IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	**Chapter 11**
WASHINGTON MUTUAL, INC., *et al.*,[1]	:	**Case No. 08-12229 (MFW)**
	:	**(Jointly Administered)**
Debtors.	:	
	:	**Re: D.I. 12346**

WMI LIQUIDATING TRUST'S SUPPLEMENTAL
OBJECTION TO GRANT THORNTON'S SANCTIONS MOTION

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Wilmington, Delaware

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[1] The Debtors in these chapter 11 cases are: (i) Washington Mutual, Inc. (3725); and (ii) WMI Investment Corp. (5395). The principal offices of WMI Liquidating Trust are located at 1201 Third Avenue, Suite 3000, Seattle, Washington 98101.

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WMI Liquidating Trust (the "**Trust**"), as successor to Washington Mutual, Inc. and WMI Investment Corp. ("**WMI**" or the "**Debtors**"), respectfully submits this supplemental objection to the motion for sanctions [D.I. 11994] (the "**Motion**") and supplemental motion [D.I. 12346] (the "**Supplemental Motion**") filed by Grant Thornton LLP. The Trust hereby incorporates (1) the affidavits of Curt Brouwer ("**Brouwer**") and Brian Pedersen ("**Pedersen**") filed contemporaneously herewith, and (2) its original objection to the Motion [D.I. 12008].

INTRODUCTION AND SUMMARY OF ARGUMENT

1. This case presents the troubling issue of an estate professional that has misrepresented the scope of its work in an effort to seek a greater fee than to which it knows it is entitled. In so doing, Grant Thornton ignores its own professionals' testimony proving that the position it now takes is not how it understood (and still understands) the engagement letter and corresponding fee, a violation of its duty of candor. In this brief, the Trust will present this testimony to show why the contingency fee is improvident.

2. As one Grant Thornton professional testified, by its nature, a contingency fee is *contingent*: it depends on the success of the underlying claim. Grant Thornton freely admits that the contingency fee here, as currently construed and being proffered by Grant Thornton, is not based on the success of Grant Thornton's work:

> [N]either the California Engagement Letter or California Engagement Order limited the contingency fee to any economic value received specifically as a result of the services Grant Thornton provided under the Statement of Work.

Supplemental Motion ¶ 37. The question for the Court is whether a contingency fee that does not depend on the success of the underlying claim is improvident.

3. The question answers itself. It is improvident to pay Grant Thornton a success fee for claims unrelated to its own claim, especially since its own claim was unsuccessful. This is all the more true here because the Debtors were entitled to $400 million of unrelated,

uncontroversial refunds from the California Franchise Tax Board (the "**FTB**"). As a result of the sheer size of these unrelated refunds, under the fee as construed, Grant Thornton immediately became assured of a maximum fee. In other words, the "contingency fee" was not contingent at all; it was a guaranteed maximum fee.

4. Why did the engagement agreement ("**Engagement Agreement**"), as construed, contain such an improvident term? Because the Debtors and Grant Thornton both believed that they had agreed to something else, and they both believed that the Engagement Agreement incorporated their understanding. They believed that Grant Thornton would be paid for the success of the refund claim on which it worked, and because they read the agreement this way, they could not have reasonably anticipated that the Engagement Agreement provided for a fee that was so far beyond their understanding and industry custom. This was confirmed by the testimony of Grant Thornton's professionals:

> **Scot Grierson, senior partner who took over the engagement after original partner's death**: Q: So you understood that the contingency fee was to be based on the value provided by the treasury interest idea, right? A: Yes. A501.[2]
>
> **Don Corbett, relationship partner who led contingency fee discussions with Debtors**: Q: You were talking about . . . was there any value produced by the Treasury interests idea? A: Correct. Q: That was what you were discussing on the call? A: Correct. Q: And that was to determine Grant Thornton's fee; right? A: At least claim for one. Not the fee, but just a claim for one. Q: What does that mean? A: I mean -- I mean, if -- if -- if there was no value, it would be difficult to think that there would be a fee. A483.
>
> **Tim Cleary, executive director who assisted engagement partner with negotiating engagement:** Q: You understood that the Treasury interest issue had to yield value in order for the contingency fee to be earned, correct? A: Correct. A439.

See also infra pp. 13-17. Everyone admits that the fee was to be calculated based on the success of the refund claim that Grant Thornton worked on, the "Treasury Interest Issue" (described at p.

[2] Citations of "**A___**" refer to page numbers in the *Trust's Appendix* filed herewith.

6 below). That Grant Thornton ignores its own professionals' testimony, and insists on a fee far broader than what it knows to be the parties' understanding, is vexing.

5. Equally distressing is Grant Thornton's affirmative mischaracterization of its work to the Court. Grant Thornton told the Court that it worked on every tax issue raised by the FTB, thereby giving the impression that it should be compensated for every issue. A376 ("[T]his is a broad-base review of all the debtor's tax returns…. We were hired to address those issues -- all the issues with respect to the California Franchise Tax Board's Proof of Claim"). At deposition, Grant Thornton's professionals admitted that this was false, and that they did not work on any California proof of claim issues—just the Treasury Interest Issue. *Infra* pp. 17-18.

6. Discovery also has established the following undisputed facts:

- At the time of engagement, the parties did not know how much of a refund the Debtors could seek for the Treasury Interest Issue—they estimated it could be as high as $60 to $80 million. It turned out to be $42 million, plus interest.
- The Debtors had unrelated claims before the FTB, including claims for $400 million in refunds that the FTB accepted with only minor adjustments.
- From the beginning, the parties never believed that the Treasury Interest Issue would yield 100 cents on the dollar. Early in the engagement, Grant Thornton wrote to the FTB that the Debtors would accept "a percentage" of the $42 million request.
- The FTB rejected the issue repeatedly in writing, leading the Debtors and Grant Thornton to agree to reduce the claim to $21 million plus interest.
- The Debtors were responsible for litigation costs, and had authority to decline to pursue the claim. Grant Thornton was paid $150,000 in non-contingent hourly fees for this risk.
- The FTB continued to reject the claim based on a detailed written defense, leading the Debtors to exercise their authority to ultimately withdraw the claim.

The fact that the Treasury Interest Issue was reduced to a $21 million claim means that the highest conceivable contingency fee at that point was $1.95 million ($21 million x 10%, minus $150,000 hourly fees) plus 10% of any interest. And, because the Debtors later abandoned the theory, Grant Thornton must look solely to its hourly fees for compensation.

7. Grant Thornton never addresses why being paid $5 million for the success of unrelated issues is provident, particularly where those issues were so large that they guaranteed a maximum fee. Nor does Grant Thornton attempt to reconcile its professionals' testimony. Instead, Grant Thornton's entire argument depends on preventing the Court from seeing this evidence, based on an insupportable narrow reading of the Court's statements at a discovery hearing. At that hearing, the Court stated that it would not re-litigate whether the Engagement Agreement was ambiguous. The Trust is not attempting to do so here. In this brief, the Trust assumes that the Engagement Agreement provides for a contingency fee based on the resolution of every FTB issue, whether Grant Thornton was involved or not. **This is *why* the agreement is improvident**.

8. The Trust offers evidence of the parties' understanding only to show that, at the time, the parties could not have anticipated that the Engagement Agreement contained an improvident term, because they jointly believed (even if mistakenly so) that it reflected a more limited fee. The fact that both parties read the agreement to provide for a more limited fee consistent with their absolute understanding is why they could not reasonably foresee that it incorporated something different, particularly where the broader fee was so contrary to common sense or anything in the industry. In short, the Engagement Agreement's inclusion of a broader fee than agreed was the product of an unforeseeable mutual mistake in reducing the agreement to writing. *See Tex. E. Transmission Corp. v. McCrate*, 395 N.E.2d 624, 627-28 (Ill. App. 1979) (doctrine of mistake applies where "the parties came to an understanding but in reducing it to writing, through mutual mistake … some provision agreed upon was not properly incorporated into the written instrument"). Showing this mistake does not depend on re-interpreting the

contract; it depends on the construction already adopted by the Court. Evidence of the parties' understanding is admissible to show mistake, even if the contract is unambiguous. The Court therefore should find the contingency fee improvident based on this unforeseeable circumstance.

9. Grant Thornton's request for sanctions should likewise be denied. The final fee order approved the contingency fee without saying in what amount, because, at the time, the refund request was still pending. The disagreement here concerns the fee's amount. As the order does not speak to this issue, the Trust has not intentionally disobeyed a court order.

10. Grant Thornton argues that the Trust could have simply read the order and concluded that a $5 million fee was owed. But, discovery has proven that Grant Thornton had the same understanding of the fee order as did the Trust: the fee applies solely to the Treasury Interest Issue. For example, in reference to the fee, Grant Thornton wrote the following to the Trust:

> I have circled the wagon with my team to discuss and consider **what potential financial impact the Treasury Interest had on the California Settlement** … **to identify a fair amount to compensate Grant Thornton for its efforts.**

A365 (emphasis added). Grant Thornton itself did not believe that the fee applied to every issue. So, how could the Trust be in contempt of the order for reading it the same way as Grant Thornton? And, given the circumstances, including the Debtors' reduction of the claim to $21 million and then to $0, a $5 million fee (which assumes $50 million in value) was not even possible. Resisting Grant Thornton's overreaching demand for fees is not sanctionable conduct.

