IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF ALABAMA
NORTHERN DIVISION

THE COLONIAL BANCGROUP, INC., and KEVIN O'HALLORAN, **Plaintiffs,** **v.** **PRICEWATERHOUSECOOPERS LLP and CROWE HORWATH LLP,** **Defendants.**	**Case No. 2:11-cv-00746-BJR**
FEDERAL DEPOSIT INSURANCE CORPORATION AS RECEIVER FOR COLONIAL BANK, **Plaintiff,** **v.** **PRICEWATERHOUSECOOPERS, LLP and CROWE HORWATH, LLP,** **Defendants.**	**Case No. 2:12-cv-00957-BJR**

THE FDIC-R'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING DAMAGES CAUSED BY PWC'S NEGLIGENCE

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On the basis of the testimony and other evidence admitted at trial, and the arguments of counsel, the following findings of fact and conclusions of law regarding the damages of the FDIC as Receiver for Colonial Bank ("FDIC-R") are recommended for adoption and approval by the Court.

I. INTRODUCTION

Plaintiff FDIC-R brings this action against Defendant PricewaterhouseCoopers LLP ("PwC"), which served as the independent, external auditor for Colonial Bancgroup, Inc. ("CBG"), for failing to discover a fraud perpetrated against Colonial Bank ("Colonial") by Taylor, Bean & Whitaker Mortgage Corporation ("TBW") and certain of Colonial's employees. This Court bifurcated the liability and damages portion of the case. This Court issued an Order on Liability Phase dated December 28, 2017 in which the Court found that PwC was negligent in its 2003, 2004, 2005 and 2008 audits of CBG.[1]

A bench trial regarding damages was held March 19 through March 23, 2018. Stephen Sorensen of Thomas, Alexander, Forrester & Sorensen LLP, David Mullin of Mullin Hoard & Brown LLP, Lawrence H. Heftman of Schiff Hardin LLP, and Grace L. Kipp of Spotswood Sansom & Sansbury LLC appeared for the FDIC-R; and Philip S. Beck, Mark L. Levine, Christopher D. Landgraff, Christopher Hagale, Jameson R. Jones, and Nicolas Martinez of Bartlit Beck Herman Palenchar & Scott; and Meredith Moss of King & Spalding appeared for PwC.

The Court heard testimony in open court from: the FDIC-R's damages expert, Kenneth Malek, and PwC's damages expert, Kenneth Lehn. In addition, the parties submitted the

[1] The 2006 and 2007 audits of CBG were not tried in the bench trial because, for those audit years, the FDIC did not waive its right to a jury trial.

depositions of Wayne Beahler, Ray Bowman, Laura Bryan, Desiree Brown, Cherie Fite, Tim Kviz, Teresa Kelly, Wes Kelly, Cathie Kissick, Neil Luria, Sarah Roland and Brent Spencer.

The Court has considered the testimony of each of the witnesses, the admitted trial exhibits, the parties' proposed findings of fact and conclusions of law, and the arguments of counsel. The following constitutes the Court's Findings of Fact and Conclusions of Law on the Damages Phase pursuant to Rule 52(a) of the Federal Rules of Civil Procedure.[2]

II. SUMMARY

PwC's negligence caused the FDIC-R to suffer $625,309,085 in damages. PwC's repeated failures to properly audit Colonial Bank permitted the fraudsters to steal more and more every year until Bank close. Through a detailed forensic analysis performed by its expert Kenneth Malek, the FDIC-R proved the precise amount of fraud losses on a loan-by-loan and trade-by-trade basis. The FDIC-R clearly satisfied its burden to establish damages with reasonable certainty. None of these fraud losses would have occurred had PwC performed a proper audit in 2003. All $625 million in damages are fraud losses that were proximately caused by PwC's negligence.

PwC cannot contest the clear factual basis for the FDIC-R's damages calculation. At trial, PwC conceded that AOT was entirely fake at Bank close and the loss on AOT was $1.473 billion. PwC conceded that, of the $1.473 billion lost on AOT, $1.244 billion was stolen after PwC's failed 2003 audit. PwC conceded that every junk loan that Mr. Malek identified as a fraud loss was ultimately hidden in fake trades and listed in the fraudsters' secret, second set of books for fraudulent AOT trades at Bank close. PwC also conceded it was fraud to dump junk, impaired loans directly onto the AOT. Finally, PwC conceded that Mr. Malek properly calculated and

[2] To the extent certain findings of fact may be deemed conclusions of law, or certain conclusions of law be deemed findings of fact, they shall each be considered findings or conclusions, respectively.

deducted the "net income" from the TBW relationship and correctly applied certain "setoffs" to damages.

PwC lodged two objections to the FDIC-R's damages. First, PwC claims that certain loans ($415 million) hidden in fake AOT trades in the fraudsters' second set of books at Bank close may not have been fraudulent when funded on other Colonial lines.[3] Essentially, PwC claims that the fraud never involved dumping junk loans on TBW's COLB or Warehouse lines at Colonial. Second, based on an entirely new argument at trial not supported by their own damages expert, PwC challenged the FDIC-R's settlement with the TBW Bankruptcy Estate, claiming the FDIC-R gave up AOT REO that should have reduced PwC's damages.

