer standard of control

for securities law purposes. I would also clarify something that debtor's counsel said that in the New York Attorney General's complaint, upon which we rely, that there was a general definition of WaMu that included this collection of entities. That's simply not true.

If you look at the New York Attorney General's complaint, and we cited this language in our response, it is unquestionably the case that they defined WaMu as its used, as Washington Mutual, Inc. Now whether or not that was shoddy drafting is certainly something they're entitled to argue and we can discuss it when we get to the hearing on this. But from a pleading standpoint, that complaint is full of very specific and very detailed allegations against the debtor. They allege that Washington Mutual, Inc., the debtor, did a variety of things that led to the inflate of appraisals. There are dates. There are times. There are places. There are emails. There are titles. That is above and beyond what a plaintiff would typically be able to plead at this early stage and we're fortunate to have access to that information.

We were less fortunate to have access to the information with respect to the specific loan files that would link the alleged inflated appraisals to the actual mortgages at issue which is the next issue they argue under 9(b). Now two points here, Your Honor, first this notion that we have to establish a nexus is simply not borne out by the case law.

Effectively what they're trying to argue at this stage is we're obligated to plead loss causation. That we have to show a relationship between the mortgages and our eventual losses. This is a relatively new argument, really coming up for the first time in oral argument today. They had pled it before under a specified pleading analysis under 9(b). Now they seem to be saying no, substantively you need to plead loss causation. I would submit to you that is not a requirement under any of the statutes that we've pled. So to the extent they're trying to impose that now, that's unreasonable pleading requirement.

But getting back to the notion of nexus generally, what we have pled is that the entire underwriting process used by Washington Mutual, Inc. and its subsidiaries were so pervasively defective that any mortgage that came through it would be defective in and of itself.

We've also pled which is really all we're required to plead under the applicable statutes at issue that the representations that they made about the underwriting process were wrong. They said they complied with USPAP. We have pled that they did not. Whether or not that resulted in any losses is largely irrelevant as they concede we're dealing with primarily strict liabilities statutes here.

As far as the burden of pleading, one court addressing a fairly similar situation which is the Wells Fargo case that

we cite recognize that whereas here, there are detailed allegations of pervasive problems with the entire underwriting process at a pleading stage that is sufficient to at least get to the next step.

I would also point out that to the extent this court is inclined to impose a pleading requirement like this which we don't believe would be appropriate, that pleading standard is relaxed typically, whereas here the information that we would need to plead that is exclusively within the possession, custody and control of the debtors. Now as we point out in our response, we asked for those materials before we filed our proof of claim and they said no. We wanted to take a look at the loan files.

So what you have here, Your Honor, is a restaurant that told all of the patrons that they had a clean kitchen, seventy percent of the people got food poisoning who ate there and they won't let us look in the kitchen to see what went wrong. We would submit that we have pled beyond what would be required under 9(b) to the extent that 9(b) even applies here and although not addressed in oral argument as we pointed out in the papers, we don't believe 9(b) would be the appropriate pleading standard in any event.

But even if the Court were inclined to apply it, we believe we have more than adequately satisfied it. So for those reasons, Your Honor, we would respectfully ask that at

this stage those portions of the objections that are issue be denied and that we'd be entitled to proceed with discovery and move towards a prompt hearing of this matter.

THE COURT: Thank you. Any reply?

MR. STROCHAK: Thank you, Your Honor, just -- thank you, it's Adam Strochak from Weil, just a few points in response. They seem to be trying to have it both ways on the parent company issue. They've made all of these allegations about what we know is bank conduct; right? I mean nobody's asserting that the parent company was out there originating loans. What we're talking about is conduct at Washington Mutual Bank.

And then with respect to the preemption argument, they're saying well, you know, the holding company wasn't regulated under this statute. We're not suggesting, Your Honor, that any ruling the Court might make on mortgage origination processes is going to affect this debtor's future conduct. We know that's not going to happen. This debtor isn't going to be out there issuing mortgages. It wasn't in the past and it's not going to be in the future.

The argument on preemption, Your Honor, is that the rulings that the Court will have to make in order to adjudicate their claim will by definition require the Court to dig into the substance of the loan origination process, the substance of the appraisal processes. And it's the potential for

inconsistency in court rulings that requires preemption here, not because anything the Court might say is going to interfere with this debtor's future business practices.

The offering circular -- the private placement memorandum that counsel provided to the Court says, you know, in bold face on page 2 -- it's page 3 of the notebook if you count the cover page -- "The offered certificates will not be registered under the Securities Act of 1933 or qualified under the securities laws of any jurisdiction."

It could not be clearer that they were not buying registered securities. They simply cannot assert a claim under Section 11, under those circumstances. Very sophisticated purchasers. They knew what they were getting. They knew what rights they had and what rights they didn't have.

One of the rights they did have, Your Honor, and this is probably beyond the pleadings but they had the right to review the monthly reports regarding the servicing of loans. It's not as if they were just out there as you know some common shareholder who had no rights with respect to these securities. Again, very sophisticated purchasers bought in a private placement. They had rights to go out and review things understand exactly what they were getting and how it was performing over time.