11. Indeed, if sanctions were to be considered by the Court, then the evidence supports the Court's award of the Trust's fees and costs as against Grant Thornton. As an estate professional, Grant Thornton owes duties of candor to the Court, the chapter 11 estates, and the creditor and equity interest holders awaiting distributions. Grant Thornton wrongly told the Court that it worked on every issue in California, and it presses for a fee that it knows (and

knew) is not what it agreed upon. Accordingly, an award to the Trust of its attorneys' fees and costs in having to defend this action would be appropriate.

BACKGROUND

A. The Debtors Hire Grant Thornton To Develop The "Treasury Interest Issue"

12. About a year before the bankruptcy, Grant Thornton partner Steve Ryan ("**Ryan**") met with WMI's corporate tax director, Curt Brouwer ("**Brouwer**"), to pitch the "Treasury Interest Issue." Brouwer ¶ 5; *see also* A387, A515-16 (deposition excerpts about initial meeting). The Treasury Interest Issue (the parties sometimes called it the "treasury interest theory" or "treasury interest idea") is a refund theory based on the constitutional principle that a state cannot discriminate between the taxation of interest on federal bonds versus state bonds. Brouwer ¶ 5; Pedersen ¶ 5. If a state taxes federal bond interest, then it also must tax state bond interest; if a state exempts state bond interest from tax, then it must exempt federal bond interest too. Brouwer ¶ 5; Pedersen ¶ 5; A242-47 (Grant Thornton engagement memo describing Treasury Interest Issue).

13. California's franchise tax does in fact tax interest income from federal bonds, so the franchise tax also must tax interest income from state bonds. Grant Thornton had located a municipal bond issuance in California, dated 1941, that appeared to exempt interest income from taxation. *See* A245 (Grant Thornton memo describing bond); A92-219 (copy of bond). This appeared to discriminate illegally against federal bonds. Grant Thornton contended that the only possible remedy was for the FTB to treat interest on federal bonds the same by exempting all federal interest income from tax and refunding the corresponding taxes. *See* A245 (Grant Thornton memo); A576 (Pedersen Dep.); A516 (Brouwer Dep.). As explained by one Grant Thornton professional, "the idea was essentially to identify transactions that had federal interest associated with them and exempt them." A430 (Cleary Dep.).

14. Brouwer did not have a firm opinion about the merits of the issue, other than that it was novel and that he had not seen the issue raised anywhere in his thirty years of experience as a tax professional. Brouwer ¶ 7. Based on Ryan's explanations, Brouwer thought there was enough of a possibility of recovery to pursue the refund. *Id.*; A542 (Brouwer Dep.). Grant Thornton was willing to proceed on a contingency basis, which was important to Brouwer, because he was not convinced that the theory was worth the upfront fees that could accrue if Grant Thornton were engaged on a purely hourly basis. Brouwer ¶ 8; A524 (Brouwer Dep.).

15. At the time, neither Brouwer nor Ryan knew the amount of the refund that WMI could seek. Brouwer ¶ 7. WMI held large amounts of treasury bonds, but Ryan wanted to determine if the idea could apply to other types of federal interest. *Id.*; A524-26 (Brouwer). Only after making this determination could WMI then calculate a number. *Id.* At the time, Grant Thornton estimated that WMI could ask for $50 million or more in refunds. Brouwer ¶ 7; A525 (Brouwer Dep.). The actual request when made was for $42 million in tax, plus interest. Brouwer ¶ 29; Pedersen ¶ 16.

16. Grant Thornton believed that the FTB would initially deny the refund request. Brouwer ¶¶ 6 & 25(b); *see also* A63 (language in the Engagement Agreement stating that "it is anticipated that the FTB will initially deny the claims"). In Ryan's opinion, though, the issue could cause enough concern within the FTB that it might settle the claim and provide some value to WMI. Brouwer ¶ 6; A521-22 (Brouwer Dep.); A241 (Grant Thornton email to FTB asking for "percentage" of the issue). Grant Thornton projected a high degree of confidence that the Treasury Interest Issue would yield some value based on prior experience with a similar issue in Illinois. Brouwer ¶ 7.

17. Brouwer and Ryan came to the following agreement: Grant Thornton would

develop the Treasury Interest Issue for WMI's use. Brouwer ¶ 9. As taxpayer, WMI would retain complete control over the claim, but would also bear all expenses, including litigation costs. *Id.*; A545 (Brouwer Dep.). As compensation, Grant Thornton would charge hourly fees, at a 20% discount, up to a maximum of $100,000. Brouwer ¶ 11. After hitting this cap, all further compensation would arise from a contingency fee only if the Treasury Interest Issue prevailed. *Id.* ¶¶ 11-12.

18. The contingency fee was 10% of the value that WMI recovered from the Treasury Interest Issue, up to a maximum of $5 million. *Id.* Brouwer and Ryan agreed on this cap with the understanding that it was based on their estimate at the time that the potential benefit was $50 million or higher. *Id.* ¶ 11. Brouwer accepted these terms because it limited WMI's exposure to $100,000, which he viewed as a reasonable sum to pay for the possibility of a larger recovery, and because Grant Thornton was willing to shoulder most of the risk of its theory by proceeding on contingency. *Id.* ¶¶ 8-11; A525-26 (Brouwer Dep.).

19. Brouwer and Ryan agreed that the contingency fee would apply to the value that WMI received from the Treasury Interest Issue. Brouwer ¶ 12. That was how they discussed the fee. *Id.*; *see also* A547 (Brouwer Dep.). Ryan never suggested, and Brouwer never understood, that Grant Thornton would receive a contingency fee for refunds unrelated to Grant Thornton's work or based on work done by other WMI professionals, or if the Treasury Interest Issue did not prevail. Brouwer ¶ 12. Such an arrangement would have been unheard of in the industry. *Id.* ¶¶ 12, 24, 27; Pedersen ¶ 30; A548 (Brouwer Dep.). Brouwer would not have engaged Grant Thornton if it had taken the position that its contingency fee would be calculated based on anything other than value received by WMI from the Treasury Interest Issue. Brouwer ¶ 12.

20. In February 2008, the parties incorporated their understanding into a "statement of

work." Brouwer ¶ 14. By this time, as described below, the Debtors had already filed an uncontroversial refund claim for $172 million of the $400 million in unrelated refunds that they were entitled to obtain from the FTB. Brouwer ¶ 17; Pedersen ¶ 9. A contingency fee based on all value received from the FTB, whether related to the Treasury Interest Issue or not, therefore already would have led to a guaranteed non-contingent fee based on this unrelated refund claim.

B. The Debtors Re-Engage Grant Thornton Post-Bankruptcy To Finish Developing The Treasury Interest Issue

1. The Debtors had numerous other issues with the FTB, including approximately $400 million in unrelated refunds

21. The Debtors filed for bankruptcy in September 2008 and retained Alvarez & Marsal ("**Alvarez**") to lead their restructuring. The Debtors had no tax employees on the petition date as a result of JPMorgan's purchase of the bank, so Alvarez's tax professionals took over all outstanding tax issues. Brouwer ¶ 15; Pedersen ¶ 3. In late 2008, the Debtors hired Brouwer to serve as Tax Director and oversee all tax matters for the Debtors. Brouwer ¶ 15; Pedersen ¶ 3. At the time, the Debtors had two major tax issues pending before the FTB.

a. The $400 million in refunds from the IRS audits

22. First, the Debtors became entitled to recover $400 million from the FTB primarily on account of IRS audits that had been underway for years (some of the audits had even concluded before the bankruptcy case began). Brouwer ¶¶ 16-17; Pedersen ¶¶ 9-10. These audits confirmed that the Debtors had overpaid their federal taxes. *Id.* The FTB uses federal taxable income numbers as a starting point in calculating franchise taxes, so any alteration to federal taxable income directly affects California franchise taxes. *Id.* Using the lower numbers reported by the IRS, the Debtors were entitled to approximately $350 million in refunds from the FTB, and, with the addition of certain other overpayments that the Debtors had made, approximately $400 million in total refunds. *Id.* This refund request was not controversial

because it was primarily a matter of mathematically applying the formal IRS findings to California's franchise tax formula. *Id.* To claim this refund, the Debtors only had to amend their franchise tax returns for prior years using the new numbers found in the IRS audits. Pedersen ¶ 9. WMI started this process in 2007, before the bankruptcy case began and before hiring Grant Thornton for the first time. Brouwer ¶¶ 16-17; Pedersen ¶¶ 9-10. In 2007 alone, WMI already had filed for $172 million of the refund, based on the adjusted federal income reported by the IRS. Brouwer ¶ 17; Pedersen ¶ 9.

23. Throughout the engagement, Grant Thornton did not work on the IRS audits, or on requesting any of the $400 million from the FTB. Brouwer ¶¶ 16, 20, 28; Pedersen ¶¶ 6, 10, 12. Likewise, Grant Thornton was not expecting to be compensated for these refunds, as Grant Thornton's second-in-command on the engagement testified:

> Q: And if the federal adjustments were being reported to the state, it, therefore, was not your view that Grant Thornton would be compensated for the reporting of the federal adjusted numbers to the state; correct?
>
> A: Correct.