PwC's unsupported claim that there was no junk loan fraud on COLB was contradicted by its own pleadings and the evidence. PwC alleged in previous litigation, the TBW lawsuit in Florida, that there *was* a junk loan fraud on COLB and offered no evidence here to contradict its prior position. PwC should be held to its admission. PwC's claim that these loans that started on COLB did not result in a fraud loss is also contrary to the evidence. It is undisputed that every loan Mr. Malek identifies as part of the fraud loss was part of a fake AOT trade at Bank close and hidden in the fraudsters' secret second set of books. Hiding these loans that could not be sold instead of returning them to TBW for repayment (as was the normal process for a legitimate mortgage warehouse lending relationship) was part of the fraud and harmed Colonial. It also allowed the fraud to keep going. The fraudsters' testimony also clearly establishes the pattern and practice of

[3] PwC refers to these as the "blue" loans at trial. Of course, the fraudsters made no such distinction. At Bank close, there was $1.473 billion of fake AOT and those fake trades were a total loss. $495 million was Plan B; the trades did not exist and there was not even a fake list of loans. The other $978 million were fake trades that did not exist, but there was a secret second set of books listing the junk loans allegedly "associated" with those non-existent trades, which were either worthless to Colonial because they were owned by another bank or seriously impaired so that they ultimately generated only $191 million in bankruptcy recoveries.

dumping junk loans that could not be sold on all of Colonial's lending lines (not just AOT but also the COLB, Warehouse, and Overline facilities) and ultimately concealing them in fake AOT trades. All of these badges of fraud are present for every one of the $415 million in loans that PwC claims were merely economic, not fraud, losses.

PwC's belated objection to the FDIC-R's settlement of disputed bankruptcy issues should be rejected as well. The FDIC-R properly allocated and applied setoffs for all monies actually received. PwC claims the FDIC-R should reduce damages for money it never received because PwC believes it was disadvantaged by the bankruptcy settlement. There is no factual or legal basis for any further setoff to damages.

The evidence clearly shows that the FDIC-R's damages caused by PwC's negligent 2003 audit are, after appropriately accounting for recoveries from other sources, $625,309,085. Accordingly, the Court awards the FDIC-R $625,309,085 in damages for PwC's negligence.[4]

III. STANDARD OF REVIEW

In a bench trial, the judge serves as the sole fact-finder. In this capacity, the judge's function includes weighing the evidence, evaluating the credibility of witnesses, and deciding questions of fact, as well as issues of law. *See Childrey v. Bennett*, 997 F.2d 830, 834 (11th Cir. 1993) (holding that "it is the exclusive province of the judge in non-jury trials to assess the credibility of witnesses and to assign weight to their testimony"); *Prickett v. United States*, 111 F. Supp. 2d 1191, 1192 (M.D. Ala. 2000) (citing *Childrey*, 997 F.2d at 834) *aff'd*, 268 F.3d 1066 (11th Cir. 2001).

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[4] The Court rejects PwC's equitable appeal, first raised during closing argument, that the Court should reduce the actual damages because PwC is a private partnership. Tr. 4006:8-12. The FDIC-R responded that PwC is a very large and extremely profitable global entity. Tr. 4023:10-14. Both sides' statements on this issue are irrelevant and not considered by the Court in calculating damages based upon the actual harm caused by PwC's negligence.

FINDINGS OF FACT

This section contains the Court's findings of fact for the issues raised by the parties during the damages phase of trial. Additional factual background and certain findings of fact are also provided in the Court's Order dated December 28, 2017, regarding liability ("Liability Order"). ECF 798. This order presumes familiarity with the Liability Order.

I. <u>PwC's negligence allowed the Fraud to continue.</u>

1. As set forth in this Court's Liability Order, PwC violated its professional duties to Colonial Bank by negligently performing its 2003 audit of Colonial BancGroup (CBG). *See* ECF 798 at 26-41, 91.

2. In violation of the applicable professional standards, PwC failed to design its audits to detect fraud, failed to obtain sufficient competent evidence of the existence of COLB and AOT assets, failed to understand the assets it was auditing, and failed to adequately test for the existence of those assets. ECF 798 at 26-41.

3. If PwC had not breached its professional duties in performing its 2003 audit, it would have uncovered the TBW fraud during that audit. ECF 798 at 31-34. For example, if PwC had followed up on the illogical dates on the 2003 and 2004 pipeline reports, the fraud would have been uncovered. *Id.* at 33.

4. It was reasonably foreseeable that PwC's negligence in connection with its 2003 audit allowed the fraud to continue, causing damage to Colonial Bank. ECF 798 at 52 ("It is foreseeable that an auditor's negligence in failing to discover fraud will allow that fraud to continue.").

5. Before its 2003 audit, PwC foresaw the very fraud risk that came to pass here. In its Colonial audit workpapers, PwC flagged fraud by a loan originator (i.e., TBW) as the Mortgage

Warehouse Lending Division's biggest risk. ECF 798 at 33; *see also* A83 at 2 (2002 PwC workpaper stating: "[h]istorically speaking, the largest losses related to the mortgage warehouse lending industry have come from frauds perpetrated by mortgage originators."); Kviz Dep. at 108:5-21 (F4366).