Let me just check my notes for one second. The suggestion about the, you know, the shoddy draftsmanship, you

know, the New York Attorney General's complaint simply -- just bear with me one second, Your Honor -- you know, paragraph 5 of the New York Attorney General's complaint says "Washington Mutual, Inc., defined as WaMu is the country's largest savings and loan." The only thing that could mean is that what they are talking about there is the whole enterprise. We know that Washington Mutual, Inc. was not a savings and loan. It was a thrift holding company.

So the suggestion that somehow that loose drafting in the New York Attorney General's complaint and then loose drafting in incorporating it into the proof of claim somehow survives the requisite pleading standard doesn't work, Your Honor. There needs to be some specificity, some specific allegations about what the parent company did in order to satisfy the legal standard as a control person under either California law or federal law and it's just here.

We have loose allegations of control that do nothing more than kind of repeat the standard but no facts from which we can figure out why they think the parent company is responsible here. To the extent that there was a whole network created, sure, there was a whole network created. It was created under the bank. You had this massive bank out there and this small parent company on top of it with a handful of employees. So sure, I mean the bank did create a network. The bank created subsidiaries. It created subsidiaries with the

specific purpose of serving as an underwriter in connection with mortgage-backed securities. There's no doubt that it did those things and those things are alleged. But what's not alleged is anything that we can point to to say well why is the parent company controlling? Sure it happened. No doubt that the subsidiaries were created. They were authorized. They were done. And they, in fact, issued these securities.

Mortgages were made. Assets were transferred into trusts. Certificates were granted. Those things happened. But there's nothing in here that alleges the type of culpability, the next step beyond simply being the parent shareholder that's necessary for control person liability. And I was not suggesting, Your Honor, that the same standard applies. I mean this is not a piercing the veil argument. I recognizes they're not making that argument. I think there are very similar circumstances, similar things that might satisfy the piercing of the veil test or the alter ego test, might also satisfy the control person test but those are exactly the things that are missing here. They're just not here and I'm not suggesting that the same standard is applicable. What I'm suggesting is that the analysis is similar. You simply need to have facts that allege control and while the legal standard is alleged here, the facts are not. Thank you, Your Honor.

THE COURT: All right. Well let me -- I'm sorry,

somebody else wants to be heard?

MR. OZOLS: Your Honor very quickly, Robert Ozols of Aiken Gump Strauss Hauer & Feld on behalf of the official committee of unsecured creditors. The committee's advisors have worked extensively and constructively with the debtors on this matter and we've also kept the committee apprised of all issues and developments in accordance with our analysis. The committee supports the debtor's objection and all of their arguments as put forth today and in their pleadings. Thank you.

THE COURT: All right. Well let me issue my ruling. First with respect to the Section 11 argument, I agree with the debtors that to the extent these were unregistered securities, Section 11 simply is not applicable. I think the fact that the private placement memorandum referenced and in fact encouraged or strongly urged the investor to read the registration statements or other public documents filed by the debtors is not sufficient to bring it within Section 11. Section 11 deals with registered securities. So just -- I think the debtor's correct on that point.

With respect to the issues of preemption though, I disagree with the debtor. As I suggested, I think the same set of facts may give rise to two different claims, again without stating whether or not there is a claims again without stating whether or not there is a claim. To the extent the underlying

facts with respect to the misrepresentations regarding underwriting standards is correct or proven, I think they may have stated a claim and that is not preempted either by HOLA or by NSMIA. This does not interfere with the regulation of banks. This deals with affiliates who issue securities based on mortgages. Nor does it interfere with the federal statutes which deal with what statements must be made in connection with the issuance of securities.

To my knowledge, there isn't any case that has held that state securities statutes are preempted by NSMIA. Again, I make no statement as to whether a finding as to whether or not there is a valid claim under the California statute but I think that the allegations stated do not interfere or -- and are not preempted by either statute.

With respect to the 9(b) argument, however, I agree with the debtor. I think as I told Mr. Shore today and I advised Ms. Eucklesohn, I think you have to plead more facts that specifically provide a nexus between the actions of subsidiaries and the debtor in this case. It's not sufficient to say they were a control person. I think you have to plead sufficient facts regarding the exact claim that you're asserting and why the actions of SMI specifically caused the harm that you're alleging. I will, however, give the plaintiff the opportunity to -- or excuse me, Tranquility, the opportunity to amend its pleading to state those allegations.

So I guess it would be an amended proof of claim.

Anything else today then?

MR. STROCHAK: I believe that concludes the agenda, Your Honor. On the committee claim, shall we submit an order?

THE COURT: Yes, if you will.

MR. STROCHAK: Yes, we'll circulate it with counsel. Thank you very much.

THE COURT: All right. We'll stand adjourned then. Thank you.

(Whereupon these proceedings were concluded at 11:57 a.m.)

I N D E X

R U L I N G S

C E R T I F I C a T I O N

I, Linda Ferrara, certify that the foregoing transcript is a true and accurate record of the proceedings.

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