The Honorable Marsha J. Pechman

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

THE FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER OF WASHINGTON MUTUAL BANK, Plaintiff, v. KERRY K. KILLINGER, STEPHEN J. ROTELLA, DAVID C. SCHNEIDER, LINDA C. KILLINGER, and ESTHER T. ROTELLA, Defendants.	Case No. 2:11-cv-00459 MJP STEPHEN J. ROTELLA AND DAVID C. SCHNEIDER'S MOTION TO DISMISS NOTE ON MOTION CALENDAR: September 15, 2011 ORAL ARGUMENT REQUESTED

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Defendants Stephen J. Rotella and David C. Schneider (together, "Defendants") respectfully move pursuant to Federal Rule of Civil Procedure 12(b)(6) and Local Civil Rule 7 to dismiss Counts I-III, V and VI of the Complaint (Doc. No. 1) ("Complaint" or "Compl.") of the Federal Deposit Insurance Corporation, as Receiver for Washington Mutual Bank ("FDIC").

PRELIMINARY STATEMENT

This lawsuit amounts to a pure public relations stunt designed to deflect criticism away from the FDIC, which has been—and continues to be—under fire for its regulatory failures with respect to WaMu and refuses to take any responsibility for its central role in the financial crisis. In March 2011, ***two and a half years*** after Washington Mutual Bank was seized, the FDIC filed its politically-motivated complaint purporting to stand in the shoes of a bank that no longer exists and whose assets the FDIC hastily and improvidently sold off without regard to the impact on creditors, shareholders, employees, or the Seattle economy. The same day the FDIC wiped out more than $7 billion in shareholder equity, the FDIC issued a press release declaring that its fire sale of WaMu's banking operations to JPMorgan Chase for $1.9 billion ensured that "neither the uninsured depositors nor the insurance fund absorbed any losses."[1] The reckless and widely-criticized seizure and sale of a well-capitalized bank with $29 billion in net liquidity had catastrophic effects on Seattle's local economy and thrust Washington Mutual into bankruptcy. Despite the FDIC's role in causing staggering losses to creditors, shareholders, and employees it has inserted itself at the eleventh hour into the WaMu-related director and officer litigation under the pretext of seeking to recover unspecified losses for unidentified creditors.

Despite exhaustively investigating the former Washington Mutual officers for over two years at enormous taxpayer expense—with complete and unfettered access to Washington Mutual's books and records (but without ***ever*** asking to interview the officers themselves), and with an obvious agenda to find scapegoats—the FDIC alleges no fraud, no intentional

[1] FDIC, *JPMorgan Chase Acquires Banking Operations of Washington Mutual*, Press Release, Sept. 25, 2008, http://www.fdic.gov/news/news/press/2008/pr08085.html (last visited June 14, 2011).

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wrongdoing, no bad faith, and no corporate looting. Rather, the FDIC simply contends that Messrs. Rotella and Schneider were "negligent" in executing their duties during their relatively brief careers at WaMu. With the benefit of hindsight, the FDIC criticizes statements made in a handful of emails, memoranda and presentations and surmises that the officer defendants negligently pursued a high-risk strategy—one sanctioned by the FDIC itself at all times relevant to this lawsuit—that resulted in significant losses to WaMu.

Leaving aside the obvious impropriety of the FDIC's shameless blame-shifting exercise, the Court should dismiss the FDIC's Complaint for the following reasons:

First, the FDIC is looking back on the country's worst economic crisis since the Great Depression in search of anyone other than itself to blame and improperly attacking Defendants' good faith business decisions. "Business decision-makers must operate in the real world, with imperfect information, limited resources, and an uncertain future." *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 126 (Del. Ch. 2009). In these circumstances, based upon the allegations in the Complaint, Washington's business judgment rule mandates dismissal. Indeed, from 2004 until 2008, neither the FDIC nor the OTS raised any significant concerns about WaMu. The FDIC knew in the Summer of 2004 (before the 2005 arrivals of Messrs. Rotella and Schneider at WaMu) that WaMu's Board of Directors reviewed and later approved a five-year strategic plan pursuant to which WaMu intended to implement a higher risk mortgage loan strategy. Neither the FDIC nor the OTS questioned this strategy; in fact, both agreed with the OTS's "fundamentally sound" rating of WaMu until July 2008—just two months before WaMu was seized.[2] The high-risk lending strategy that the FDIC now decries is the very lending strategy that the federal government promoted through the "government-sponsored" secondary market for subprime loans that the Government-Sponsored Enterprises (Fannie Mae and Freddie

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[2] *See* Office of Inspectors General, Department of the Treasury and Federal Deposit Insurance Corporation, *Evaluation of Federal Regulatory Oversight of Washington Mutual Bank*, EVAL 10-002 (April 2010) ("OIG Report") at 45, http://fdicoig.gov/reports10%5C10-002EV.pdf (last visited June 16, 2011).

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Mac) in large part created. It is also the lending strategy that the OTS, WaMu's primary regulator, ***and*** the FDIC countenanced throughout the relevant time period. In these circumstances, where high-profit, high-risk lending was effectively a government-sponsored lending strategy for a government-sponsored market, the FDIC cannot establish that Defendants acted with negligence—much less gross negligence. During the limited time Messrs. Rotella and Schneider worked at WaMu, the FDIC—like many others—failed to foresee the depth or severity of the looming financial crisis. Indeed, "FDIC examiners explained that no one could have predicted the precipitous fall in home prices and the complete shut-down of the secondary market."[3]

Second, the FDIC's causation allegations do not pass muster under *Twombly* and *Iqbal*'s "plausibility" requirement given that the FDIC has alleged in separate, later-filed federal lawsuits that the ***real*** cause of the losses in the Bank's held-for-investment portfolio was the gross negligence of two appraisal companies, eAppraiseIT and LSI. Just weeks after filing this action, the FDIC filed two lawsuits in the Central District of California alleging that the Bank's outside appraisal companies proximately caused the same losses that the FDIC alleges the officer defendants supposedly caused. *See FDIC v. Corelogic Valuation Servs., LLC*, No. SACV11-704 DOC (ANx) (C.D. Cal. May 9, 2011); *FDIC v. LSI Appraisal, LLC*, No. SACV11-706 JST (MLGx) (C.D. Cal. May 9, 2011) (the "Appraisal Vendor Lawsuits"). The FDIC's assertion that the appraisal companies' superseding acts caused the losses here is fatal to the FDIC's claims. And, the FDIC's contradictory causation allegations cannot be accepted as true.