6. If PwC had uncovered fraudulent TBW loans in the 2003 audit, the relationship between TBW and Colonial Bank would have terminated by February 2004, just as it did in August 2009 when the fraud was actually discovered:

- PwC would have immediately stopped its audit work and would not have issued an audit opinion certifying the accuracy of CBG's financial statements. Tr. 1052:7-20 (Jackson) (PwC auditor Kim Jackson testifying that PwC would have stopped the audit and not signed the audit opinion upon discovery of missing mortgages in 2003 audit).

- Upon discovery of the fraud, the United States Department of Housing and Urban Development ("HUD"), the Government National Mortgage Association ("Ginnie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") would have terminated TBW's authority to originate, sell or service mortgages, just as they did in August 2009. Tr. 3417:4-11 (Malek); B182 at 3 (FDIC-R Settlement with TBW Bankruptcy Estate).

- The Bank's primary regulators would have barred the Bank from engaging in any transactions with TBW without regulatory approval. B182 at 3.

- The Bank's management also would have ordered lending to TBW to cease upon discovery of the fraud and would have placed an administrative hold on all of TBW's accounts. *Id.*; Tr. 3417:4-13 (Malek); Tr. 2142:7-18 (Beville) (detection of fraud brought mortgage warehouse lending operations to immediate, "screeching halt;" business with TBW was "shut down" and "frozen").

- Termination of Colonial lending to TBW would have put TBW out of business almost immediately because TBW was losing money on every loan it financed and relied on money stolen from Colonial Bank to stay in business. Brown Dep. at 211:21-212:4 (F4363) ((TBW out of business without continued stealing from Colonial); Tr. 3430:3-10 (Malek) (TBW was losing money on each loan originated and depended on stealing to make up for cash shortfall); Tr. 3417:4-11 (Malek) (stating that TBW laid off virtually all employees within two days of the uncovering of the fraud and was effectively out of business within 4 days).

7. If PwC had detected the fraud (as it would have if it had done a competent audit) by February 20, 2004—the date of completion of its 2003 audit work and of its sign-off on Colonial's financials—Colonial's relationship with TBW would have ended within days (as it did in August 2009) and the stealing would have stopped. A0063 at 52 (indicating PwC's signing off on Colonials financials on February 20, 2004); Tr. 3416:21-3417:11 (Malek).

8. Accordingly, Mr. Malek correctly sets February 25, 2004, five days after the conclusion of PwC's 2003 audit, as the starting point for calculating damages. Tr. 3416:21-3417:11 (Malek).[5] PwC does not contest Mr. Malek's starting date for damages.

II. The Fraud

9. As this Court has already found, the massive fraud on Colonial Bank began in 2002 and evolved through several phases until it was finally uncovered in 2009. ECF 798 at 16-17; *see also* Brown Dep. at 210:10-17 (F4363) (purpose of the fraud was to hide the overdraft hole, though the means of the conspiracy changed over the years "from the Plan B COLB to Plan B AOT to the aged receivables, the shipped not paid losses . . . ."); T. Kelly Dep. at 193:8-16 (F4364).

10. The fraudsters began with sweeping in 2002 to cover a growing overdraft and then moved the fraud to the COLB facility in 2003, using "Plan B mortgages." ECF 798 at 16. Plan B mortgages were fake loans with no value to Colonial Bank. Tr. 3430:16-24 (Malek). The fraudsters also then started to use the AOT facility, where loan-level detail was not available on Colonial's computer system, ProMerit, to advance fake trades and conceal aged and defective loans and further conceal the fraud. ECF 798 at 16-17. The fraudsters tracked the fraudulent AOT loans in a

[5] Mr. Malek's use of a five-day grace period shows the FDIC-R's damages were calculated in a principled and conservative way. If Mr. Malek had used February 20, 2004, the date PwC negligently signed off on materially misstated financials, the fraud losses would have been over $7 million higher because the fraudsters stole an additional $7,681,658 on February 24, 2004. Tr. 3462:13-3463:3 (Malek); *see also* F4115 (indicating that $7,681,658 of cash was stolen from the Bank on a fake COLB Plan B advance on February 24, 2004).

secret, offline database maintained by Teresa Kelly. Tr. 3415:3-3416:19; 3431:16-24 (Malek). In the summer of 2005, the fraudsters transferred the balance of the fake Plan B loans into purely fictional fake AOT trades. ECF 798 at 11.

11. Throughout the fraud, the fraudsters dumped junk loans that could not be sold to legitimate end investors onto the AOT and COLB facilities and the Warehouse and Overline lines. Tr. 3430:25-3431:14, 3531:17-21 (Malek); F4138—F4144 (Malek schedules identifying which lines fraudulent junk loans were initially funded on before being concealed in fake AOT trades).

12. At Bank close in August 2009, the fraud was concentrated in $1.473 billion of fake AOT trades. Tr. 3457:4-3458:1 (Malek). PwC does not contest that all $1.473 billion of the AOT trades at Bank close were fake. Tr. 3458:12-13.

