The Honorable Marsha J. Pechman

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON

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 PLAINTIFF FDIC'S REPLY IN SUPPORT OF ITS MOTION FOR PROTECTIVE ORDER **Noted on Motion Calendar: August 26, 2011**

Law Offices
KARR TUTTLE CAMPBELL
A Professional Service Corporation
1201 Third Avenue, Suite 2900, Seattle, Washington 98101-3028
Telephone (206) 223-1313, Facsimile (206) 682-7100

Plaintiff Federal Deposit Insurance Corporation, as Receiver of Washington Mutual Bank ("FDIC"), hereby submits this Reply in Support of Its Motion for Protective Order, as follows.[1]

I. O'Melveny Did Not Abrogate the "No Duty" Rule.

The Defendants incorrectly assert that the Supreme Court's decision in *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 86 (1994), abrogated the "no duty" rule for either the pre-receivership conduct of federal regulators or the FDIC's post-receivership conduct.

A. *O'Melveny* Did Not Affect the "No Duty" Rule for Pre-Receivership Conduct by Federal Regulators.

Defendants seem intent on litigating the regulators' pre-receivership conduct regarding WaMu. But the "no-duty" rule continues to apply to such pre-receivership conduct. "Courts have uniformly held that claims or defenses based on pre-receivership actions of regulators are legally insufficient." *Grant Thornton, LLP v. FDIC*, 535 F. Supp. 2d 676, 722 (S.D.W.Va. 2007) (collecting cases), *rev'd on other grounds*, 530 F.3d 280 (4th Cir. 2008); *see, e.g.*, *FDIC v. Raffa*, 935 F. Supp. 119, 124 (D. Conn. July 20, 1995) ("Whether pre- or post-bank failure, the FDIC's duty is owed, not to bank directors or officers, but to the insurance fund it is charged with protecting and to the banking public."). Indeed, even one of the post-*O'Melveny* cases cited by Defendants in their Joint Opposition acknowledged the continuing viability of the "no duty" rule for regulators' pre-receivership conduct. *See FDIC v. Ornstein*, 73 F. Supp. 2d 277, 281 (E.D.N.Y. 1999) (striking affirmative defense based on pre-receivership conduct of regulators

[1] The Defendants assert that the FDIC attempted to "evade the rules" by not complying with the format of Local Civil Rule 37's expedited discovery dispute procedure. Any such lack of compliance was inadvertent and the FDIC's counsel apologizes if that format should have been followed. Because the oral agreement at the July 20, 2011 status conference to use CR 37 was not included by any of the parties in the revised Joint Status Report, was not included in the Scheduling Order, and was not raised in the multiple meet-and-confer discussions with defense counsel, the FDIC's counsel inadvertently did not focus on it. The FDIC notes that, on its face, CR 37 provides an alternative procedure for motions to compel under CR 7(d)(3), but not clearly for a motion for protective order under CR 7(d)(2). In any event, the record reflects that the parties met and conferred in the utmost good faith and resolved most of their discovery disputes, but that the issue presented by the FDIC's motion requires the Court's review. The FDIC did put Defendants on notice that it might file a Motion for Protective Order. (*See* B. Stewart Decl., Ex. C, Aug. 8, 2011, H. Pietrkowski Ltr. at 3 ("the FDIC stands on its objections regarding discovery of confidential regulatory documents and communications and *reserves the right to file a motion for protective order on this issue* unless you can produce binding precedent to the contrary.") (emphasis added).

Law Offices
KARR TUTTLE CAMPBELL
A Professional Service Corporation
1201 Third Avenue, Suite 2900, Seattle, Washington 98101-3028
Telephone (206) 223-1313, Facsimile (206) 682-7100

and noting that, "[P]re-conservatorship conduct of federal banking regulators cannot be attacked by directors.") (quoting *RTC v. Sands*, 863 F. Supp. 365, 372-73 (N.D. Tex. 1994)).

Most of Defendants' other cited cases either were aimed solely at *post*-receivership conduct or failed to reach any conclusion about *O'Melveny*'s impact on the "no duty" rule for pre-receivership conduct. *See RTC v. Mass. Mut. Life Ins. Co.*, 93 F. Supp. 2d 300, 302, 304-05 (W.D.N.Y. 2000) (discussing *O'Melveny*'s impact only on post-receivership conduct); *FDIC v. Gladstone*, 44 F. Supp. 2d 81, 90-91 (D. Mass. 1999) (distinction between the RTC as regulator and as receiver remains "undisturbed by *O'Melveny*") (citation omitted); *RTC v. Baker*, No. CIV A. 93-0093, 1994 WL 637359, at *3 (E.D. Pa. Nov. 14, 1994) (noting split in case law as to application of *O'Melveny*). "Given the fact that *O'Melveny* did not address the issue of pre-receivership conduct by regulators," *Grant Thornton*, 535 F. Supp. 2d at 724, *O'Melveny* did not affect the "no duty" rule as applied to federal regulators while the bank was still operational.