Finally, the FDIC has failed to make any particularized allegations under Rule 9(b) of the Federal Rules of Civil Procedure that would transform the Rotellas' ordinary financial planning into fraudulent conveyances. The truly commonplace estate planning measure of putting a home

[3] Hearing on *the Role of Regulators in Exercising Their Supervision of Washington Mutual Bank from 2004–2008*: Hearing before the Perm. Subcomm. On Investigations of the Committee on Homeland Security and Governmental Affairs of the U.S. Senate, 111th Congress, Statement of Jon T. Rymer, Inspector General, FDIC (April 16, 2010) at 10, http://www.fdicoig.gov/testimony/T10-01_04-16-10.shtml (last visited June 16, 2011).

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into a qualified trust, for example, hardly rises to the level of a fraudulent conveyance. That there were pending lawsuits against Mr. Rotella at the time of the alleged transfers is of no moment given that—as the FDIC knows—Mr. Rotella was protected at all times both by directors and officers insurance as well as an indemnification agreement with Washington Mutual. And the meritless claims the FDIC is asserting against Mrs. Rotella (who is separately moving to dismiss for lack of personal jurisdiction) and Mrs. Killinger demonstrate the *in terreroem* purpose of this lawsuit.

Accordingly, the Court should dismiss the Complaint in its entirety.

FACTUAL BACKGROUND

A. During the Relevant Time Period, Neither the FDIC Nor the OTS Raised Any Red Flags about WaMu

As WaMu's federal regulators, the FDIC and OTS oversaw the bank. Unlike Messrs. Rotella and Schneider, who did not join WaMu until January 2005 and August 2005, respectively (*see* Compl. ¶¶ 15, 16), the FDIC and OTS knew in the Summer of 2004 that the WaMu Board of Directors reviewed and later approved a five-year plan guiding WaMu to undertake a higher risk business strategy. (*See* Compl. ¶¶ 22–25.) Although the FDIC now vigorously takes issue with the five-year plan, at the time the plan was conceived and approved, neither the FDIC nor the OTS questioned this strategy. In fact, both the FDIC and the OTS agreed that WaMu deserved a "fundamentally sound" rating until July 2008—just two months before WaMu was seized. (*See* OIG Report, *supra* note 2, at 45 ("FDIC did not challenge the OTS CAMELS composite rating for WaMu in any year except for the composite 3 rating assigned by OTS in July 2008. FDIC did not challenge those prior ratings… because FDIC believed the CAMELS composite ratings were appropriate.").)

The following chart shows the OTS's "CAMELS" ratings of WaMu since 2003—well before the five-year plan was approved—and illustrates that the five-year plan did not affect the rating. The composite ratings range on a scale from 1 (best) to 5 (worst), and reflect the agency's assessment according to the following definitions: 1=Sound in every respect;

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2=Fundamentally Sound; 3=Exhibits some degree of supervisory concern in one or more of the component areas (*i.e.*, capital adequacy, asset quality, management, earnings, liquidity, sensitivity to market risk); 4=Generally exhibits unsafe and unsound practices or conditions; 5=Exhibits extremely unsafe and unsound practices or conditions; exhibits a critically deficient performance; often contains inadequate risk management practices relative to the institution's size, complexity, and risk profile; and is of the greatest supervisory concern. (*See Uniform Financial Institutions Rating System*, http://www.fdic.gov/regulations/laws/rules/5000-900.html at 16; 62 Fed. Reg. 752, 753 (Jan. 6, 1997).)

Report Transmittal Date	Capital Adequacy	Asset Quality	Management	Earnings	Liquid Assets	Sensitivity to Risk	Composite Rating
8/22/2003	2	2	2	2	2	3	2
9/13/2004	2	2	2	2	2	3	2
8/29/2005	2	2	2	2	2	2	2
8/29/2006	2	2	2	2	2	2	2
9/18/2007	2	2	2	2	1	2	2
2/27/2008	2	3	2	4	3	2	3
6/30/2008	3	4	3	4	3	2	3
9/19/2008	3	4	3	4	4	2	4

In addition, the FDIC assigned its own CAMELS rating to WaMu. (*See Wall Street & the Financial Crisis: Anatomy of a Financial Collapse*, Staff Report by the Perm. Subcomm. on Investigations of the Comm. on Homeland Sec. & Governmental Affairs of the U.S. Senate, Apr. 13, 2011, at 37, http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf (last visited June 16, 2011).) But it was not until September 18, 2008 that the FDIC independently downgraded the bank for the first time. (*Id.* at 229.) As the OIG report explained, "WaMu remained in the highest-rated (lowest-risk) deposit insurance risk category from January 2003 until December 2007 and in the second highest-rated deposit insurance category from March to ***June 2008***. FDIC monitoring did not influence WaMu's deposit insurance risk category because the risk category was based on WaMu's consistent CAMELS composite 2—'fundamentally sound'—rating and WaMu's regulatory capital level." (OIG Report, *supra* note

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2, at 36.) Thus, the FDIC did not foresee the looming financial meltdown when it was WaMu's regulator—but has filed a complaint predicated on the fanciful notion that Defendants were negligent because they should have predicted what the FDIC did not.

