J.P. Morgan, Regulators Wage War of Wording
Terms of 2008 Purchase of Washington Mutual in Dispute

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In the frenzied final hours before J.P. Morgan Chase JPM +1.48% & Co. acquired the banking operations of failed thrift Washington Mutual Inc., WMIH -0.91% the bank's lawyers tangled with regulators over the wording of the 39-page purchase agreement.

The question of who bears responsibility for Washington Mutual's legal liabilities is taking on increasing urgency as J.P. Morgan negotiates a pact with the Justice Department. Ryan Tracy joins MoneyBeat. Photo: Getty Images.

Five years later, J.P. Morgan and the Federal Deposit Insurance Corp. are still fighting over the meaning of those words.

Washington Mutual Purchase Agreement
The document governing J.P. Morgan's purchase from the FDIC of Washington Mutual Inc.'s banking operations is at the heart of a dispute over which claims each party is liable to pay.

The question of who bears responsibility for Washington Mutual's legal liabilities is taking on increasing urgency as J.P. Morgan negotiates a pact with the Justice Department that would end probes of soured mortgage bonds issued by J.P. Morgan and Washington Mutual during the housing boom.

The Justice Department is trying to insert language into the settlement stipulating that none of the costs the bank pays regarding Washington Mutual will be passed to the FDIC, said people close to the talks. J.P. Morgan wants the ability to recover costs associated with Washington Mutual from the FDIC receivership that liquidated the thrift in 2008.

The settlement talks are at risk of falling apart over this and other disagreements, said people close to the talks.

At issue is exactly which liabilities J.P. Morgan assumed when it took control of Washington Mutual in September 2008.

J.P. Morgan has argued in court documents that the purchase agreement shields it from lawsuits targeting alleged misconduct on the part of Washington Mutual. The FDIC has countered that J.P. Morgan inherited those headaches, which include mortgage bonds that are the subject of numerous lawsuits from investors and regulators.

The collapse of Washington Mutual was the largest-ever U.S. bank failure, and it presented immediate benefits to J.P. Morgan. The purchase gave it $188 billion in deposits and a coast-to-coast presence. FDIC chose J.P. Morgan's $1.88 billion bid over a competing offer from Citigroup Inc.

But J.P. Morgan since 2008 has identified more than 35 lawsuits or claims it believes qualify for payouts from the FDIC receivership, according to documents submitted to the FDIC between 2008 and 2012.

On these requests the bank cites a key section in the original purchase agreement: The FDIC receivership "agrees to indemnify and hold harmless" J.P. Morgan for any liabilities of Washington Mutual that "are not assumed" by J.P. Morgan.

The claims submitted to the FDIC include a mortgage-bond investor lawsuit seeking $10 billion, millions of dollars in unpaid state taxes, cleanup duties on a contaminated site in Oregon and injuries sustained by 67-year-old Raffaela Izzo after she slipped on a ceramic tile outside a Washington Mutual branch in East Islip, N.Y. Ms. Izzo and J.P. Morgan settled for $13,000, Ms. Izzo said.

J.P. Morgan hasn't included specific dollar requests to the FDIC, but the potential damages cited in the lawsuits are larger than the $2.7 billion remaining in the receivership.

The FDIC declined to comment on specific J.P. Morgan claims. The agency said it has denied some claims and accepted at least one, while others are pending or are the subject of continuing lawsuits. Washington Mutual bondholders also are seeking billions from the same receivership.

Another point of contention is the true meaning of a section in the original purchase agreement stating that J.P. Morgan "agrees to pay, perform and discharge all the liabilities of the Failed Bank which are reflected on the Books and Records of the Failed Bank as of Bank Closing." The phrase "Books and Records" isn't defined. d in the document

The agreement "was remarkably unspecific," said Kevin Starke, an analyst with CRT Capital Group LLC in Stamford, Conn.

Yet the FDIC and J.P. Morgan sparred over the final wording up until hours before signing the final agreement.

In one exchange, a J.P. Morgan lawyer made it clear he didn't like any language that saddled the bank with liability for breaches of contract that happened before the closing, according to emails uncovered by a bankruptcy-court examiner.

"In a normal [purchase and assumption agreement] between parties this is not something a buyer would ever assume and it really doesn't make sense (nor frankly is it fair) here," the lawyer, Dan Cooney, wrote to FDIC lawyer David Gearin at 9:29 p.m. on Sept. 23, 2008. Mr. Cooney no longer works for the bank, said a person close to J.P. Morgan. Mr. Gearin's response: "Ok I will look at again."

The back and forth continued through 4:42 p.m. on Sept. 24—less than two hours before bids were due. Mitchell Eitel, a lawyer with Sullivan & Cromwell representing J.P. Morgan, sent a message to Mr. Gearin saying that "the indemnity provision does not work and we understood you were re-drafting it…what should we be assuming from that?"

J.P. Morgan in the end convinced FDIC to change a section that allows the bank to pursue the FDIC receivership for liabilities. J.P. Morgan, said a person close to the bank, believes the change lets it pursue the receivership for an array of liabilities regardless of whether they were explicitly assumed at the sale.

Another ambiguity in the final agreement is the absence of specific liabilities included and excluded from the Sept. 25, 2008, sale. The lack of such detail makes the deal unusual compared with agreements drawn up to resolve other large institutions that were seized during the financial crisis, such as IndyMac Bank of Pasadena, Calif. and Colonial Bank of Montgomery, Ala.

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"**Subsidiary**" has the meaning set forth in Section 3(w)(4) of the Federal Deposi Insurance Act, 12 U.S.C. Section 1813(w)(4), as amended.

ARTICLE II
ASSUMPTION OF LIABILITIES

2.1 **Liabilities Assumed by Assuming Bank.** Subject to Sections 2.5 and 4.8, the Assuming Bank expressly assumes at Book Value (subject to adjustment pursuant to Article VIII) and agrees to pay, perform, and discharge, all of the liabilities of the Failed Bank which ar reflected on the Books and Records of the Failed Bank as of Bank Closing, including the Assumed Deposits and all liabilities associated with any and all employee benefit plans, except as listed on the attached Schedule 2.1, and as otherwise provided in this Agreement (such liabilities referred to as "Liabilities Assumed"). Notwithstanding Section 4.8, the Assuming Bank specifically assumes all mortgage servicing rights and obligations of the Failed Bank.

2.2 **Interest on Deposit Liabilities.** The Assuming Bank agrees that it will assume a deposit contracts as of Bank Closing, and it will accrue and pay interest on Deposit liabilities assumed pursuant to Section 2.1 at the same rate(s) and on the same terms as agreed to by the Failed Bank as existed as of Bank Closing. If such Deposit has been pledged to secure an obligation of the depositor or other party, any withdrawal thereof shall be subject to the terms of the agreement governing such pledge.