13. PwC attempts to challenge $415 million of junk loans—what PwC referred to at trial as the "blue" loans—all of which were ultimately hidden in fake AOT trades, on the grounds that those loans may not have been fraudulent when funded on COLB, Warehouse, or Overline at Colonial. Tr. 3397:7-3398:3.[6] PwC concedes that $495 million of fake Plan B AOT trades and $562 million of fake trades with junk loans directly advanced onto AOT are properly included as fraud losses. Tr. 3870:17-21 (Lehn).

14. Due to the limited factual dispute between the parties, the Court focuses its factual background on the TBW fraudsters' dumping of junk loans onto Colonial and later hiding those defective loans in fake AOT trades.

[6] PwC claims these loans were merely economic losses unconnected to the fraud. On that basis, PwC seeks a net $300 million reduction to damages.

A. The Fraud on AOT

15. In its Liability Order, the Court found that "during the AOT phase of the fraud . . . Colonial paid TBW for pools of loans that were supposedly in the process of being issued as a MBS by Freddie Mac. In fact, the vast majority of the pools of loans had no underlying mortgages backing them, that is, the mortgages were non-existent." ECF 798 at 19. At Bank close, Mr. Malek identified $495 million of fake AOT trades which were Plan B. Tr. 3641:13-17 (Malek); F4116.

16. The Court also found that during the AOT phase of the fraud "[t]here were also pools of loans that contained so-called 'junk loans'—real mortgages that were in default or had other problems." ECF 798 at 19. At Bank close, Mr. Malek identified $978 million of fake AOT trades, for which the fraudsters listed junk loans in an offline database even though none of the trades were real or associated with any loans and many of those "loans" were owned by other banks or charged off. Tr. 3641:18-19 (Malek); F4116.

17. As set out in the Liability Order, the "fraud on AOT" included *both* fake trades with no possible collateral behind them (Plan B) *and* fake trades theoretically composed of impaired loans either directly advanced on AOT or moved off of other Colonial lines and onto AOT. *See* ECF 798 at 19; *see also* Brown Dep. at 210:10-17 (F4363) (noting that the fraud on AOT included *both* Plan B AOT and aged receivables).

18. The fraudsters created a secret, offline database where they would track the impaired loans they concealed using fake AOT trades. Tr. 3415:22-3416:19 (Malek); ECF 798 at 85 (citing T. Kelly Dep. at 328:19-329:8 (Ex. D3071)).

19. For each fake AOT trade, "TBW sent Colonial a fraudulent 'assignment of trade' document that looked like a legitimate AOT agreement and generally contained the same information required for a real AOT transaction." ECF 798 at 19.

20. The junk loans in the fraudsters' secret second set of books were charged off, foreclosed, impaired-value loans that had no investor commitment and could never be part of a real AOT. Tr. 3415:4-10 (Malek); *see also* Brown Dep. at 265:15-267:5; 338:6-24; 344:5-25; 424:24-425:9 (F4363) (if PwC had asked for loan documents and the servicing files on the junk COLB and junk AOT, they would have seen that the junk COLB and junk AOT pools contained loans that were charged off, foreclosed, REO, paid off, and owned by other banks); T. Kelly Dep. at 48:22-49:5 (F4364) (AOT pools were misrepresented as agency pools); Kissick Statement of Facts (P2957) ¶ 12 (Farkas and other conspirators caused Colonial Bank to hold in its accounting records AOT trades backed by assets that TBW was unable to sell, including, but not limited to, impaired-value loans, charged-off loans, previously sold loans, loans in foreclosure, and real estate-owned property), ¶ 13 (the conspirators did this by, among other things, engaging in sham sales to hide the fact that the vast majority of assets backing the AOT trades could not be resold because the assets were either wholly fictitious or consisted of, among other things, impaired-value loans and REO and, in either case, had no corresponding, legitimate commitment to be purchased by third parties.); *see also* Kelly Statement of Facts (P1747), ¶¶ 12-13 (same). Nor was there a real takeout investor commitment or participation certificate as required for a real AOT transaction. Tr. 3435:1-12; P2879 ¶¶ 22-23.

21. Hiding these junk loans in fake AOT trades was part of the fraud. The fraudsters dumped loans that they could not sell and were sitting on other lending lines, like COLB and Warehouse, into fake AOT trades. P2114 (describing "clean up" of moving junk loans from COLB to AOT); *see also* Tr. 3431:15-3432:5, 3448:2-3449:8 (Malek); Brown Dep. at 343:20-344:25 (moving junk loans into AOT pools and falsely designating them as agency pools was a frequent practice of the fraudsters) (F4363), 341:7-343:3; T. Kelly Dep. at 48:22-49:5 (loans were "dumped

onto AOT"), 132:9-132:25 (F4364). In doing so, the fraudsters falsified bank records to show the loan had been paid off when it really just moved to a fake AOT trade where the loan was no longer listed on the Bank's books. Brown Dep at 343:20-344:25 (moving junk loans into AOT pools and falsely designating them as agency pools was a frequent practice of the fraudsters), 341:7-343:3 (F4363).