B. The FDIC Intervenes to the Detriment of Shareholders, Creditors, Employees, and the Seattle Economy

During the country's financial meltdown, WaMu faced repeated runs on deposits and in early September 2008, the FDIC—through Chairman Sheila Bair—gave WaMu until September 30, 2008 to find a buyer for the bank. (*See* Kirsten Grind, *The Downfall of Washington Mutual*, Puget Sound Bus. Journal, Sept. 27, 2009, http://www.bizjournals.com/seattle/stories/2009/09/28 /story1.html (last visited June 28, 2011) ("Sept. 27 PSBJ").) In the following weeks, WaMu's management worked tirelessly to find a possible buyer—shopping the bank on the East Coast, and inviting potential buyers to WaMu's headquarters in Seattle to pore over the bank's books. (*Id.*) During this time, the FDIC undercut WaMu's efforts to sell the bank in an open-market transaction. (*Id.*) The FDIC began to secretly solicit bids—a clear sign to potential buyers that seizure was imminent and a signal they could obtain the bank at a bargain price rather than a more lucrative private sale price. (*See* Kirsten Grind, *The Washington Mutual Decision*, Puget Sound Bus. Journal, Dec. 6, 2009, http://www.bizjournals.com/seattle/stories/2009/12/07/ story1.html (last visited June 28, 2011) ("Dec. 6, 2009 PSBJ"); Heidi N. Moore, *How J.P. Morgan Raised $11.5 Billion in 24 Hours*, Wall Street Journal, Sept. 29, 2008, Wall Street Journal, http://blogs.wsj.com/deals/2008/09/29/how-jp-morgan-raised-115-billion-in-24-hours/ (last visited June 29, 2011); Dealbook, *WaMu Fails, and JPMorgan Steps In*, N.Y. Times, Sept. 26, 2008, http://dealbook.nytimes.com/2008/09/26/jpmorgan-buys-wamu-assets-after-government-seizure/?pagemode=print (last visited June 29, 2011).) The FDIC's actions undermined any ability of WaMu management to preserve shareholder value by independently selling the bank. Despite Ms. Bair's stated deadline of September 30, the FDIC and OTS entered WaMu's headquarters on the evening of September 25, 2008, seized the bank, and choreographed the sale of WaMu to JPMorgan Chase & Co. the same evening. (Sept. 27 PSBJ.)

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The FDIC's premature actions wiped out $7 billion in shareholder equity, created the very creditors it now purports to represent, and imposed thousands of job losses and significant economic hardship in the Seattle area. (Dec. 6, 2009 PSBJ.) If the FDIC had not undermined WaMu's efforts to sell the bank, these damages would have been significantly reduced—if not eliminated.

More fundamentally, the FDIC's actions took place despite the fact that WaMu's liquidity and capital thresholds remained well above the levels typically required for seizure. (*Id.*) For example, a bank is considered in danger of being seized if its net liquidity dips below 5% of total assets. (*Id.*) WaMu had $29 billion in net liquidity—about 9.4% of assets and nearly twice the closure threshold on the day it was seized. (*Id.*) Likewise, WaMu's capital exceeded all regulatory minimums. (*Id.*) Its leverage ratio stood at 7.66% of total assets while regulators consider a level of 5% to be well-capitalized. (*Id.*; 12 C.F.R. § 325.103(b) (2011).)

C. The FDIC Files Its Complaint Two-and-a-Half Years Later

The FDIC's 215-paragraph Complaint spends a paltry 11 paragraphs addressing specific acts by Mr. Rotella and 15 paragraphs addressing specific acts by Mr. Schneider. Elsewhere, the FDIC makes broad claims against all three defendants collectively and fails to differentiate what purportedly wrongful acts each committed. (*See, e.g.*, Compl. ¶¶ 1 ("their negligence . . ."); 2, 8, 182, 184, 185, 188–190, 193 ("Killinger, Rotella, and Schneider . . . "); 2, 3, 5–12, 57, 70, 86, 88, 90, 91, 93, 95, 96, 98, 100, 103, 107, 116, 119, 136, 141, 142, 153, 155, 156, 161, 165, 170, 176, 177, 180, 186, 191, 194–196 ("Defendants . . . "); 4, 72, 88, 99, 109, 137, 138, 143–145, 148, 151, 152, 157, 157, 166, 169, 171, 174 ("WaMu . . . "); 7 ("They . . .."); 26–27, 29, 31–32, 44–45 ("Killinger and Rotella . . .").) The allegations specific to Messrs. Rotella and Schneider merely establish that they kept the Board apprised of their activities, continually assessed risks, carried out their duties, and attempted to survive the financial crisis.

With respect to the FDIC's fraudulent conveyance claim against the Rotellas, the FDIC alleges that in early 2008, Mr. and Mrs. Rotella transferred their interest in their home to trusts bearing their own names. (Compl. ¶ 204.) The FDIC's allegations do not explain how this

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common financial planning tool amounts to fraud. And, with respect to Mrs. Rotella in particular, the FDIC does not plead any facts that explain how a transfer by Mrs. Rotella (who the FDIC does not claim to be an FDIC creditor) of her unknown—and not described—interest in the residence to the Esther T. Rotella QPRT 2008 Trust can be a fraudulent conveyance.

The FDIC concedes the remaining fraudulent conveyance allegations lack any factual basis as the FDIC makes these allegations of fraud "on information and belief." (*See* Compl. ¶ 205.) The FDIC's allegation "[o]n information and belief, Stephen Rotella transferred in excess of one million dollars to Esther Rotella after WaMu failed in September 2008" (*id.*), fails to set forth the "what," "when," and "how" of the purported fraud.