B. The Weight of Authority and Better Reasoned Cases Hold that the "No Duty" Rule for Post-Receivership Conduct Remains Viable After *O'Melveny*.

As Defendants point out, some district courts have held that *O'Melveny* abrogated the "no duty" rule with respect to the FDIC's *post*-receivership conduct. However, these cases are poorly reasoned and do not reflect the majority view that *O'Melveny* – which did not involve regulator conduct but bank officer conduct imputed to the FDIC – did not address whether state law defenses could be raised against the FDIC for its discretionary *post*-receivership actions. *See, e.g., FDIC v. Healey*, 991 F. Supp. 53, 61 (D. Conn. 1998); *Raffa*, 935 F. Supp. at 125.

Defendants take issue with the FDIC's citation to *Raffa*, asserting that it was "effectively reversed" by *FDIC v. Haines*, 3 F. Supp. 2d 155, 159 (D. Conn. 1997). But they fail to mention that *Haines* itself was "effectively reversed" the next year, when the court in *Healey* determined that *Haines* was wrong and *Raffa* was right all along. *Healey*, 991 F. Supp. at 60-62. More specifically, *Healey* found that *Haines* overlooked the fact that *O'Melveny* never addressed whether the "no duty" rule should apply to the FDIC's post-receivership conduct. Similarly, *Haines* failed to assess whether FIRREA's statutory provisions involving the FDIC's broad

Law Offices
KARR TUTTLE CAMPBELL
A Professional Service Corporation
1201 Third Avenue, Suite 2900, Seattle, Washington 98101-3028
Telephone (206) 223-1313, Facsimile (206) 682-7100

discretionary powers as receiver of a failed bank presented a "significant conflict" with state law affirmative defenses that merited application of the "no duty" rule. *Id.* A number of other courts have reached a similar conclusion that *O'Melveny* did not abrogate the "no duty" rule for the FDIC's post-receivership conduct. *See, e.g.*, *RTC v. Gravee*, No. 94 C 4589, 1995 WL 599056, at *2-3 (N.D. Ill. Oct. 5, 1995) (collecting numerous post-*O'Melveny* cases and holding that "the majority rule is the better one"); *RTC v. Edie*, Civ. No. 94-772 (DRD), 1994 WL 744672, at *3 (D.N.J. Oct. 4, 1994) ("*O'Melveny*'s narrow holding leaves the no duty rule undisturbed."). And in *FDIC v. Liebert*, 871 F. Supp. 370 (C.D. Cal. 1994), on which Defendants heavily rely, the court admitted that "the heavy majority position is that the 'no duty' rule applies to post-FIRREA suits" and that it was "[r]ejecting the majority trend of District Court authority." *Id.* at 373.

II. Discovery of Regulators' Internal Documents and Communications is Precluded by the "No Duty" Rule.

Defendants cite to the magistrate judge's opinion in *FDIC v. Schoenberger*, No. CIV. A. No. 89-2756, 1990 WL 52863 (E.D. La. Apr. 24, 1990), for the proposition that, "in cases where discovery was at issue, the FDIC's argument [regarding the 'no duty' rule] has been rejected." (Joint Opp'n at 12.) Defendants fail to inform the Court, however, that the district court in that case ***reversed*** the relevant portion of the magistrate judge's ruling and held that the defendants were "not entitled to discovery of all post-closing documents" because they only would be "relevant to prove defendants' affirmative defenses such as failure to mitigate damages" and "the great weight of the authority leads the Court to conclude that the FSLIC owed no such duty to defendants." *FDIC v. Schoenberger*, No. CIV. A. No. 89-2756, 1990 WL 130641, at *2 (E.D. La. Aug. 30, 1990). The *Schoenberger* court also cited two other federal court decisions – *FSLIC v.* Roy, No. CIV JFM-87-1227, 1988 WL 96570, at *2 (D. Md. June 28, 1988), and *Vogel v. Grissom*, No. CA3-89-467-D (N.D. Tex. May 3, 1989) – that similarly limited defendants' discovery based on the "no duty" rule as applied to federal regulators' post-receivership conduct.