22. Regardless of where these junk loans were first placed at Colonial, they were part of the fraud and were used to steal money from Colonial. All of these loans were also ultimately hidden in a secret, offline database, thereby concealing the age and condition of the loans and denying Colonial Bank any ability to protect itself from the ensuing losses.[7] Tr. 3415:4-3416:10; 3431:15-24; 3433:2-14; 3519:19-3520:23; 3568:22-24 (Malek); T. Kelly Dep. at 328:19-329:8 (D3071); F4134 (Malek Schedule 4.6c reflecting every single loan found in the AOT offline database at Bank close).

23. The fake AOT *trades* were the "asset" that PwC improperly certified on Colonial Bank's balance sheets year after year. *See* Tr. 1585:20-1586:06 (Westbrook); Tr. 3456:7-3458:6 (Malek); F4354 (Malek Summary Exhibit listing net cash out on fake AOT trades at Bank close); Tr. 286:23-287:7 (O'Halloran, testifying that all of the AOT existing at Bank close was non-existent).

[7] PwC argues that the fact that some of the loans that were placed on AOT (and hidden in the secret, offline database) were eventually moved off of AOT and Colonial's books indicated that those loans were legitimate and should not be considered fraud losses. Tr. 3521:17-22. Given the far-reaching nature of the fraud, this Court finds this argument specious. The record indicates that loans moved off of AOT may have just been moved to Ocala Funding, another vehicle for the TBW fraud. *See* D. Brown 296:17-22 (Brown and Farkas discussing transferring loans from Colonial to Ocala, a TBW-related entity); P2100. Regardless, because Mr. Malek only included loans actually listed on the secret, offline database at Bank close in his damages calculation, Tr. 3519:19-3520:23; 3535:4-6; 3557:22-23; 3568:23-24 (Malek), the fact that some loans may have been moved off of that database, for whatever reason, is wholly irrelevant to the amount of fraud losses.

B. The Fraud included TBW dumping junk loans on Colonial Bank's Mortgage Warehouse Lending facilities.

24. TBW dumped junk loans on Colonial Bank that were rejected by other mortgage warehouse lenders or end investors. Tr. 3548:17-21 (Malek). These junk loans were impaired and ineligible for sale to Freddie Mac or Ginnie Mae. Tr. 3770:5-9 (Malek). These loans were dumped on Colonial when they were already in foreclosure, paid off, in default, lacked necessary documentation to sell, or were entirely fraudulent. Tr. 3528:13-24 (Malek); P2957, ¶ 12; P1747, ¶ 12.

25. Stealing money from Colonial by advancing far more than the actual value of these junk loans was part of the fraud. TBW fraudsters Farkas and Brown specifically identified dumping loans rejected by other banks onto Colonial as an alternative to simply using purely fictional Plan B loans to steal money. P2094; Tr. 3443:17-3445:22 (Malek). For example, in early April 2004, just prior to the creation of AOT (which occurred on April 28, 2004), Farkas and Brown dumped aged loans rejected by Credit Suisse First Boston ("CSFB") onto Colonial and stole the full balance of the loans even though they were junk and could not be sold. *Id.*

26. Although PwC claims that Colonial never placed impaired loans on any line other than AOT (Tr. 3772:19-3773:3) (Lehn), the record indicates that Colonial Bank was *already* the "dumping ground" for these unwanted mortgages *before* the AOT line came into existence on April 28, 2004. Tr. 3441:6-3442:11, 3443:17-3445:22 (Malek); P1907; P2094. Dumping junk loans onto Colonial Bank's Warehouse, COLB and Overline facilities occurred before AOT even existed. F4138 – F4144 (Malek schedules indicating dates of funding and funding lines for fraudulent junk loans that were later concealed in the secret second set of books).

27. For example, in early April 2004 before AOT began, Teresa Kelly (then Carrier) and Cathie Kissick questioned why Colonial was "always the dumping ground" for loans rejected

by other banks. P1907. In that specific instance, Washington Mutual required TBW to repurchase aged loans, as is standard practice in mortgage warehouse lending, and the fraudsters, with the knowledge and assistance of Kissick and Kelly, then stole money from Colonial and dumped the Washington Mutual junk loans onto Colonial's existing funding lines. *Id.*

28. Testimony by the TBW fraudsters and Kissick and Kelly, as well as documentary evidence, also confirmed that dumping junk loans to steal money on all of Colonial's funding lines, not just AOT, was an established pattern and practice of the fraud. Indeed, as early as 2003, TBW used Colonial's MWLD as a "dumping ground" for impaired loans that were either rejected by other mortgage warehouse lenders, in default, in foreclosure, or already in "real estate owned" (REO) status. Bowman Dep. at 184:16-185:8, 186:24-187:24 (describing Colonial as the dumping ground for TBW's repurchased loans) (F4362); Brown Dep. at 266:19-267:3 (F4363), 298:18-25; 313:10-314:15 (TBW dumping on Colonial aged, REO and repurchased loans); T. Kelly Dep. at 81:8-83:7, 84:19-85:09 (Colonial was dumping ground for TBW's rejected loans) (F4364); P1907 (identifying Colonial as the dumping ground for loans rejected by other lenders); P2094 (same); P2100 (Farkas indicating that Colonial is "full of total junk"); *see also* Brown Dep. at 296:17-297:14 (discussing P2100 and agreeing that aged loans on COLB were "junk") F4363; Tr. 3842:7-15 (D. Brown discussing P2100 and testifying that TBW dumped junked loans **on any of TBW's lines** with Colonial).