A436 (Cleary Dep.). Another Grant Thornton professional testified that handling the federal audit was beyond the scope of the engagement. A470 (Corbett Dep.). Yet another was not even aware of the audit's existence. A494 (Grierson Dep.). Despite this testimony, Grant Thornton now contends that its fee should apply to all value that the Debtors received from the FTB, including this $400 million amount.

24. With Alvarez's assistance, the Debtors completed their $400 million in refund requests in two batches, in the years 2010 and 2011. Pedersen ¶ 9. In each case, the FTB accepted the refund:

> Regarding the IRS adjustments reported in the amended return, these adjustments will be accepted as reported.

A237 (FTB response for 2010 amended returns); *see also* A297 (FTB response for 2011 amended returns, accepting amounts with minor adjustments).

25. In sum, the Debtors had been filing refund claims arising from the IRS adjustments since 2007, and they completed these filings in 2011 for an aggregate $400 million in refunds that the FTB acknowledged it owed. Brouwer ¶¶ 16-17; Pedersen ¶ 9.

b. The $280 million FTB audit proof of claim

26. The second major tax issue pending before the FTB was the FTB's audit of the Debtors' state tax returns. To comply with the bar date in these cases, the FTB filed a precautionary proof of claim in the amount of $2.4 billion before completing its audit. *See* A9 (initial proof of claim). The proof of claim assumed that the Debtors paid *no* taxes in the relevant years, and asserted the maximum conceivable tax that the Debtors could have owed based on the Debtors' then-reported federal income. Brouwer ¶ 19; Pedersen ¶ 13. When the FTB concluded its audit, it amended its proof of claim downward to $280 million. A586 (amended proof of claim); Pedersen ¶ 13.

27. The FTB raised over a dozen issues in its audit, some of which involved complex tax questions. Brouwer ¶ 18; Pedersen ¶ 12. The two largest were the Debtors' tax treatment of their real estate investment trusts (REITs) and registered investment companies (RICs). *Id.* Grant Thornton played no role in reconciling the issues raised by the FTB in its audit, or in the proof of claim that the FTB filed as a result of its audit. *Infra* pp. 17-18. Alvarez assisted the Debtors in handling the audit, with the exception of one specialized issue that was handled by a boutique California tax firm. Brouwer ¶ 20; A536 & 569 (Brouwer and Pedersen Deps.).

2. Ten months into the case, the Debtors agree to re-engage Grant Thornton to complete work on the Treasury Interest Issue

28. The filing of the bankruptcy case halted Grant Thornton's engagement. At the

time, Grant Thornton had not yet developed the Treasury Interest Issue into something that the Debtors could use. Grant Thornton still had to determine whether the Debtors could seek to exempt other types of federal interest, meaning that the Debtors were not yet in a position to calculate the amount of the potential refund. Brouwer ¶¶ 21-22.

29. In early 2009, Brouwer discussed re-engaging Grant Thornton to complete its work on the Treasury Interest Issue. *See Id.* ¶ 21; A2, A5, A7, A14 (email discussions). During these discussions, Grant Thornton proposed two compensation alternatives. *See* A3 (Grant Thornton's written proposals). The first was to continue the same arrangement as before: Grant Thornton would receive hourly fees up to $150,000 (increased from $100,000), and then would receive a contingency fee of 10% of the "economic benefit" yielded by its idea, capped at $5 million, minus the hourly fees. *Id.* The "economic benefit" was listed as $60-$80 million, which was Grant Thornton's estimate of the size of the treasury interest refund request (at this time the Debtors still had not calculated the actual number). Brouwer ¶ 22. The second proposal was an hourly arrangement with a minimum fee of $1 million and a maximum of $2 million. At that time, the parties' discussion of the contingency fee potentially due under the Engagement Agreement was based on and in reference to the $60-$80 million "economic benefit range" attributed to the Treasury Interest Issue under Grant Thornton's proposal. *Id.*; A3.

30. Brouwer agreed to re-engage Grant Thornton under the first proposal, which mirrored the pre-bankruptcy engagement. *Id.* ¶ 23. He agreed that Grant Thornton would receive hourly fees up to $150,000, after which it would receive 10% of the value recovered from Grant Thornton's work product, up to $5 million, with Grant Thornton bearing the risk of not receiving a contingency fee if the Treasury Interest Issue did not succeed. *Id.* ¶¶ 23-24. Brouwer did not agree to the alternative $1 million/$2 million proposal in part because he did not

believe that he could justify committing the estates to a guaranteed million dollar payment for an idea that he could not demonstrate could yield value in excess of that fee. *Id.* ¶ 23.

31. In June 2009, the parties entered into the Engagement Agreement, which the Court approved later that month. A60. Brouwer and Ryan were the signatories. A62, A67. The agreement attached a "Statement of Work" setting forth the scope of Grant Thornton's services and its compensation terms. A63-67.

32. Brouwer believed that the Statement of Work accurately incorporated his agreement with Grant Thornton. Brouwer ¶¶ 25-26. As before, Brouwer never discussed with Grant Thornton the option of billing a contingency fee for unrelated claims. *Id.* ¶ 24. Nor did Brouwer ever discuss the option of billing a fee for any reduction in the FTB's proof of claim. *Id.* Brouwer never would have considered these proposals. *Id.*

33. The Debtors were responsible for all litigation costs associated with obtaining the refund. A63 (final paragraph). The Debtors also controlled "all management decisions regarding matters that are the subject of this engagement." *Id.* (penultimate paragraph). In other words, the Debtors could decide how to assert the Treasury Interest Issue, including whether to stop asserting it at any time.

C. Grant Thornton's Professionals Understood That The Contingency Fee Applied Only To The Treasury Interest Issue

34. Other than Ryan, who passed away in 2012, four other professionals were associated with the engagement: (1) Scot Grierson, who later replaced Ryan as lead partner; (2) Don Corbett, the senior "relationship partner" with WMI; (3) Tim Cleary, a former WMI employee who assisted Ryan in negotiating the post-petition Engagement Agreement, and who was Grant Thornton's second-in-command in the engagement until he left the firm in late 2010; and (4) Paul Bogdanski, who was responsible for performing the technical analysis underlying

the Treasury Interest Issue. At deposition, each of these professionals confirmed that they understood that the contingency fee applied to the Treasury Interest Issue only.

Replacement partner Scot Grierson freely admitted this:

> Q: -- and that's because you understood that the contingency fee was based on the treasury interest issue; right?
>
> Mr. Donoyan: Objection. Asked and answered.
>
> A: Agree.
>
> ***
>
> Q: So you understood that the contingency fee was to be based on the value provided by the treasury interest idea; right?
>
> A: Yes.

A497 & A501 (Grierson Dep.).

35. Relationship partner Don Corbett, who spoke numerous times with Brouwer about calculation of the contingency fee, had the same understanding:

> Q: You were to be paid based on the value brought by the Treasury interests idea?
>
> A: Correct.
>
> Q: And that's what you were trying to communicate to Curt [Brouwer]?
>
> A: Correct.
>
> Q: And that's your understanding at the time?
>
> A: That was my understanding at the time.

A480 (Corbett Dep.).

36. Second-in-command Tim Cleary, who helped Ryan negotiate the engagement, also confirmed this:

> Q: You understood that the Treasury interest issue had to yield value in order for the contingency fee to be earned; correct?

> A: Correct.

A439 (Cleary Dep.). Like in any contingency engagement, the claim must prevail:

> Q: Okay. But at the -- the idea as proposed by Grant Thornton still had to yield value, correct?
>
> A: Correct. I think that's the important part.

A453 (Cleary); *see also* A483 (Corbett) ("Q: You were talking about . . . was there any value produced by the Treasury interests idea? A: Correct…. [I]f there was no value, it would be difficult to think that there would be a fee"); *see also* A445 (Cleary: "Our job was to provide the idea, provide the client to use it. He used it as he sees fit, and we would offer assistance. If it provided the client a benefit, we felt that we should get paid").

37. Technician Paul Bogdanski explained his understanding of the fee to his supervisors in writing:

> It is a contingent fee…. I think Brian [Pedersen of Alvarez] and Curt [Brouwer] at WaMu see value in the argument and based on prior discussions with Steve they would give GT credit if it is due. I can't say that there has been any indication that they would approach this differently due to Steve's passing.

A320. When questioned, Bogdanski acknowledged that he was telling his supervisors that the contingency fee would be triggered if the *Treasury Interest Issue* yielded value:

> Q: Okay. And then, you also tell the Grant Thornton group that based on prior discussions with Steve, they would give GT credit if it is due; correct?
>
> A: Correct.
>
> Q: All right. And that's -- we're talking about the Treasury interest issue here; right? That's the argument? WaMu sees value in the argument; that's the Treasury Interest issue; right?
>
> A: Yes.
>
> Q: And your understanding was that WaMu would give Grant Thornton credit, if it is due?
>
> A: Correct.

> **Q: That means if the Treasury Interest issue yields value; correct?**
>
> **A: (Speaking sotto voce.) If -- yeah, if credit is due.**
>
> **Q: Okay. That's what it means, if the Treasury interest yields value, correct?**
>
> **A: Correct.**

A415-16 (emphasis added).