D. The FDIC Files the Appraisal Vendor Lawsuits

On May 9, 2011, the FDIC filed the Appraisal Vendor Lawsuits against eAppraiseIT and LSI. These complaints are attached hereto as Exhibits A and B, respectively, and Defendants respectfully request that the Court take judicial notice of the allegations pled by the FDIC pursuant to Rule 201 of the Federal Rules of Evidence.

In the Appraisal Vendor Lawsuits, the FDIC alleges that ***unbeknownst to WaMu***—and the Defendants here—eAppraiseIT and LSI were grossly negligent in conducting appraisals for WaMu, resulting in substantially inflated appraised values. (Ex. A ¶ 3; Ex. B ¶ 3.) The FDIC also alleges that the appraisal companies breached their contracts with WaMu by failing to follow federal and state law, regulatory guidelines, and the Uniform Standards of Professional Appraisal Practice ("USPAP") in performing their appraisal function. (*Id.*)

According to the Appraisal Vendor Lawsuits, eAppraiseIT and LSI engaged in the following grossly negligent conduct resulting in artificially inflated appraisals: (1) use of improper comparables; (2) failure to include adequate comparables; (3) failure to disclose prior sales history; (4) failure to perform site visits; (5) use of appraisers unfamiliar with the area; (6) failure to identify information obtained from interested parties; (7) use of improper factors that impact value; (8) failure to consider factors that impact value; (9) failure to address long unsold listing periods; and (10) inadequate or improper licensing of appraisers. (*See* Ex. A ¶ 43;

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Ex. B ¶ 43.) In turn, the FDIC alleges WaMu relied on those grossly-inflated appraisals when it provided mortgage loans to borrowers and was forced to charge-off portions of those loans when borrowers subsequently defaulted. (Ex. A ¶¶ 31, 33–34; Ex. B ¶¶ 30, 32–33.)

The FDIC's complaints against eAppraiseIT and LSI demonstrate conflicting theories of fault for WaMu's alleged damages. The FDIC claims WaMu relied upon appraisals performed by LSI and eAppraiseIT for loans WaMu held for investment rather than selling into the secondary market—the same portfolio the FDIC targets in the instant suit. (*Compare* Compl. ¶ 2 *with* Ex. A ¶ 3 and Ex. B ¶ 3.) The FDIC claims that "but for" the inflated appraisal services provided by LSI and eAppraiseIT (and corresponding breaches of contract), WaMu would not have made the residential mortgage loans at issue and would not have suffered losses on those loans. (Ex. A ¶ 3:13, 12:16–17; Ex. B ¶ 3:11, 12:21–22.) The FDIC further claims that it was clearly foreseeable to eAppraiseIT and LSI that WaMu would incur losses on loans made in reliance on the inflated appraisals. (Ex. A ¶ 3; Ex. B ¶ 3.)

The FDIC calculates that as a direct and proximate result of eAppraiseIT's and LSI's gross negligence, WaMu suffered damages in the amount of at least $129,102,303.77 and $154,519,071.10, respectively. (Ex. A ¶ 45, 18:4-5; Ex. B ¶ 45, 17:24-25). The FDIC also claims that as a direct and proximate result of eAppraiseIT's and LSI's breaches of their respective agreements, WaMu suffered damages in the amount of at least $113,140,271.76 and $146,168,762.34, respectively. Finally, the FDIC states that it bases its complaints on mere "samples" of a few hundred of the hundreds of thousands of appraisals eAppraiseIT and LSI performed—specifically, 259 of the 260,000 eAppraiseIT appraisals and 292 of the 386,000 LSI appraisals provided to WaMu. (Ex. A ¶¶ 26, 31; Ex. B ¶¶ 28, 30.) Incredibly, the FDIC alleges 97% of the appraisals contained USPAP violations and 75% of the appraisals "contained multiple egregious violations of USPAP and appraisal industry standards." (*See* Ex. A ¶ 31; Ex. B ¶ 30.) Thus, once the FDIC analyzes the remaining 259,741 eAppraiseIT appraisals and the 385,708 LSI appraisals, it will likely seek billions of dollars in damages.

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LEGAL STANDARD

Federal Rules of Civil Procedure 8(a)(2) and 12(b)(6) govern motions to dismiss for failure to state a claim upon which relief can be granted. A complaint must allege enough facts to state a claim to relief that is plausible on its face. *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570 (2007). To avoid dismissal, a complaint must contain more than a "formulaic recitation of the elements of a cause of action;" it must contain factual allegations sufficient to "raise a right to relief above the speculative level." *Id.* at 555. "The pleading must contain something more . . . than . . . a statement of facts that merely creates a suspicion [of] a legally cognizable right of action." *Id.* (citation omitted). The Court need not accept conclusory allegations in the complaint as true; rather, it must "examine whether [they] follow from the description of facts as alleged by the plaintiff." *Holden v. Hagopian*, 978 F.2d 1115, 1121 (9th Cir. 1992).