29. TBW dumped its junk loans on Colonial any time they were rejected by its other mortgage warehouse lenders. Tr. 3538:1-8 (Malek); Bowman Dep. at 184:16-185:8, 186:24-187:24 (Colonial as the dumping ground for TBW's repurchased loans) (F4362); Brown Dep. at 266:19-267:3, 298:18-25; 313:10-314:15 (TBW dumped on Colonial aged, REO and repurchased

loans) (F4363); T. Kelly Dep. at 81:8-83:7, 84:19-85:09 (Colonial was dumping ground for TBW's reject loans) (F4364); P1907; P2094.[8]

30. Regardless, the Court finds whether the loan was impaired at funding irrelevant to calculating fraud losses. There is no question that refusing to exercise the Bank's "put back" rights, and then hiding these loans on AOT with a secret, second set of books was part of the fraud and caused the FDIC-R the losses on those loans, all of which were ultimately hidden among the $1.473 billion of fake AOT trades at Bank close.

31. Kissick and Kelly only permitted these reject loans to be dumped on Colonial and the money for those loans to be stolen because they were compromised by the fraud. T. Kelly Dep. at 81:8-83:7 (F4364) (Kelly conceding that being the dumping ground was not in Colonial's best interests and that she and Kissick were compromised by the fraud and could not refuse); Tr. 3566:24-3567:3 (Malek). As Raymond Bowman, TBW's president, explained, Kissick had to keep TBW going to conceal her involvement in the fraud, so she was forced to accept and conceal junk loans whereas a legitimate lender would have just cutoff TBW and rejected those loans. Bowman Dep. at 184:16-185:4 (F4362).

32. Even after the creation of AOT, the fraudsters continued to dump junk loans on Colonial's other lending lines, including Warehouse, COLB and Overline, depending on where there was room under Colonial's lending limits for TBW. Tr. 3541:8-15; 3557:8-13 (Malek);

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[8] PwC tried to suggest a false equivalence between these fraudulent junk loans and the sublimits for non-conforming loans on Warehouse. Tr. 3633:11-3635:12 (Malek). As Mr. Malek and the Court pointed out, Colonial's actual exposure to such non-conforming product, as part of a lending syndicate, was quite small. *Id.*; Tr. 3720:23-3722:10 (Malek); F4030 at 23 (Sublimit C); Schedule 1 to F4030 (showing Colonial's 17.9% percent exposure); F4030 at 27 (Warehouse commitment limits); A279 at 8 (indicating non-conforming is typically less than 2% of Colonial's Warehouse and COLB business). Plus, those loans were still subject to stringent credit quality standards as well as Warehouse margin protections. F4030 at 11-12. In short, they were not the fraudulent junk loans dumped on Colonial.

F4138—4144 (Malek schedules indicating dates of funding and funding lines for fraudulent junk loans that ended up in the secret second set of books).

33. Naturally, these impaired junk loans would age on Colonial's lending lines because they could not be sold. Tr. 3450:7-14 (Malek) (aging is indicator of fraud because these junk loans could not be sold). Once the amount of these junk loans increased and drew unwanted scrutiny, the fraudsters hid them in fraudulent AOT trades off the Bank's official books and records. Tr. 3569:14-25 (Malek). That concealment was part of the fraud. ECF 798 at 85.

34. Every one of the $415 million in loans challenged by PwC (the so-called "blue" loans) was hidden in a fraudulent AOT trade at Bank close. Tr. 3541:1-3542:15 (Malek); Tr. 3859:20-22 (Lehn). Every one of those loans was dumped onto Colonial Bank, failed to sell to an end investor and was not returned to TBW for a refund. Instead, those loans were concealed as part of the fraud, which caused Colonial Bank to lose the full amount of those loans.

35. In addition to those overall indicia of the fraud, which were applicable to every one of the $415 million in so called "blue" loans, 2,113 of the 4,225 loans also had specific data showing they were fraudulent when put on Colonial's books. F4100 (Exhibit 4.0 to Malek's Rebuttal Report); Tr. 3438:19-25; 3703:10-3704:6 (Malek) (summarizing this data); *see also* ECF 529, Exh. 2 at 20 (table summarizing the data in F4100). Over 1,000 of those loans said "DNS or Do Not Sell" in TBW's records but were nonetheless sold to Colonial despite the lack of a committed end investor. *Id.*[9] The data also showed 323 of the loans did not meet investor guidelines, 194 were already aged or lacked documentation, 186 had been repurchased by TBW

[9] At trial, PwC's counsel attempted to create the impression that there were only a handful of "Do Not Sell" loans. Tr. 3686:2-3688:22 (Malek). As elicited on re-direct, however, Mr. Malek explained that "DNS," as used on F4100, was short for "Do Not Sell." Tr. 3703:10-3704:10 (Malek). Over 1,000 of these loans were marked "DNS" or "Do Not Sell" in TBW's records but were, nonetheless, dumped on Colonial. *Id.*

from other lenders, 166 had already been charged off, 81 had been previously shipped to and rejected by other lenders, 52 had missing or incomplete documents, 37 had wires returned, 13 were in foreclosure, 9 were already post-foreclosure REO, 3 were listed as "delinquent," and 2 were identified as "returned from investor."[10] *Id*.