38. The most important Grant Thornton professional on the engagement was Steve Ryan, who developed the idea and was lead engagement partner. Ryan passed away in late 2012, but in an email to his practice leaders he confirmed that he agreed Grant Thornton's fee was based on the value derived from the treasury interest issue:

> [We] submitted a response (drafted by Paul Bogdanski and me, signed by Alvarez) to the FTB's rejection of our 'bond discrimination' refund claim…. **The refund for this issue for WAMU is approx. $60 million. I don't think a $10-$15 million or so settlement is out of the question** — the FTB has been very resistant so f[a]r, but client is currently committed to litigating this, etc. **Our fee arrangement is 10% with a $5 million cap, so we could have a $1 - $1.5 million (or more) fee here or "zero".**

A284 (emphasis added). In other words, Ryan understood that Grant Thornton's contingency fee was based on the success or failure of the Treasury Interest Issue. He wrote that the issue could yield up to $60 million in potential refunds (the actual request was for $42 million plus interest), and that a settlement of $10-$15 million was not "out of the question." *Id.* He then stated that the contingency fee could be "$1 million to $1.5 million"—10% of the hypothetical settlement he had just referenced. Ryan also noted that the fee could be "zero"—because he understood that Grant Thornton's fee was based on the Treasury Interest Issue and not the Debtors' resolution of their non-treasury interest issues with the FTB. Ryan also believed that the Debtors were "currently committed to litigating this." *Id.*; *see also* A282 (Ryan to Corbett: "Curt [Bouwer] commented that if the FTB does not want to settle on the position, he would litigate it -

- so I think we are in good shape….”). The Debtors had the discretion to decline to litigate, which is what ultimately happened. *Supra* p. 13 & *infra* pp. 22-23.

39. Had Ryan understood that Grant Thornton could bill for any value that the Debtors received from the FTB on any issue, he would have written a different email. By this point, the FTB had accepted the validity of most of the Debtors' $400 million refund. Brouwer ¶¶ 16-17. "Zero" would not have been an option. Likewise, Ryan's calculation of the fee as 10% of his hypothetical treasury interest settlement only would have made no sense.

D. Grant Thornton Worked On The Treasury Interest Issue Only

40. At the initial hearing in May 2015, Grant Thornton told the Court that it worked on every issue in California:

> And again, this is a broad-base review of all the debtor's tax returns and, Your Honor, this engagement agreement was only entered into after the Franchise Tax Board filed their Proof of Claim for something around $4 billion [$2.4 billion]. **We were hired to address those issues -- all the issues with respect to the California Franchise Tax Board's Proof of Claim**.

A376 (emphasis added). This statement gave the Court the impression that Grant Thornton worked on and should be compensated for every California issue, regardless of the success of the Treasury Interest Issue. But, the statement is untrue. Throughout the engagement, Grant Thornton did not work on a single other issue, including on any proof of claim issue. Brouwer ¶ 28; Pedersen ¶¶ 6, 10, 12. Alvarez handled the proof of claim and audit. *Id.*

41. Despite his initial resistance to admitting this, Grant Thornton's 30(b)(6) witness could not identify a single other issue that any Grant Thornton professional worked on. A401-08 (Bogdanski Dep.). He personally never worked on any other issue, nor was he aware of anyone else at Grant Thornton who worked on any other issue. A391, A400-03. He also admitted that Grant Thornton never interacted with the FTB on any proof of claim issues. A393-94, A396-97. Grant Thornton's time records show no work on any other issues, and Grant Thornton's

communications with the Debtors concerned no other issues. *See*, *e.g.*, A221, A224, A227, A230 (meeting agendas and "to-do" lists relating only to Treasury Interest Issue); A456-58 (Cleary testifying that the agenda items (A222) related to Treasury Interest Issue); A460 (Cleary testifying that the to-do list related to Treasury Interest Issue). In Cleary's words, addressing the issues raised by the FTB in its proof of claim "wasn't part of our engagement." A463.

42. This was a single-issue engagement—a "one trick pony." Grant Thornton may have wanted to broaden the engagement, and, if while assisting with the Treasury Interest Issue, Grant Thornton happened to discover some new idea, then the Engagement Agreement allowed Grant Thornton to bring that idea to the Debtors' attention to see whether the Debtors would like to proceed. Brouwer ¶¶ 10, 25(a), 25(c). But, Grant Thornton never discovered any other ideas:

> Q: Were there any other refund theories or ideas that Grant Thornton was pursuing for Washington Mutual on that engagement?
>
> A: I'm not aware of any.
>
> ***
>
> Q: Did you assert or work on any theory other than the treasury interest theory?
>
> A: I did not work on any other position, no.

A490-91 (Grierson Dep.); *see also* Brouwer ¶¶ 10, 25(a), 25(c).

E. Grant Thornton Tells The FTB That The Debtors Only Want A Percentage Of The Treasury Interest Refund, But The FTB Rejects The Refund In Full

43. The Debtors included a request for a Treasury Interest Issue refund in their 2010 and 2011 amended tax returns. Pedersen ¶ 16. In total, the Debtors asked for approximately $42 million plus interest, above and beyond the amounts they were seeking on account of the IRS adjustments. *Supra* p. 10; Pedersen ¶¶ 9, 16.

44. The FTB accepted the IRS refund, but rejected the treasury interest refund in full:

> We have reviewed the amended returns…. Regarding the IRS adjustments

> reported in the amended return, these adjustments will be accepted as reported…. Although the above net IRS adjustments will be accepted as reported, the adjustment to treat interest income from US obligations as exempt income will not be allowed.

A237 (FTB letter rejecting Treasury Interest Issue refund request for 2010 amended returns); *see also* A299 (FTB letter rejecting Treasury Interest Issue refund for 2011 amended returns).

45. After receiving the FTB's first rejection letter, Grant Thornton wrote to the FTB and suggested that it settle for a fraction of the total amount:

> **I view our discussion as an opportunity for California to limit its exposure to a percentage of what Washington Mutual has attributed *to this issue*.** It is also an opportunity to quietly clear up the offending language. As Steve indicated, he has not marketed this issue to a wide array of potential clients, so there is a real benefit to addressing the problem head on and not pushing it to court.

A241 (emphasis added). In other words, Grant Thornton understood that the Treasury Interest Issue was to be compromised on its own terms and would not yield 100 cents on the dollar, since it communicated these same assumptions to the FTB, the Debtors' tax adversary.

46. In 2011, the Debtors offered to resolve all tax issues with the FTB, including the Treasury Interest Issue. A254. The offer proceeded on an issue-by-issue basis, and asked for 100% of the Treasury Interest Issue refund. *Id.* Before formally responding, the FTB provided the Debtors with its technical reasoning for denying the refund. A590 & A594. In sum, the FTB included income from even "tax-exempt" bonds in its franchise tax assessments. *Id.* A franchise tax is a tax on the privilege of doing business in the state, and differs materially from a direct tax. In California, the franchise tax has long been held to include income that is exempt from tax. The California Supreme Court so held in *Pacific v. Johnson*:

> A franchise tax is a tax imposed upon a corporation for the right or privilege of being a corporation or of doing business in a corporate capacity…. Accordingly, it was early held that where a tax is lawfully imposed upon the exercise of privileges within the taxing power of the state or nation, the measure of such tax may be the income from the property of the corporation, **although part of such**

> **income is derived from property in itself nontaxable.**

Pacific Co. v. Johnson, 212 Cal. 148, 154-55 (1931), *aff'd*, *Pacific Co. v. Johnson*, 285 U.S. 480 (1932) (emphasis added; citations omitted). The U.S. Supreme Court affirmed:

> [under California law] there was a well-recognized distinction between a tax on the privilege of exercising the corporate franchise and a tax on corporate property or income, even though the former was measured by the latter, **and tax immunity of the property or income was not deemed to extend to the franchise.**

285 U.S. at 489 (emphasis added). In upholding California's right to include exempt income in the calculation of franchise tax, the Supreme Court stated that the franchise tax statute "evidence[d] a definite and specific legislative purpose to levy a new type of franchise tax, measured by corporate net income, **including the tax exempt income from federal and state bonds**." *Id.* at 492 (emphasis added). So since before 1931, the franchise tax has applied to bond interest income, whether exempt from tax or not. Accordingly, the FTB rejected the "discriminatory treatment" upon which Grant Thornton premised its claim both as a matter of fact and law.

47. In responding to this reasoning, Grant Thornton retreated to its original analysis that focused solely on the plain words of the "discriminatory" bond. Pedersen ¶¶ 20-21; Brouwer ¶ 31. But, this response did not address the core of the FTB's position, which was that, despite those words, such bond interest is included in the franchise tax. Pedersen ¶ 20. Unknown to the Debtors at the time, certain Grant Thornton personnel also questioned the validity of Grant Thornton's position:

> Based on an initial read I have difficulty agreeing with the "more likely than not" conclusion in the memo [Grant Thornton's internal memo concluding that the Treasury Interest Issue would more likely than not prevail]. The conclusion appears to be in direct contrast to the CA Supreme Court's holding in *Security-First National Bank of Los Angeles v. Franchise Tax Board*, 55 Cal. 2d 407 (1961) and numerous SBE [State Board of Equalization] decisions.