Where a plaintiff alleges fraud, Rule 9(b) of the Federal Rules of Civil Procedure requires the plaintiff to plead "particularized allegations of the circumstances constituting fraud." *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1547 (9th Cir. 1994) (superseded by statute on other grounds). *See also Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1125 (9th Cir. 2009) (finding that any claim "grounded in fraud," even where fraud is not a necessary element of the claim, "must satisfy the particularity requirement of Rule 9(b)); *In re Daisy Sys. Corp.*, No. C-92-1845-DLJ, 1993 WL 491309, *9 (N.D. Cal. Feb. 3, 1993) (applying Rule 9(b) to fraudulent transfer claim). The purpose of Rule 9(b) is to ensure a defendant has adequate notice of the "precise misconduct" with which it is charged and safeguard its reputation and goodwill from groundless accusations of fraud. *See, e.g., Bly-Magee v. Cal.*, 236 F.3d 1014, 1018 (9th Cir. 2001) (affirming the lower court's dismissal of *qui tam* claims because they contained only conclusory assertions without supporting factual allegations). Thus, "[t]o allege fraud with particularity, a plaintiff must set forth more than the neutral facts necessary to identify the transaction," it must set forth specific facts demonstrating what is fraudulent about the transaction and why it is fraudulent. *In re GlenFed.*, 42 F.3d at 1548. In the context of a fraudulent transfer claim, failure to allege "how" or "under what conditions" the transfer occurred is a fatal pleading defect under

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Rule 9(b). *In re Daisy*, 1993 WL 491309, at *11; *see Global View Ltd. Venture Capital v. Great Cent. Basin Exploration, L.L.C.*, 288 F. Supp. 2d 473, 479 (S.D.N.Y. 2003) (fraudulent conveyance claim should allege the specifics of the purported fraud including the time and amount of transfer, the identification of what was transferred, and how the transfer occurred).

ARGUMENT

I. THE FDIC'S COMPLAINT FAILS TO STATE A NEGLIGENCE-BASED CLAIM AGAINST DEFENDANTS

A. Washington's Business Judgment Rule Insulates Officers from Lawsuits Attacking Allegedly Mistaken but Good Faith, Informed Business Decisions

"Business decision-makers must operate in the real world, with imperfect information, limited resources, and an uncertain future." *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 126 (Del. Ch. 2009). The corporate officer's function "is to encounter risks and to confront uncertainty, and a reasoned decision at the time made may seem a wild hunch viewed years later against a background of perfect knowledge." *Joy v. North*, 692 F.2d 880, 886 (2d Cir. 1982). The "circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later," and thus "a corporate officer who makes a mistake in judgment as to economic conditions" will "rarely, if ever, be found liable for damages suffered by the corporation." *Id.* at 885-86. Accordingly, "[c]ourts are reluctant to interfere with the internal management of corporations and generally refuse to substitute their judgment for that of the directors." *Nursing Home Bldg. Corp. v. DeHart*, 13 Wn. App. 489, 498, 535 P.2d 137, 143 (1975) (explaining that business judgment rule "immunizes" management from liability for good faith decisions).

Washington courts "review business decisions under the business judgment rule and infrequently reverse a business decision." *Lane v. City of Seattle*, 164 Wn. 2d 875, 885, 194 P.3d 977, 979 (2008). Under the business judgment rule, corporate officers cannot be held liable "for mere mistake or errors of judgment . . . when they act without corrupt motive and in good faith." *DeHart*, 13 Wn. App. at 498-99, 535 P.2d at 144 (citation and internal quotation marks omitted). This is true even if the errors are "so gross that they may demonstrate the unfitness of the

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directors to manage the corporate affairs." *Id.* at 499, 144 (citation and internal quotation marks omitted). The business judgment rule applies to both directors and officers of a corporation. *Para-Med. Leasing, Inc. v. Hangen*, 48 Wn. App. 389, 395, 239 P.2d 717, 721 (1987); *Grassmueck v. Barnett*, No. C03-122P, 2003 WL 22128263, at *3 (W.D. Wash. July 7, 2003) (Pechman, J.).

The business judgment rule permits liability only if management reached its decision in bad faith or made an uninformed decision. "Absent a showing of fraud, dishonesty, or incompetence, it is not the court's job to second-guess the actions of directors." *Schwarzmann v. Ass'n of Apt. Owners*, 33 Wn. App. 397, 403, 655 P.2d 1177, 1181 (Wash. Ct. App. 1982). *See also Riss v. Angel*, 131 Wn. 2d 612, 632, 934 P.2d 669, 681 (1997) (courts will not substitute judgment for that of management absent fraud, dishonesty, or incompetence); *In re Spokane Concrete Prods., Inc.*, 126 Wn. 2d 269, 279, 892 P.2d 98, 104 (1995) (same); *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 66 (Del. 1989) (requiring failure "to act in an informed manner" to overcome business judgment rule).

B. The Allegations in the Complaint Fall Well within the Protection of the Business Judgment Rule

The FDIC's Complaint against Mr. Rotella and Mr. Schneider for gross and ordinary negligence fail as a matter of law. Specifically, the FDIC's Complaint contains ***no*** allegations that Rotella and Schneider acted in bad faith or were uninformed; instead, it attacks Messrs. Rotella's and Schneider's historical business decisions—and the business judgment rule insulates them against such allegations. *See supra*, Section I.A. Indeed, the FDIC alleges WaMu's credit risk managers regularly ***informed*** Mr. Rotella and Mr. Schneider of the risks associated with the business strategy. (*See, e.g.*, Compl. ¶¶ 27-30, 39, 44, 47, 51, 58, 85.) The Complaint further alleges that Mr. Rotella and Mr. Schneider weighed those risks against the potential returns for shareholders and determined to continue with the business strategy despite the known risks. (*Id.* ¶¶ 48, 113 (alleging Mr. Rotella identified a "laundry list of risk factors that WaMu faced" in December 2005); *id.* ¶ 105 (alleging Mr. Rotella was "worried" about taking on more credit risk

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"if a credit downturn occurred"); *id.* ¶ 67 (alleging Mr. Schneider "advocated for continued focus on subprime originations" even though the subprime market "experienced a market correction"); *id.* ¶ 73 (alleging Mr. Schneider thought "[c]urrent mortgage market conditions" presented an "opportunity" to gain a "competitive advantage and add higher quality assets at attractive risk adjusted returns"); *id.* ¶ 74 (alleging Mr. Schneider saw "[o]pportunities to grow" by "applying risk-based pricing and economic capital").)