36. These loans, which all ended up in fake AOT transactions and the fraudsters' database and which PwC claims had nothing to do with the fraud, were not only junk but, in some cases, were entirely fraudulent. For example, as demonstrated at Farkas' criminal trial, certain of the "blue" loans were Lee Farkas' own fraudulent loans where "Do Not Sell" was put in TBW's records because no legitimate mortgage warehouse lender, only Colonial, would ever take those loans. Tr. 3706:23-3708:23; 3708:1-23; 3854:3-3857:10 (Malek); F4100. Another example of fraudulent loans were the Welch loans, obtained after Farkas committed identity theft and took out loans in the name of an Ocala lawyer without his knowledge. *Id.*

C. The Fraud prevented Colonial Bank from sending back junk loans and getting repaid.

37. PwC's negligence compromised Colonial's protections against losses from loans that could not be sold. Under its contracts with TBW, Colonial had the right to recover money on loans that did not sell either by curtailment of Warehouse loans or by requiring repurchase of

[10] To the extent that PwC claims that these notations are not evidence that there was an issue with the loan *prior* to the sale to Colonial, the Court is not convinced. Even though TBW may have had ongoing dealings with the loans as the servicer, there would have been no reason for a servicer to note that a loan should not be sold *after* the loan had already been sold. Regardless of when these entries were made, TBW was always required to buy the loan back if there was no committed end investor. Due to the fraud, that did not occur and Colonial suffered these fraud losses.

PwC also attempted to argue for the first time at trial that the date of certain "Document Exceptions" found in the ProMerit data was after the loan funding date, suggesting that could mean problems arose later after funding. Tr. 3849:22-25 (Lehn). Of course, the absence of loan documents would always be present at origination and loans could not be sold without proof of a note and mortgage. Moreover, Professor Lehn lacked any expertise to testify or substantiate PwC's claims. Tr. 3850:10-3851:10; 3851:18-24 (Lehn). The Court finds that any time gap between when Colonial noted the loan lacked necessary documents and the funding date is immaterial and thus irrelevant to its determination of damages.

COLB loans. Since Kissick and Kelly were part of the fraud and would be exposed for their criminal acts, Kissick did not require repayment on the impaired loans but instead hid them in fake AOT trades depriving Colonial of repayment.

38. As a mortgage warehouse lender, Colonial was only supposed to provide short term funding between the time a loan was advanced to a closing table and its purchase by an end investor. Tr. 3574:16-21 (Malek). Loans were normally supposed to be sold and Colonial repaid within thirty to forty-five days of the funding date. Tr. 3554:11-18; 3559:21-3560:3; 3563:17-21 (Malek). Should Colonial Bank find itself with impaired loans on its books, it had two remedies: curtailment and the right to "put back" impaired loans to TBW.

39. With regard to impaired Warehouse loans, Colonial could "curtail" the loan (also known as a margin call) by actually going into its customers account with the Bank and taking back a portion of the advance on the loan as a paydown on part of the balance due. Kissick Dep. at 911:20-912:8 (D4020). The vast majority of the junk loans advanced outside of AOT and later hidden in fake AOT trades were never curtailed.[11] For the limited number of loans where records show they may have been curtailed, that same money was later stolen on fake AOT trades. Tr. 3653:6-24 (Malek). As Mr. Malek explained, TBW would steal the money again later through fake AOT advances but the FDIC-R conservatively calculated the date the money was stolen as the initial funding date. Tr. 3542:6-15; 3544:4-14; 3546:20-3547:10 (Malek).

40. Colonial's second option was to exercise its "put back" right and force TBW to repurchase that COLB loans for the full amount of the original advance. *See* A372 at 5-6, ¶ 4 (setting forth requirements for COLB loans including existence of commitment of an end investor);

[11] An analysis of F4100 reveals that of the 4,225 fraudulent junk loans that were transferred into the fraudsters' secret second set of books, only 212 contain a "margin call" notation indicating that they were curtailed to any degree.

6-8, ¶ 5 (setting forth documents TBW had to deliver including end investor commitment and note); 11, ¶ 10 (representations and warranties of TBW that loans comply with requirements for sale); 18-20, ¶ 17 (contract provision obligating TBW to buy back COLB loans from Colonial for **full repurchase price** when in violation of representations and warranties); Ex. C (Participated Mortgage Loan Requirements); Beahler Dep. at 45:15-18 (if there was any indication that a COLB loan was not going to be purchased by an end investor, TBW could be forced to pay that loan in full at any time) (D4017); Bowman Dep. at 186:24-187:17 (F4362); W. Kelly Dep. at 83:9-22 (Colonial had the ability to push COLB loans back on the originator) (F4365); Tr. 3712:6-9 (Malek).[12] Pursuant to its "put back" right, Colonial was entitled to get the full repurchase price, i.e., a full refund of the money taken on that loan.