A302 (email from Grant Thornton Managing Director Griffiths to Grierson).

48. In March 2013, the FTB formally responded to the Debtors' settlement offer. A317. The response proceeded issue-by-issue, and rejected the Treasury Interest Issue. *Id.* ("FTB has determined that its positions related to the U.S. Treasury obligations … are correct").

49. The Trust counter-offered (A326), and the FTB yielded on several issues, but again rejected the Treasury Interest Issue in full:

> The last tax issue in dispute relates to inclusion from U.S. Treasury Bonds in the measure of income for purposes of determining the amount of franchise tax owed by WMI. For purposes of resolution, we offer nothing on this issue. Every tax return for every taxpayer we have examined has included this income in the measure of tax. We do not find the arguments in favor of your position persuasive, and we make no concession with respect to this issue. (We have previously written to you an analysis, and we do not repeat it here).

A332. At this point, the Debtors/Trust had tried for years to get traction out of the Treasury Interest Issue, but were met with consistent rejection.

F. The Trust Reduces The Treasury Interest Refund Request To $21 Million

50. Because the Trust was making headway with the FTB on some issues, but not the Treasury Interest Issue, the Trust convened with Grant Thornton by phone in early 2014 to discuss strategy. Brouwer ¶ 33; Pedersen ¶ 23; *see also* A339-40 (follow-up email referencing call). The call was attended by Brouwer, Pedersen, and Grierson and Bogdanski of Grant Thornton. Pedersen ¶ 23. On the call, the parties discussed their frank views of the Treasury Interest Issue. As the Trust's lead negotiator, Pedersen believed that the Treasury Interest Issue did not alarm the FTB, and that the FTB was willing to litigate all the way. *Id.* ¶ 23. Pedersen also believed that the issue would likely lose in litigation. *Id.* ¶¶ 15, 23.

51. The parties agreed that, if the Trust continued to advocate for a Treasury Interest Issue refund, it could not simply continue to demand the full amount. Brouwer ¶ 34; Pedersen ¶ 24. They agreed to reduce the request to $21 million plus interest. *Id.*; *see also* A339-40 (follow-up email to call referencing "our 50% offer on treasury interest"). The Trust did not

expect the FTB to accept this amount, but hoped that this reduction would serve as a springboard to negotiation. Brouwer ¶ 34; Pedersen ¶ 24.

52. At this point, the FTB could have paid $21 million plus interest to fully resolve the claim. Because a rational person would never pay more than asked, this was now the maximum benefit that the Trust could have received from the Treasury Interest Issue. But, the FTB rejected the offer, and also rejected offering any concession for the issue:

> FTB remains firmly of the opinion that the WMI position with respect to the Treasury Bond interest issue is devoid of merit and offers no concession on that matter.

A343. Thus, despite lowering the claim by half, the Trust still could get no traction from it.

G. The Trust Withdraws The Treasury Interest Request After It Is Continually Unable To Get Any Traction From It

53. The Trust continued discussions with the FTB, but made no headway on the Treasury Interest Issue. As a result, the Trust exercised its authority to concede the claim.

54. The decision to stop asserting the claim lay primarily with Brouwer. In his view, the FTB had raised significant defenses, and Grant Thornton had not developed a persuasive response. Brouwer ¶ 36; Pedersen ¶ 25. Standing on its merits, he believed that if the Trust litigated the Treasury Interest Issue, it would have had a high likelihood of losing. *Id.* Any litigation would have been time consuming and costly, and he believed that pursuing the issue was not worth the costs, which the Trust would have to bear. *Id.* Further, the issue had the potential to distract the parties from discussion of issues on which the Trust had real, substantive positions. *Id.* As the FTB was not willing to concede an inch on the Treasury Interest Issue and the Trust was not planning to litigate it separately, Brouwer determined that the Trust should bow to reality and no longer pursue the refund. *Id.* Brouwer made this decision in consultation

with Trust management and JPMorgan, who was the 80% beneficiary of any recovery from the FTB. Brouwer ¶ 37.

55. Once this decision was made, Pedersen told the FTB's lead negotiator that the Trust would no longer seek a treasury interest refund:

> Q: When you say "stopped talking about the treasury interest issue," do you mean you communicated to the FTB that you were no longer pursuing that claim?
>
> A: Yeah. We -- I told Mr. Hilson [FTB's lead negotiator] that we wouldn't waste time talking about that issue any further.

A583; *see also* Pedersen ¶¶ 25-26.

56. Negotiations continued on the other issues, and, in May 2014, the parties executed a settlement agreement providing for $225 million in immediate net refunds (and approximately $35 million in deferred refunds), as well as full releases between the parties. A346 (the "**FTB Settlement Agreement**") [D.I.11815-1]. This payment was the net result of the $400 million in refunds that the FTB agreed it owed to the Debtors, minus the settlement that the parties had reached on the FTB's proof of claim. Pedersen ¶ 27; Brouwer ¶ 38.

57. The settlement amount did not include a refund for the Treasury Interest Issue because the FTB refused to provide any value for that issue, and the Trust had then withdrawn that request without receiving anything in exchange from the FTB. Brouwer ¶ 39; Pedersen ¶ 28. The Trust also never "traded off" the issue to reduce any audit liability. *Id.*

H. After Settlement, Grant Thornton Contacts The Trust To Discuss Whether The Treasury Interest Issue Yielded Any Value

58. Shortly after the settlement, Grant Thornton held an internal meeting consisting of relationship partner Don Corbett, replacement partner Scot Grierson, and technician Paul Bogdanski to discuss Grant Thornton's entitlement to a fee. A473 (Corbett Dep.). Corbett was chosen to reach out to Brouwer due to their good relationship. A476 (Corbett Dep.).

59. At this internal meeting, Corbett learned that Grant Thornton's contingency fee was "to be paid based on the value brought by the Treasury Interes[t] idea." A480. Specifically, Grierson and Bogdanski told him that "they needed to figure out the impact the Treasury Interes[t] issue might have on the settlement." A477. If the issue provided no value, then there would be no contingency fee:

> I mean -- if -- if -- if there was no value, it would be difficult to think that there would be a fee.

A483 (Corbett).

60. After Grierson and Bogdanski explained to Corbett how the contingency fee worked, he called Brouwer to discuss the fee, businessperson to businessperson. Brouwer ¶ 40. In Brouwer's view, the Treasury Interest Issue provided no tangible value because the FTB had not conceded anything for it and the Trust had withdrawn it. But, because of his good relationship with Corbett, Brouwer was willing to entertain a discussion about value. *Id.* ¶ 41. For example, Brouwer was willing to entertain the theory that the FTB would have had to incur $1 million in costs to litigate the Treasury Interest Issue, and, therefore, the possibility that the issue added that much in value. *Id.*; A554 (Brouwer Dep.). The call ended with Brower agreeing that he would think about whether there was a basis for a fee. *Id.* In his view, any possible value that the Treasury Interest Issue provided would have been intangible and *de minimis*, given the FTB's consistent rejection, and the Debtors' withdrawal, of the claim. *Id.*

After this call, Corbett emailed Brouwer the following message:

> A few weeks ago we talked about the settlement with California, **and specifically what impact the Treasury Interest issue might have contributed to the overall success of the resolution**. You kindly suggested that you take some time to think about this further, and that maybe a follow up call in a few weeks would be appropriate…. I figure it might be time to schedule a call to discuss.

A362 (emphasis added). As is evident from this email, Corbett understood that any contingency fee was to be based on the value provided by the Treasury Interest Issue. Had Grant Thornton believed that it was entitled to 10% of all value, Grant Thornton simply would have demanded a maximum fee. Corbett did not do so. Nor did he ever suggest to Brouwer that Grant Thornton should receive a contingent fee based on *any* refund from the FTB—he wrote that the parties needed to determine what impact "*the treasury interest issue*" had on the settlement.

61. The parties held more calls about the fee in the summer of 2014. These were attended by Brouwer and Pedersen for the Debtors, and a combination of Corbett, Grierson, and Bogdanski for Grant Thornton. Brouwer ¶ 44. Brouwer asked Grant Thornton to explain how the Treasury Interest Issue could have yielded value. In September 2014, Corbett responded:

> I have circled the wagon with my team to discuss and consider what potential financial impact the Treasury Interest had on the California Settlement … **to identify a fair amount to compensate Grant Thornton for its efforts.**

A365 (emphasis added). As before, this email demonstrates that Corbett and his "team" (Grierson and Bogdanski) understood that the contingency fee was based on the value provided by the Treasury Interest Issue.