Because the Complaint contains no allegations that Messrs. Rotella or Schneider acted in bad faith or without knowledge of the risks in reaching their decisions, the business judgment rule shields them from liability. The Court should dismiss the negligence-based claims.

II. THE FDIC CANNOT ADEQUATELY ALLEGE THAT THE DEFENDANTS' CONDUCT PROXIMATELY CAUSED THE BANK'S FAILURE

In its Complaint, the FDIC contends Defendants caused Washington Mutual Bank to incur losses as a result of their purported focus on higher risk products. *See id.* ¶¶ 175-177. In the Appraisal Vendor Complaints filed less than two months later, the FDIC pled that WaMu's outside appraisal vendors engaged in grossly negligent conduct resulting in artificially inflated appraisals and that "***[b]ut for*** the inflated appraisal services by [eAppraiseIT and LSI], WaMu would not have made the residential mortgage loans at issue and would not have suffered losses on those loans." (Ex. A ¶ 3; Ex. B ¶ 3 (emphasis added).) These allegations are fatal to the FDIC's proximate cause allegations which, in turn, is fatal to the negligence claims. *Oki Semiconductor Co. v. Wells Fargo Bank*, 298 F.3d 768, 777 (9th Cir. 2002) (affirming dismissal of action for failure to meet all elements of negligence); *see also, e.g., Reddy v. Litton Indus., Inc.*, 912 F.2d 291, 296-97 (9th Cir. 1990) (affirming denial of leave to amend because plaintiff could only plead the elements of a cause of action by contradicting prior pleading); *Am. W. Airlines, Inc. v. GPA Group, Ltd.*, 877 F.2d 793, 801 (9th Cir. 1989) (affirming dismissal and denial of leave to amend when revised allegations could not be proven because they would contradict sworn affidavits); *In re Sunrise Sec. Litig.*, 138 F.R.D. 60 (E.D. Pa. 1991) ("In order to

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prove its negligence claims . . . the FDIC must demonstrate first that the defendants were negligent and second that such negligence was a proximate cause of the losses sustained.");.

First, the Appraisal Vendor Complaint's allegations amount to judicial admissions that WaMu's losses in its held-for investment portfolio were not caused by Defendants' alleged action or inaction—but by a third party's gross negligence in virtually ***every*** appraisal the FDIC reviewed. *See Hakopian v. Mukasey*, 551 F.3d 843, 846 (9th Cir. 2008) ("Allegations in a complaint are considered judicial admissions") (citation omitted)); *Walaschek & Assocs., Inc. v. Crow*, 733 F.2d 51, 54 (7th Cir. 1984) ("[p]leading in one proceeding is admissible and cognizable as an admission in another"). "A superseding cause relieves [a defendant] from liability." Restatement (Second) of Torts § 440, Comment B (2010). "A superseding cause is an act of a third person or other force which by its intervention prevents the actor from being liable for harm to another which his antecedent negligence is a substantial factor in bringing about." *Id.* § 440. *See Schooley v. Pinch's Deli Market, Inc.*, 134 Wn. 2d 468, 482, 951 P.2d 749, 756 (1998) ("A defendant's negligence is a proximate cause of the plaintiff's injury only if such negligence, unbroken by any new independent cause produces the injury complained of.").

Second, in light of the causation allegations in the Appraisal Vendor Lawsuits, the FDIC has failed to allege a claim to relief that is "plausible on its face." *Twombly*, 550 U.S. at 555, 570. The Court need not accept as true the FDIC's allegations that the FDIC itself contradicts in other pleadings filed in different courts. *Shwarz v. United States*, 234 F.3d 428, 435 (9th Cir. 2000) (court need not accept as true allegations that contradict facts that may be judicially noticed by the court); *see also Minnick v. Clearwire US, LLC*, 683 F. Supp. 2d 1179, 1188 (W.D. Wash. 2010) (Pechman, J.) ("the documents Plaintiffs incorporate by reference undermine the allegations in the Complaint. . . . The Court is left with Plaintiffs' conclusions of law, which are insufficient to state a claim.") (citing *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1295–96 (9th Cir. 1998)). Indeed, in *Churchill v. Barach*, 863 F. Supp. 1266, 1276–77 (D. Nev. 1994)—a case directly on point—the court granted a motion to dismiss because the plaintiff accused two defendants of causing her termination in two different lawsuits. In one suit, plaintiff alleged that

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defendant committed tortious interference in her employment relationship. *Id.* at 1276. In response, defendant explained that plaintiff had filed a separate suit against another defendant alleging that the other defendant caused her termination. *Id.* The court granted the first defendant's motion to dismiss because plaintiff's allegations in the second case revealed defendant was not the proximate cause of her damage. *Id.* at 1276–77.

Accordingly, because the FDIC has failed to plausibly plead proximate cause, the Court should dismiss its Complaint. *See, e.g., Nguyen v. Boeing Co.*, No. C10-0415MJP, 2010 WL 2102501, at *4 (W.D. Wash. May 25, 2010) (dismissing negligence claim for failing "the *Iqbal/Twombly* requirements completely" as plaintiff did "not plead with any specificity what the duty is, what injury was suffered, or the proximate cause of the breach").