Law Offices
KARR TUTTLE CAMPBELL
A Professional Service Corporation
1201 Third Avenue, Suite 2900, Seattle, Washington 98101-3028
Telephone (206) 223-1313, Facsimile (206) 682-7100

See also Sands, 863 F. Supp. at 375 (limiting the scope of defendants' discovery against the FDIC as a result of striking defendants' affirmative defenses under the "no duty" rule).[2]

The only exception to discovery that the district court in *Schoenberger* allowed was based on the FDIC's agreement that defendants were entitled to certain loan information related to damages. *Schoenberger*, 1990 WL 130641, at *2. This is true here as well; the FDIC has not objected to production of relevant causation and damages information, such as documents reflecting "the value of the home loans sold to JPMC [JP Morgan Chase]." (*See, e.g.*, B. Stewart Decl., Ex. A, FDIC's Resps. & Objs. to Killingers' First Request for Production, at General Objection 6; *Id.*, Ex. F, Aug. 15, 2011 Pietrkowski Meet-and-Confer Ltr. at 2 n.2.)

III. Defendants Seek Internal Regulatory Documents to Put the FDIC and OTS on Trial, and Not For Some Legitimate Purpose.

Defendants' clear strategy is to try to put the conduct of WaMu's regulators at the forefront of this litigation. Defendants Rotella and Schneider attack the FDIC in the opening sentence of their Motion to Dismiss, calling this lawsuit "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." Defendant Killinger's broad discovery requests confirmed the Defendants' improper strategy of putting the conduct of WaMu's regulators front and center, and Defendants' Joint Opposition further confirms the tactic. Indeed, Defendants state that they seek regulatory documents "to show the FDIC's [supposed] hindsight bias," which, under the no-duty rule, is wholly irrelevant. (Joint Opp'n at 6.) The Joint Opposition also refers to the alleged "premature seizure" of WaMu, which again is not relevant to any issues in this case since it is not for the Court or trier of fact to second guess the timing or wisdom of the regulatory decision to close WaMu.

---

[2] The two other cases cited by Defendants that refused to limit discovery against the FDIC failed to address the "no duty" case law discussed in this motion. Rather, they relied on *FDIC v. Jenkins*, 888 F.2d 1537, 1546 (11th Cir. 1989), which held that the FDIC was not entitled to absolute priority over shareholders in the collection of assets. *See In re Sunrise Secs. Litig.*, 138 F.R.D. 60, 62-63 & n.4 (E.D. Pa. 1991); *FDIC v. Cherry, Bekaert & Holland*, 131 F.R.D. 202, 203-04 (M.D. Fla. 1990). Not only are these cases poorly reasoned, the *Cherry* decision was rejected by *Schoenberger*, 1990 WL 130641, at *4, and the court in *Sunrise* subsequently decided that it would strike a number of affirmative defenses because of the "no duty" rule. *See In re Sunrise Secs. Litig.*, 818 F. Supp. 830 (E.D. Pa. 1993).

Law Offices
KARR TUTTLE CAMPBELL
A Professional Service Corporation
1201 Third Avenue, Suite 2900, Seattle, Washington 98101-3028
Telephone (206) 223-1313, Facsimile (206) 682-7100

Defendants suggest that their primary goal is to use regulatory evidence not to criticize the regulators, but to show that the regulators approved or acquiesced in their conduct. But, as discussed on pages 9-10 of the FDIC's Motion for Protective Order, such "acquiescence" evidence might simply mean that the regulator was unduly lax or ill-informed, and the introduction of such evidence would open a Pandora's box concerning the basis for regulators' statements and their probative value. Such a "mini-trial" on regulator performance is exactly what is prohibited by the "no-duty rule."

The Defendants further claim that internal regulatory documents, in particular related to the seizure of WaMu, are relevant to causation and damages issues. But as explained above, they fail to inform the Court that the FDIC has agreed to provide documents reflecting "the value of the home loans sold to JPMC [JP Morgan Chase]." As to their theory that the alleged "premature seizure" of WaMu caused the losses, the Complaint seeks damages for the billions of dollars of losses suffered by WaMu *before* the Bank was seized. Moreover, Defendants cite no cases that allow them to challenge the regulatory decision to seize WaMu; again, this would be a sideshow that would distract from the real issues in the case. The Defendants also suggest that regulatory documents might be relevant to the issue of whether the losses were caused by "external market factors." Assuming *arguendo* this is even a proper defense here – given that a central allegation is that the Defendants failed to adequately prepare the Bank for weakened market conditions – they do not explain how internal regulatory documents might be relevant to the issue, at least without having a mini-trial regarding FDIC's statements about the market factors.