62. Over the next months, the parties continued their discussions on the premise that any fee would be based on the Treasury Interest Issue. Brouwer ¶¶ 42-47; Pedersen ¶ 29. In November 2014, Grant Thornton proposed a resolution: $1.23 million, which it calculated by taking roughly the total amount at issue under the Treasury Interest Issue ($41 million), multiplied by a 30% chance of success to reach a value of $12.3 million. A369. Grant Thornton then applied its 10% fee to this number to reach $1.23 million. *Id.* So, even as late as November 2014, the parties were discussing a resolution based on the impact of the Treasury Interest Issue only. The Debtors rejected the offer, because a withdrawn issue could not have yielded $12.3 million in value. Brouwer ¶ 47. In February 2015, after insisting on a seven-figure fee, Grant

Thornton commenced this contested matter. Brouwer ¶ 47.[3]

ARGUMENT

I. The Legal Standard

63. Under Bankruptcy Code § 328(a), the Court may alter compensation terms if they are improvident in light of unforeseeable circumstances:

> The trustee, … with the court's approval, may employ … a professional person … on any reasonable terms and conditions of employment … or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

11 U.S.C. § 328(a). By its terms, § 328(a) has two requirements: (1) the compensation must be improvident; and (2) the circumstances leading to this improvidence must have been unforeseeable at the time of retention. *Id.* When assessing foreseeability, the test is one of foresight, not hindsight. *In re Argose, Inc.*, 372 B.R. 705, 710 (Bankr. D. Del. 2007).

64. The distinction between foresight and hindsight is illustrated in the case law addressing contingency fees. If a debtor hires a contingency professional whose work yields an unexpected slam-dunk victory leading to a high fee, then courts typically do not alter the fee because a victory can be anticipated, even if the parties believed that the chances were slim. *See In re Merry-Go-Round Enters.*, 244 B.R. 327, 337 (Bankr. D. Md. 2000) (contingency fee counsel settled the case for $185 million even though the debtor initially believed the odds of success were "slim to none"; court approved 40% fee because the law firm hit a "home run" and it would be unfair to use the firm's success as a reason for depriving it of its fee).

[3] Federal Rule of Evidence 408 does not prohibit evidence of this settlement offer, because the Trust does not offer it to prove liability or amount (*i.e.*, the actual value of the Treasury Interest Issue). Rather, the Trust offers it to show that the parties were making offers to each other based on the Treasury Interest Issue. This is relevant to showing that both parties understood the final fee order the same way and thus that sanctions are inappropriate.

65. By contrast, courts have altered compensation terms where an event that the parties had no reason to anticipate rendered the compensation arrangement improvident. For example, in *Coho Energy*, the Fifth Circuit affirmed altering a contingency fee that was calculated based on a mistaken assumption. *Gibbs & Bruns LLP v. Coho Energy Inc. (In re Coho Energy Inc.)*, 395 F.3d 198, 204-05 (5th Cir. 2004). There, the debtor had replaced one contingency counsel with another, and arbitrated with the replaced counsel to determine its fee. The arbitrator awarded a $6 million fee based on the assumption that the case would have yielded $20 million in value to the estate. But, during arbitration, unbeknownst to the arbitrator, the case resolved for $8.5 million. So, when the replaced counsel moved the bankruptcy court to affirm the arbitrator's $6 million award, the court modified the firm's fees, and the Fifth Circuit affirmed, holding that the fee was based on a mistake that was not anticipatable:

> This shows that the arbitration panel was operating on the assumption that the total settlement would be $20 million. That the arbitration panel would be kept so ill-informed as to use figures two and a half times in excess of the actual amount qualifies as an unanticipatable development within the discretion of a bankruptcy court's finding of fact.

Id. at 205. In other words, at the time of retention, no party had any reason to anticipate that counsel would receive a 70% contingency fee ($6 million for an $8.5 million claim).

66. So too here. This is not a case like *Merry-Go-Round*, where the professional prevailed on its claim in a greater amount than anticipated; here, Grant Thornton would receive a fee for *not* prevailing, based on *unrelated issues*, contrary to everyone's expectations at the time, and contrary to industry norms. The parties could not anticipate that Grant Thornton's "contingency" fee was in actuality a non-contingent maximum fee.

II. The Engagement Agreement's Terms Are Improvident Due To Unforeseeable Circumstances

A. The Engagement Agreement's Terms Are Improvident Because Only One Outcome Was Possible: A Maximum Assured Fee

67. The Engagement Agreement as currently construed entitles Grant Thornton to 10% of any value received from the FTB, whether related to Grant Thornton's work or not. This is improvident because Grant Thornton earns a fee for refunds secured by other estate professionals that are unaffected by Grant Thornton's work. And, because these other refunds were so large in scope, the *only* potential outcome was a maximum fee to Grant Thornton. Grant Thornton had no risk of any other result—even if it had done no work on the Treasury Interest Issue, it still would have earned $5 million because the Debtors had such large, uncontroversial, unrelated refund claims against the FTB. In sum, under the Engagement Agreement as currently construed, Grant Thornton's contingency fee was not a contingency fee at all: it was risk-free payment of $5 million that was not tied to the work that Grant Thornton performed, or the benefits that the estate derived from that work.

68. Two brief examples demonstrate this. First, Grant Thornton does not dispute that the Debtors were entitled to $400 million in unrelated, uncontroversial refunds from the FTB. *Supra* pp. 9-11. Grant Thornton played no role in securing these refunds. Yet, since Grant Thornton's contingency fee as currently construed applies to all value received from the FTB, these unrelated refunds alone cause the fee to reach the $5 million cap eight times over. *See* Statement of Work, p. 4, ¶ 2 (A66) (providing that Economic Value will not be reduced by audit assessments); Brouwer ¶ 25(e) (discussing same provision).

69. Second, Grant Thornton contends that it should be entitled to bill a contingency fee for the FTB's reduction of its proof of claim from $2.4 billion to $280 million. *Supra* p. 11. In addition to being based on the false statement that Grant Thornton worked on the proof of

claim, this $2 billion in "value" causes Grant Thornton to hit its fee cap 40 times over!

70. "The bankruptcy code manifests a strong policy of maintaining jurisdiction and control over the payment of professionals' fees." *Gibbs & Bruns LLP v. Coho Energy Inc. (In re Coho Energy Inc.)*, 395 F.3d 198, 204 (5th Cir. 2004). Here, common sense and experience dictate that the Engagement Agreement's contingency fee, as construed, is neither fair nor acceptable, particularly in a bankruptcy case.

B. The Parties Could Not Anticipate That The Engagement Agreement Contained This Improvident Term Because They Each Reasonably Believed That The Engagement Agreement Provided For A More Limited Fee

71. The reason why the Engagement Agreement contained this improvident fee is because both parties believed that the Engagement Agreement provided for a more limited fee. The evidence above demonstrates that both parties read the agreement to mean that Grant Thornton would receive a fee only for the success of its work. *Supra* pp. 11-17. They may have been mistaken given how the agreement has since been construed, but, a contingency fee based on the success of unrelated arguments was so far beyond the parties' understanding of their engagement—and so contrary to industry norms—that neither party could have anticipated that the Engagement Agreement could be construed this way at the time. Pedersen ¶ 30; Brouwer ¶¶ 12, 24, 27. Certainly, Grant Thornton never read the Engagement Agreement this way. *See supra* pp. 13-17; A435 (Cleary: "Q: Was it your expectation that Grant Thornton would receive compensation in any way for the work that these other professionals were doing for WaMu? A: No".); A436 (Cleary: no expectation to be compensated for IRS adjustment refunds).

72. An analogy can be drawn to the doctrine of mistake, which provides that a contract term that mistakenly does not reflect the true agreement of the parties should be reformed if the mistake is mutual. *See Tex. E. Transmission Corp. v. McCrate*, 395 N.E.2d 624, 627-28 (Ill. App. 1979) (doctrine of mistake applies where "the parties came to an understanding

but in reducing it to writing, through mutual mistake … some provision agreed upon was not properly incorporated into the written instrument”).[4] Brouwer and Ryan agreed on a more limited fee and believed that the Engagement Agreement incorporated that agreement. *Supra* pp. 11-13. They read the agreement consistent with their belief, and acted consistent with that reading during the engagement. Because of this, they had no reason to believe that Grant Thornton could earn a broad fee for every California issue. Brouwer ¶¶ 24-27.

73. The Court’s ruling that the Engagement Agreement is unambiguous does not mean that the parties could simply “read the words” and discover the mistake, as Grant Thornton implies. The doctrine of mistake applies even to unambiguous contracts:

> It is well settled that the parol evidence rule is no bar to the admission of evidence on the question of mutual mistake, and this is so **even when the instrument to be reformed is clear and unambiguous on its face**. Thus, parol evidence may be used to show the real agreement between the parties when a mistake has been made and the evidence is for the purpose of making the contract conform to the original intent of the parties.

See In re Marriage of Johnson, 604 N.E.2d 378, 385 (Ill. App. 1992) (emphasis added). Under Grant Thornton’s theory, any party to an unambiguous contract could simply “read the words” to find the mistake, a result that would mean that no unambiguous contract could ever contain a mistake, in contradiction of Illinois case law. Grant Thornton itself never discovered the mistake during the engagement, as its professionals believed (*and continue to believe*) that the fee applies only to the Treasury Interest Issue. *Supra* pp. 13-17. For these reasons, the Court should conclude that the contingency fee is improvident, and that this improvidence was unforeseeable to the parties because of their mistaken belief that the Engagement Agreement accurately reflected their agreement. In 2009, no one had a basis to foresee what actually happened.