III. THE BREACH OF FIDUCIARY DUTY CLAIM DUPLICATES THE NEGLIGENCE CLAIMS, AND THE COURT SHOULD DISMISS IT

Count III of the Complaint for "breach of fiduciary duty" is based upon and incorporates by reference the same facts supporting the negligence claims. (Compl. ¶¶ 192–196.) It thus duplicates Counts I and II. As such, the Court should dismiss it. *See Swartz v. KPMG LLP*, 476 F.3d 756, 766 (9th Cir. 2007) (*per curiam*) (claim that was "merely duplicative" was "properly dismissed"); *Hua v. Boeing Corp.*, No. C08-0010RSL, 2009 WL 1044587, at *5 (W.D. Wash. Apr. 17, 2009) ("Plaintiff's negligent supervision claim is based on the same facts that support his claim against Boeing for unlawful discrimination. It is therefore duplicative, and, under Washington law, must be dismissed."); *Jacobson v. Wash. State Univ.*, No. CV-05-0092-FVS, 2007 WL 26765, at *11 (E.D. Wash. Jan. 3, 2007) ("A claim is duplicative and must be dismissed under Washington law when the plaintiff asserts the same factual basis for two claims."); *Beringer v. Standard Parking O'Hare Joint Venture*, Nos. 07 C 5027, 07 C 5119, 2008 WL 4890501, at *4 (N.D. Ill. Nov. 12, 2008) (dismissing negligence and breach of fiduciary duty claims because "both counts involve the same operative facts, the same injury, and require proof of essentially the same elements"); *CMMF, LLC v. J.P. Morgan Inv. Mgmt. Inc.*, 915 N.Y.S.2d 2, 6 (App. Div. 2010) (affirming dismissal of negligence and breach of fiduciary

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duty claims as duplicative of breach of contract claim); *Awai v. Kotin*, 872 P.2d 1332, 1337 (Colo. App. 1993) (affirming dismissal of breach of fiduciary duty claim as duplicative where "[t]he factual allegations in support of this claim are the same as those in support of the claim of negligence"); *Resolution Trust Corp. v. Vanderweele*, 833 F. Supp. 1383, 1386 (N.D. Ind. 1993) (dismissing breach of fiduciary duty claim because it "amount[ed] to nothing more than a reformulation of the negligence claim").

Accordingly, Count III should be dismissed.

IV. THE FDIC'S ALLEGATIONS OF FRAUDULENT CONVEYANCE DO NOT SATISFY THE PLEADING REQUIREMENTS OF RULES 9(b) OR 8(a) OF THE FEDERAL RULES OF CIVIL PROCEDURE

The FDIC purports to seek relief pursuant to the Washington Uniform Fraudulent Transfer Act, RCW §§ 19.40.011 *et seq.*, which provides remedies to "creditors" in the event of fraudulent transfers by debtors. RCW §§ 19.40.041, 19.40.071. A "creditor" under the statute means "a person who has a claim." RCW § 19.40.011(4). Where the purported creditor has no underlying "enforceable claim, the UFTA does not provide the Plaintiff with a remedy." *Nat'l Ctr. for Emp't of the Disabled v. Ross*, No. CV 05-2014-PHX-JAT, 2006 WL 778647, at *8 (D. Ariz. Mar. 27, 2006) (finding "only one who has a valid claim and right to payment[] may attack a conveyance as fraudulent"). Because the FDIC has no enforceable claims under Counts I, II, and III, its claim for relief under the fraudulent transfer statute (Count V) fails as a matter of law. Moreover, for the reasons set forth below, Count V does not satisfy the pleading requirements of Rules 9(b) or 8(a) of the Federal Rules of Civil Procedure.

A. The FDIC Does Not Sufficiently Plead Its Allegation Concerning an Alleged Transfer of $1 Million

Paragraph 205 of the FDIC's Complaint alleges, in full: "On information and belief, Stephen Rotella transferred in excess of one million dollars to Esther Rotella after WaMu failed in September 2008." Where allegations of fraud thus rest ***only*** on information and belief, the complaint ***must*** "state the factual basis for the belief." *Neubronner v. Milken*, 6 F.3d 666, 672 (9th Cir. 1993); *see also Kranz v. Koenig*, 240 F.R.D. 453, 456 (D. Minn. 2007) (dismissing

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fraudulent transfer claim for failing to satisfy Rule 9(b) by, *inter alia*, not identifying the source of the information for the allegations based on information and belief). The FDIC's Complaint fails to do so. For this reason alone, the Court should dismiss the FDIC's bald assertions of fraud concerning the purported one million dollar fraudulent conveyance.

Moreover, Paragraph 205 fails to identify "what" was transferred, "when" the transfer took place, or "how" the transfer was made. *Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1124 (9th Cir. 2009); *see also Cooper v. Pickett*, 137 F.3d 616, 627 (9th Cir. 1997); *Swartz*, 476 F.3d at 764 (fraud allegations should include "an account of the time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentations"); *Global View*, 288 F. Supp. 2d at 479 (a claim of fraudulent conveyance should allege the specifics of the purported fraud including the time and amount of transfer, the identification of what was transferred, and how the transfer occurred). Identifying an amount "in excess of one million dollars" does not identify the "what" of a fraudulent transfer with particularity under Rule 9(b). In fact, "in excess of one million dollars" includes more numbers than it excludes. Similarly, the allegation that the transfer occurred sometime "after" September 2008 cannot satisfy the "when" prong of Rule 9(b) because it includes a time period spanning over two years. Further, the FDIC makes ***no*** allegations as to "how" the alleged transfer was made. In sum, the FDIC alleges Stephen Rotella gave Esther Rotella, in some unspecified way, some unspecified amount of money, at some point in time after September 2008. Such vague allegations will not satisfy Rule 8, much less Rule 9(b)'s heightened standards. *See, e.g., In re Motorwerks, Inc.*, 371 B.R. 281, 293–94 (Bankr. S.D. Ohio 2007) (trustee's allegations fail to satisfy Rule 8 where trustee's "lack of specificity fail[ed] to provide [the bank] with notice of the underlying transfers to be avoided[,] hindering the bank's ability to prepare an adequate answer and affirmative defenses").