Finally, Defendants incorrectly argue that the FDIC has "put the requested information at issue" by alleging in its complaint that Defendants failed to follow regulatory guidance on non-traditional mortgage products. (Joint Opp'n at 6-7, citing *FDIC v. Wise*, 139 F.R.D. 168 (D. Colo. 1991).) But this public guidance was published for the entire industry, and was not specifically directed at WaMu. The FDIC's Complaint contains no allegations about specific regulatory criticisms of or statements to the Defendants or other WaMu personnel, and thus no door has been opened to that subject. *Wise* is easily distinguishable on that basis, since the FDIC's

Law Offices
KARR TUTTLE CAMPBELL
A Professional Service Corporation
1201 Third Avenue, Suite 2900, Seattle, Washington 98101-3028
Telephone (206) 223-1313, Facsimile (206) 682-7100

amended complaint in that case had made repeated allegations concerning the actions, knowledge, and beliefs of regulators in connection with the specific institution at issue and the defendants' alleged misleading and deceptive behavior toward the regulators of that institution. *See S.E.C. v. Nacchio*, 2009 WL 211511, at *4 (D. Colo. Jan. 29, 2009) (distinguishing *Wise* on that basis). Moreover, without conceding their relevance or admissibility, the FDIC is producing all documents it seized upon WaMu's closure, including regulatory materials found in WaMu's files, and Defendants will have access to substantial additional regulatory materials previously produced by the OTS.[3]

Defendants' litigation strategy regarding WaMu's regulators threatens to create an enormously costly, time-consuming and irrelevant sideshow in violation of the "no-duty rule," which precludes bank officials from placing regulatory conduct at issue as a defense in bank officer mismanagement cases. A protective order is necessary to prevent Defendants from expanding the scope of discovery to support their prohibited strategy, thus placing an undue burden on the FDIC and distracting all parties from the real issues in the case.

For all the reasons stated herein and in the FDIC's Motion for Protective Order, the Motion should be granted.

[3] Contrary to Defendants' wildly incorrect assertions, the FDIC is not making available to Defendants "a subset of the documents that [the FDIC] seized from WaMu" or attempting to "shield its documents from coming to light," nor did the FDIC "make up its mind" to give Defendants only documents that the FDIC "thought were relevant to its theory of the case" and no other documents. (Joint Opp'n at 5.) Instead, as Defendants well know, without conceding relevance or admissibility, the FDIC is making available to Defendants *all* of the documents the FDIC obtained from WaMu upon WaMu's closure. (*See* FDIC's Motion for Protective Order, fn 3.) Moreover, the OTS has agreed that all regulatory documents already produced to Defendants in the WaMu consolidated securities class actions can be made available to the parties for use in this case. Thus, the FDIC's Motion is designed to limit additional wholly irrelevant discovery and to avoid protracted proceedings focused on what the majority of courts have agreed is not relevant: a trial, not of the conduct of the defendants, but of WaMu's regulators.

Law Offices
KARR TUTTLE CAMPBELL
A Professional Service Corporation
1201 Third Avenue, Suite 2900, Seattle, Washington 98101-3028
Telephone (206) 223-1313, Facsimile (206) 682-7100

Dated: August 26, 2011.

Respectfully submitted,

FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver for WASHINGTON MUTUAL BANK, *Plaintiff*

s/ Henry Pietrkowski
One of Its Attorneys

Barry S. Rosen (admitted *pro hac vice*)
Duane F. Sigelko (admitted *pro hac vice*)
Mark S. Hersh (admitted *pro hac vice*)
Henry Pietrkowski (admitted *pro hac vice*)
James A. Rolfes (admitted *pro hac vice*)

REED SMITH LLP
10 South Wacker Drive
Suite 4000
Chicago, IL 60606
(312) 207-1000

Bruce E. Larson, WSBA #6209
Walter E. Barton, WSBA #26408
Dennis H. Walters, WSBA #9444

KARR TUTTLE CAMPBELL
1201 Third Avenue, Suite 2900
Seattle, WA 98101
Telephone: (206) 223-1313
gbarton@karrtuttle.com

Leonard J. DePasquale (admitted *pro hac vice*)
Counsel, Federal Deposit Insurance Corporation
3501 North Fairfax Drive, VS-B-7058
Arlington, VA 22226
(703) 562-2063

CERTIFICATE OF SERVICE

I hereby certify that on August 26, 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.

s/ Walter E. Barton
WSBA #26408
KARR TUTTLE CAMPBELL
Of Attorneys for Plaintiff
1201 Third Avenue, Ste. 2900
Seattle WA 98101
Telephone: (206) 223-1313
Fax: (206) 682-7100
E-mail: gbarton@karrtuttle.com