74. The Trust also incorporates its initial objection to the Motion, which contains

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[4] The Engagement Agreement is governed by Illinois law. *See* A72 at § 13(c).

additional improvidence arguments. D.I. 12008 at ¶¶ 56-61. There, among other things, the Trust argued that the death of the lead engagement partner Steve Ryan was unforeseeable. Grant Thornton's response is that death can be anticipated. But, under this reasoning, anything that actually happens can be anticipated. The death of the engagement partner in the midst of the engagement, when he had no apparent health problems, was not foreseeable to the parties. A559-560 (Brouwer Dep.). This unforeseeable event (among other things) led to Grant Thornton adopting a view of the engagement after-the-fact that is contradictory to the agreement reached by its engagement partner and that appears to be solely focused on the maximization of Grant Thornton's compensation from a client with whom it has no expectation of future work.[5]

[5] In a prior brief, Grant Thornton argued that, even though the parol evidence rule is inapplicable here, the Trust cannot introduce any evidence of post-Engagement Agreement statements, because the parol evidence rule applies only to contemporaneous and prior statements. D.I. 12207 at ¶ 15. This is a logical fallacy. The parol evidence rule, when it applies, bars prior and contemporaneous statements—but when it applies, it never bars subsequent statements. *Houck v. Martin*, 402 N.E.2d 421, 427 (Ill. App. Ct. 1980) ("[T]he parol evidence rule … prohibits introducing only prior or contemporaneous, not subsequent, agreements or discussions."). And, here it does not apply in the first place.

Grant Thornton also previously argued that the FTB Settlement Agreement and the parol evidence rule prevent the Trust from introducing any evidence of pre-settlement discussions with the FTB. D.I. 12020 at ¶ 14. But, the Trust does not offer these communications to interpret, vary, or contradict the FTB Settlement Agreement. Under California law, which governs the FTB Settlement Agreement (A356), the parol evidence rule bars the use of extrinsic evidence to "reconstruct the parties' contractual obligations." *Thomson v. Canyon*, 198 Cal. App. 4th 594, 608 (Cal. Ct. App. 2011). The rule does not apply if the evidence is used for a different purpose: "[a] contracting party may introduce parol evidence where, as here, the issue in dispute is not the legal obligations of the parties to the agreement." *Id.* The Court cited the following passage from Williston as instructive:

> it does not follow from the parol evidence rule that the written contract between two parties, which is conclusive as to them, must necessarily be conclusive as to the proof of any rights or claims either one of them may have against a third party merely because those claims grow out of the same transaction reflected in the written contract.

Id. (citation omitted). Here, the issue in dispute is not the legal obligations between the Trust and FTB; it is the value of the contingency fee under a completely separate contract, the Engagement Agreement. This may arise out of the same transaction as the FTB Settlement Agreement, but because the Trust does not offer the evidence to interpret that agreement, the parol evidence rule does not come into play.

C. Grant Thornton's Opposition Is Based On The False Premise That The Trust Is Re-Litigating The Meaning Of The Engagement Agreement

75. In its Supplemental Motion, Grant Thornton does not dispute the voluminous evidence demonstrating that everyone understood the fee to be based on the Treasury Interest Issue. Instead, Grant Thornton rests its entire argument on the false premise that the Trust offers this evidence to re-litigate the meaning of the Engagement Agreement. Grant Thornton appears to believe that any evidence of the parties' understanding *can only* relate to contract interpretation. Grant Thornton then relies on the Court's statements at the hearing denying Grant Thornton's discovery motion:

> THE COURT: All right. Let me just cut through this. I'm doing to deny the motion [to preclude discovery].
>
> MR. RAMOS: Mm hmm.
>
> THE COURT: I think it is relevant to the sanctions issue. But I'm not going to revisit my ruling that the agreement was not ambiguous.
>
> MR. RAMOS: Your Honor, and if I could just clarify, that's not our intent with respect to this issue.
>
> THE COURT: All right. Whether it's your intent or not, I'm not going to.
>
> MR. RAMOS: Mm hmm.
>
> THE COURT: So proceed and finish discovery and we'll have a hearing on whether it was improvidently granted or whether sanctions should be entered.

A423. The Court's statement that it would not revisit its ruling on contract interpretation does not preclude the Trust from introducing evidence of the parties' understanding to show mistake, for three reasons.

76. First, showing a mistake does not require the Court to interpret the Engagement Agreement; rather, it *depends* on the Court's prior interpretation. The Trust offers evidence of the parties' understanding not to establish the meaning of the Engagement Agreement, but to

show that the parties *believed* that the Engagement Agreement said something else, even if that belief was mistaken. Contrary to Grant Thornton's implicit assumption, a fact can be relevant to multiple issues. Here, evidence of the parties' understanding could relate to contract interpretation, but it separately relates to the distinct issue of mistake. This is why evidence of the parties' understanding is permissible to show mistake, even when an agreement is unambiguous—they are separate issues. *Supra* p. 30.

77. Second, Grant Thornton ignores the context of the Court's statements. Grant Thornton claims that the Court "eviscerated each of [the Trust's] asserted grounds for improvidence." Supp. Motion ¶ 21. But, the Court was not asked to make any findings on improvidence; this was a discovery ruling, and the Court denied Grant Thornton's motion. The Court did not "eviscerate" any improvidence arguments; instead, it directed the parties to "proceed and finish discovery and we'll have a hearing on whether it was improvidently granted…." A423. Thus, the Court did not decide mistake as Grant Thornton now implies.

78. Third, if Grant Thornton were to attempt to argue that the Trust should be precluded from demonstrating improvidence through mistake, Grant Thornton could not meet the legal standard. Grant Thornton would have to demonstrate that the Court already has decided this issue such that the doctrines of claim preclusion, issue preclusion, or law of the case apply. It has not tried to and cannot meet the elements of those doctrines, because in denying Grant Thornton's discovery motion, the Court did not rule upon whether the parties' mistaken construction of the Engagement Agreement is why they could not foresee that it provided for an improvident fee.

79. Grant Thornton separately notes that the Trust did not raise mistake as grounds for improvidence until after receiving written discovery. Grant Thornton has not argued that this

should be grounds for preclusion, but, if it attempts to raise this argument in its reply, then the Court should deny that attempt. The purpose of discovery was to develop facts supporting improvidence, so it is no surprise that the Trust's improvidence position has developed since its initial pre-discovery objection. Grant Thornton cannot claim that it is prejudiced or surprised by this: the Trust set forth its position in detail in its discovery objection [D.I. 12204] and amended its interrogatory responses to incorporate that objection. A505. Further, Grant Thornton asked to supplement its Motion, which has provided Grant Thornton with an opportunity to respond on the merits after full discovery. Thus, the Trust should not be precluded from supplementing its objection with a meritorious defense simply by virtue of not having had the evidence to raise it before discovery.[6]

III. The Treasury Interest Issue Yielded No Value

80. If the Court applies the contingency fee so that it is based on the value derived from the Treasury Interest Issue, then the Court may determine the value that the idea yielded. The record demonstrates none, because the FTB consistently rejected it and the Debtors conceded it before settlement without receiving anything in return.

81. When the Debtors filed the Treasury Interest Issue refund request, they asked for an approximately $42 million refund. Brouwer ¶ 29; Pedersen ¶ 16. But, from the outset of the parties' discussion with the FTB, Grant Thornton admitted to the FTB that the Debtors only expected "a percentage" of the refund request. *Supra* p. 19; A241 ("I view our discussion as an opportunity for California to limit its exposure to a percentage of what Washington Mutual has

[6] Grant Thornton also quotes the testimony of the Trust's 30(b)(6) witness listing the reasons for improvidence. Supplemental Motion 18-19. The deponent listed four reasons that encompassed the Trust's pre- and post-discovery positions. Grant Thornton does not appear to argue that the deponent left anything out. To the extent that Grant Thornton improperly attempts to argue this on reply, the deposition transcript demonstrates that the deponent summarized all of the bases for improvidence, including mistake. *See* A559 ("I would never ever have perceive Grant Thornton would file a claim to try to receive monies for work that didn't produce value from the other monies.").

attributed to this issue"). So, by its own admission, Grant Thornton knew (and created the circumstances for) the Treasury Interest Issue to yield less than the maximum refund.

82. Further, this attempt to settle did not prevail. The FTB's consistent substantive rejection of the Treasury Interest Issue led the Debtors (and then the Trust) to reduce the claim to $21 million to try to induce the FTB to offer some sort of concession. *Supra* pp. 21-22. When the Debtors (and the Trust) did this, the maximum benefit that the idea could have yielded fell to $21 million plus interest, as it remains unreasonable to assume that the FTB would pay more than asked. Grant Thornton cannot reasonably dispute this.

83. When the FTB rejected this offer too, the Trust chose to concede the issue rather than continue to press it, and the Trust told the FTB that it would stop seeking a refund for the Treasury Interest Issue. *Supra* pp. 22-23. As a result of this withdrawal, the Treasury Interest Issue did not yield value: (i) the FTB never offered anything for the Treasury Interest Issue up to the point where the Trust conceded it; (ii) the FTB did not give any value for the concession of the issue; and (iii) the FTB would have no reason to offer anything for the issue after it was conceded. Brouwer ¶ 39; Pedersen ¶ 28.