B. The FDIC's Allegations Regarding the Transfer of "Their Residence" Fail As a Matter of Law

Paragraph 204 of the FDIC's Complaint alleges, in full:

> In or about March or April 2008, Stephen Rotella and his wife, Esther Rotella, transferred their residence in Orient, New York, to two irrevocable QPRTs dated

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> March 14, 2008, named the 'Stephen J. Rotella QPRT 2008 Trust' (which appointed Stephen Rotella as trustee) and the 'Esther T. Rotella QPRT 2008 Trust'(which appointed Esther Rotella as trustee).

Compl. ¶ 204.

The FDIC's allegation that Esther Rotella transferred ***her*** interest in the residence into the Esther Rotella Trust has no significance under Washington's Uniform Fraudulent Transfer Act because the FDIC does not allege that Esther Rotella is a "debtor" under the statute or that the FDIC is a creditor of Esther Rotella. *See Premier Capital, Inc. v. Klein*, 776 N.Y.S.2d 74, 76 (N.Y. App. Div. 2004) (finding transfer of real property to defendant's wife was not fraudulent as to defendant's wife because she was not alleged to be a debtor of the plaintiff's assignor). As such, the Complaint provides no factual basis for the assertion that Esther Rotella intended a transaction to "hinder, delay or defraud" creditors. *In re Daisy*, 1993 WL 491309, at *9. Further, nowhere in the Complaint does the FDIC allege that Esther Rotella believed or should have reasonably believed that she would incur debts beyond her ability to pay as they became due. Therefore, the FDIC does not—and cannot—claim that it suffered injury by Esther Rotella's transfer to the Esther Rotella Trust. Indeed, these allegations fail even under Rule 8's standard as they are implausible on their face. *See Twombly*, 550 U.S. at 570.

The FDIC's allegations of "actual intent" (Compl. ¶ 206(a)–(e)) are likewise insufficient. The FDIC does not allege that Esther Rotella was a named defendant in any lawsuits at the time of the transfer, that the transfer of her interest in the residence was concealed, or that she failed to properly record the trust according to the laws and regulations governing the public recording of real property. The only "actual intent" allegation is that Esther Rotella retained an interest in her share of the residence by remaining a trustee, and that she continued to live in the property after the trust was created. These two facts are not sufficient to uphold a fraudulent transfer allegation against Esther Rotella. *Kearns*, 567 F.3d at 1124 ("Averments of fraud must be accompanied by 'the who, what, when, where, and how' of the misconduct charged").

Likewise, the FDIC's allegations of "actual intent" fall short as to Stephen Rotella. For example, the FDIC alleges "Stephen Rotella had been personally named as a defendant in

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numerous lawsuits at the time of these transfers, which posed a potential exposure far in excess of his means." (Compl. ¶ 206(a).) Such vague and conclusory allegations cannot satisfy Rule 9(b). Though the FDIC alleges that these so-called "numerous lawsuits" exposed Stephen Rotella to debts "far in excess of his means," the FDIC fails to allege with any particularity ***how*** these suits, against which Mr. Rotella was insured, posed a risk to his personal assets. At the time of the alleged transfers, Mr. Rotella's "means" included $250 million in insurance coverage and an obligation by WaMu to indemnify him in connection with the lawsuits. In addition, the FDIC's claim that "the transfers were not disclosed to or were concealed from his present and future creditors" cannot be made "on information and belief" without citing the source of the belief. *See Neubronner,* 6 F.3d at 672

Finally, the FDIC's constructive fraud allegations fail. Esther Rotella is altogether absent from such allegations (*see* Compl. ¶ 207), and they impermissibly parrot the statutory language without providing sufficient supporting facts. See *Twombly*, 550 U.S. at 555 (a "formulaic recitation of the elements of a cause of action" will not survive a motion to dismiss); *compare* Compl. ¶ 207 *to* Wash. Unif. Fraud. Transfer Act, RCW § 19.40.041(a)(2) & (2)(ii).

Accordingly, for these reasons, the Court should dismiss the FDIC's fraudulent conveyance allegations.

V. THE FDIC'S ASSET FREEZE CAUSE OF ACTION LIKEWISE FAILS

In Count VI of the Complaint, the FDIC seeks a preliminary injunction: (i) freezing the supposedly fraudulently transferred assets and (ii) requiring Defendants "to provide 30 days advance notice to the FDIC, during the pendency of this litigation and any subsequent judgment in favor of FDIC, of any intended future transfers of their remaining assets in the amount of $10,000 or more in a single transaction." (Compl. ¶ 212.) Because Counts I, II and III fail as a matter of law, the FDIC's claim for injunctive relief fails as a matter of law. *See, e.g., Winter v. Natural Res. Def. Council, Inc.*, 129 S. Ct. 365, 374 (2008) (requiring plaintiff seeking preliminary injunction to demonstrate likelihood of success on the merits).

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CONCLUSION

The FDIC's complaint against Messrs. Rotella and Schneider does not allege fraud, intentional wrongdoing, bad faith, corporate looting, or uninformed conduct. Absent such allegations, the Court should dismiss the Complaint's negligence-based claims (and duplicative breach of fiduciary duty claim) because Defendants are entitled to the protection of Washington's business judgment rule. Moreover, the FDIC's causation allegations fail given the FDIC's admissions in separate, later-filed federal lawsuits that the gross negligence of two appraisal companies was the ***real*** cause of the losses in the Bank's held-for-investment portfolio. Because the FDIC's substantive claims fail, the Complaint's fraudulent conveyance claim (which also fails under Rules 9(b) and 8(a)) and asset freeze claim cannot withstand a motion to dismiss. Accordingly, this Court should dismiss the Complaint against Messrs. Rotella and Schneider in its entirety.

Dated this 1st day of July, 2011.

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CERTIFICATE OF SERVICE

I hereby certify that on July 1, 2011, the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system which will send notification of such filing to all counsel of record who receive CM/ECF notification and that the remaining parties shall be served in accordance with the Federal Rules of Civil Procedure.

DATED this 1st day of July, 2011.

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