84. At times in this matter, Grant Thornton has implied (and testified) that the Treasury Interest Issue provided *over* $50 million in value in the form of leverage. According to Grant Thornton, the FTB did not want the Treasury Interest Issue to become public lest other taxpayers begin seeking similar refunds, and this leverage was so powerful that the FTB would have paid over $50 million to make the issue disappear. This is an unreasonable conclusion for four reasons.

85. First, this would mean the Treasury Interest Issue could yield more than 100 cents on the dollar. Grant Thornton's own contemporaneous statements belie the idea that it ever

believed that the Treasury Interest Issue could yield more than face value, since, from the very beginning of the parties' discussion, Grant Thornton was telling the FTB that the Debtors would accept a percentage of the amount that the Debtors claimed for the Treasury Interest Issue. *Supra* p. 19; A241 This is hardly a position that would be taken by someone who actually believed that the Treasury Interest Issue was intended to yield value on other issues, in more than its face amount.

86. Second, the Debtors conceded the claim, and a conceded claim provides no "leverage." The FTB offered no value for this concession. The record also is unrebutted that the Debtors did not "trade off" the Treasury Interest Issue to reduce some other issue. Brouwer ¶ 39; Pedersen ¶ 28.

87. Third, it is axiomatic that a rational actor would never pay more than the other party is willing to accept. Prior to conceding the issue, the Debtors/Trust were asking for $21 million. Grant Thornton's theory is premised on the unreasonable conclusion that the FTB could pay $21 million to fully resolve the issue, but would instead choose to offer tens of millions more. And, when the Trust conceded the issue, there likewise was no reasonable reason why the FTB would pay anything more than $0, which is what the Trust was then willing to accept. Pedersen ¶¶ 18, 28; Brouwer ¶ 39.

88. Fourth, the premise of Grant Thornton's "leverage" argument—that the FTB was afraid other taxpayers might learn of the Treasury Interest Issue if it became public—is faulty, because (i) the FTB's analysis rebutted the factual and legal analysis prepared by Grant Thornton, and (ii) the issue was already in the public domain. A discussion of the Treasury Interest Issue was included in the Trust's claim objection, which was a public filing. Moreover, the Debtors' substantial refund claims from the IRS adjustments were not controversial and did

not need "leverage." *Supra* pp. 9-11.

IV. Grant Thornton's Request For Sanctions Should Be Denied, Because The Final Fee Order Does Not Speak To The Contingency Fee's Amount, Which Was Disputed In Good Faith

89. To show an entitlement to sanctions, Grant Thornton must prove by clear and convincing evidence that the Trust knew of and disobeyed a valid court order. *See Mariner Health Grp., Inc. v. Mariner Health Care, Inc. (In re Mariner Post-Acute Network)*, 329 B.R. 481, 486 (Bankr. D. Del. 2005). A defendant should not be held in contempt where there are grounds to doubt the wrongfulness of his conduct. *Burtch v. Masiz (In re Vaso Active Pharm., Inc.),* 514 B.R. 416, 422 (Bankr. D. Del. 2014).

90. The order at issue here is the Court's final fee order. A287. That order approved the contingency fee generally, but without saying in what amount, or whether the contingency had occurred. A293 at n.3. The order could not have done so, because at the time, it was unknown whether the issue would prevail, and if so, in what amount.

91. The disagreement here was not whether a contingency fee existed, as recognized by the final fee order, but whether the contingency had been triggered, and if so, in what amount. The final fee order does not answer these questions. Because the final fee order did not address this issue, the Trust did not intentionally violate the order.

92. Grant Thornton argues that the Trust's understanding is so wrong that it cannot be in good faith, because the Trust could have simply read the fee order to see that it owed $5 million. But Grant Thornton read the order the same way as the Trust. *Supra* pp. 23-26. The parties' discussions about the contingency fee were based on the shared understanding that it applied to the Treasury Interest Issue, as reflected in three months of discussions between Brouwer and Corbett. *Id.* Grant Thornton even made a settlement proposal premised on this understanding. *Supra* p. 25. These facts—which Grant Thornton omits from its papers—belie

its suggestion that the Trust could have simply read the final fee order to see that it owed $5 million. Even Grant Thornton did not read the final fee order that way.

93. Further, a $5 million fee was impossible under the Engagement Agreement, given that the Treasury Interest Issue was a $42 million claim that the Debtors then reduced to $21 million, and ultimately to $0. *Supra* pp. 21-23. There is no reasonable basis to say that the issue somehow provided $50 million in value, as would be needed to support a $5 million fee. For these reasons, the Trust's resistance to paying $5 million was not sanctionable; it was consistent with its understanding of the parties' agreed terms as well as its duty to properly manage estate assets.

94. Indeed, if the Court were to consider an award of attorneys' fees and costs, then it should be against Grant Thornton. As a retained professional, Grant Thornton owes the Court a duty of candor. *See In re EWC, Inc.*, 138 B.R. 276, 279 (W.D. Okla. 1992) ("Because of the common fund nature of bankruptcy estates … professionals performing duties for the estate are held to high fiduciary standards, and act as officers of the court."); *In re Kelsey*, 2001 WL 34050736, at *4 (Bankr. D. Vt. Oct. 23, 2001) (officer of court owes duty "of complete candor"; "This Court expects candor from counsel and parties that appear before it and will not countenance attempts to conceal or camouflage material facts or law pertinent to pending matters"). And, because this is a fee matter, the Court has the special authority to "protect the estate, lest overreaching attorneys or other professionals drain it of wealth which by right should inure to the benefit of unsecured creditors." *In re APW Enclosure Sys., Inc.*, 2007 WL 3112414, at *2 (Bankr. D. Del. Oct. 23, 2007). By ignoring its knowledge and closing its eyes to the testimony of its own professionals, Grant Thornton asserts a position that it knows does not reflect its true view of the engagement, and it does so for the purpose of securing a higher fee

than agreed upon by the parties and presented by them for Court approval. Grant Thornton likewise misrepresented the scope of its work to the Court by stating that it worked on every issue in California, creating a misleading impression that it should be paid regardless of the Treasury Interest Issue's success. *Supra* p. 17. In the special arena of professional compensation, where Grant Thornton stands in the position of an officer of the Court, that is regrettable. The Trust has had to incur significant expenses in defending against this action. As a result, if the Court finds it appropriate, the Court should order Grant Thornton to pay the Trust's attorneys' fees and costs, to put the estate back in the position it would have occupied had Grant Thornton not commenced this litigation under the pretense of an argument that was not supported by its own contemporaneous understandings.

95. Finally, this brief assumes that the Court will not revisit its prior ruling on the proper interpretation of the Engagement Agreement. But, if the Court relied on Grant Thornton's misrepresentations about the scope of its work in reaching its prior ruling, or if the Court otherwise finds it appropriate, the Court has the power to revisit that prior ruling if it so chooses. Because the Court rendered its ruling from the bench and has not yet entered an order in this matter, the ruling remains interlocutory and may freely be revisited as justice requires. *See Martin v. Port Auth. Transit of Allegheny Cty.*, 115 F. App'x 556, 560 (3d Cir. 2004) ("Interlocutory orders remain open to reconsideration and do not constitute the law of the case"); *see also* Fed. R. Civ. P. 60(b) Advisory Committee Notes to 1946 amendment (interlocutory orders "are left subject to the complete power of the court rendering them to afford such relief from them as justice requires."). Accordingly, if the Court desires, it can amend its prior ruling on the interpretation of the Engagement Agreement—although it need not do so, and may instead find that the agreement as construed is improvident.

CONCLUSION

The Trust respectfully requests that the Court make the following findings based on the undisputed record, deny the Motion and Supplemental Motion, enter judgment for the Trust, and grant such other relief as it deems appropriate:

a. The terms of Grant Thornton's engagement are improvident, including because by receiving a contingency fee for all value received from the FTB regardless of source, Grant Thornton received a guaranteed non-contingent fee in the maximum amount, risk free. This improvidence arose from an unforeseeable circumstance: This fee was contrary to the parties' expectations and industry norms, and the parties both believed that the Engagement Agreement already provided for the more limited fee, so could have no reason to anticipate that the agreement provided differently.

b. Grant Thornton only should be compensated under the contingency fee for the value yielded by the Treasury Interest Issue alone, as the parties intended and believed throughout the engagement. The FTB repeatedly rejected the Treasury Interest Issue, and the Debtors withdrew the treasury interest refund request. Accordingly, it provided no recovery that could serve as the basis for a contingency fee.

c. Sanctions against the Trust are denied, and Grant Thornton must pay the Trust's attorneys' fees and costs in having to defend this matter.

[*Signature page follows*]

Dated: February 9, 2017
Wilmington, Delaware

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CERTIFICATE OF SERVICE

On February 9, 2017, I caused a copy of the following documents to be served on the parties listed below.

Documents Served

- WMI Liquidating Trust's Supplemental Objection to Grant Thornton's Motion for Sanctions.
- Declaration of Curt Brouwer.
- Declaration of Brian Pedersen.
- WMI Liquidating Trust's Appendix in Support of Supplemental Objection to Grant Thornton's Motion for Sanctions.

By email and hand delivery:	By email and U.S. first class mail:
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