41. PwC has already admitted that Colonial had a right to a complete refund if an end investor failed to purchase TBW's loans. In its Answer to the Third Amended Complaint in *Taylor, Bean & Whitaker Plan Trust v. PricewaterhouseCoopers LLP*, Case No. 13-33964 CA (Fla. Cir. Ct. for Miami-Dade County), PwC admitted that "the terms of those transactions required that committed takeout investors be in place; and that Colonial's customer was required, upon request

[12] PwC relies on Cathie Kissick's testimony to argue that one of Colonial's regulators, the OCC, prohibited it from "putting back" these loans in order to meet the requirements of FAS 140. *See* Tr. 3988:13-3989:9. The Court does not find Ms. Kissick's testimony credible in light of the express terms of the LPSA, A372, as well as PwC's admissions in its answer in the Florida case and its own Formal Consultation Memo. P2879, ¶ 22; A203 at 3. PwC expressly admitted in the Florida case that Colonial could force TBW to repurchase loans when the takeout investor did not purchase the loans. P2879, ¶ 22. Furthermore, in PwC's Formal Consultation Memo on FAS 140, PwC wrote that "Colonial may put back its participating interest to Seller upon the occurrence of a repurchase event . . . Events that enable Colonial to put a loan back to the Seller include . . . breaches of representation or warranty . . . The primary rep and warranty is that the mortgage loan shall be covered by . . . the End Investor Commitment." A203 at 3. PwC cites to D163 but that memo confirms that "loans have to trigger a rep and warrant violation in order for a repurchase request to be made." D163 at 7. The evidence clearly establishes that if there was not a purchase by a takeout investor, it violated the COLB contract and Colonial had a right to get its money back. Kissick did not insist on repurchase due to her involvement in the fraud; it had nothing to do with FAS 140.

by Colonial Bank, to repurchase the loan if, among other things, a takeout investor did not purchase it." P2879, ¶ 22.

42. Other mortgage warehouse lenders required TBW to repurchase aged loans that did not sell. Washington Mutual, CSFB, and Dresdner all provided warehouse financing to TBW—just like Colonial—but they required TBW to buy back aged loans so that they did not bear the risk of loss on those loans. P1907; P2094; Tr. 3442:8-3445:10 (Malek); Bowman Dep. at 184:16-185:4; 186:24-187:24 (other lenders would require TBW to repurchase loans that did not sell) (F4362).

43. Colonial also required its other, legitimate mortgage originator customers to repurchase aged loans. During the financial crisis, other mortgage customers had aged loans (although to a vastly smaller degree than TBW) but Colonial managed its losses on those loans by enforcing its curtailment and "put-back" rights. Tr. 3578:16-24 (Malek).

44. The fraud, however, prevented Colonial Bank from exercising its "put back" rights on the TBW junk loans, causing Colonial to suffer fraud losses. Tr. 3563:22-3564:10; 3566:24-3567:3 (Malek). Because of Kissick's entanglement in the fraud, TBW knew that Colonial would not reject impaired loans. Mr. Bowman explained that the TBW fraudsters knew they could send impaired loans to Colonial Bank due to Kissick's "unique situation," meaning her participation in the fraud. In Bowman's words, "Cathie had to keep us going because . . . The other lenders could just cut us off and fold the relationship." Bowman Dep. at 184:16-185:4 (F4362); T. Kelly Dep. at 175:25-176:7 (Kissick "drove the train" as to why Colonial did not force TBW to repurchase aged loans on COLB) (F4364). As noted, when other TBW lenders not involved in the fraud would say "you've got to get these aged receivables off our line," TBW would turn to Colonial, the "dumping ground for aged receivables." Bowman Dep. 186:24-187:24 (F4362); *see also* T. Kelly Dep. at

81:8-83:7 (being the dumping ground for junk loans was not in the best interest of Colonial Bank, but Kelly and Kissick could not say no to Farkas because they were compromised by their involvement in the fraud) (F4364).

45. Periodically, once the volume of aged TBW COLB loans was sufficient to attract management attention, Kissick simply moved these impaired COLB loans into fake AOT trades. Tr. 3569:18-3570:2, 3589:17-3590:10 (Malek). The act of hiding impaired COLB loans on AOT, instead of exercising Colonial's contractual right to a refund, was part of the fraudulent scheme. *See* ¶ 21, *supra*.

46. Had Ms. Kissick not been compromised by her involvement in the fraud, Colonial would have sent back the nearly $16 million of junk loans existing as of February 25, 2004 to TBW for repayment and the fraud would have been exposed and stopped right then. Tr. 3435:1-23 (Malek). Due to PwC's negligence, the fraud continued and more loans were hidden in fake AOT trades instead of being returned for a refund.

D. Losses on the $415 million in so-called "blue" loans were fraud losses, not economic losses.

47. In addition to the clear evidence these "blue" loans were part of the fraud (failed to sell, not "put back" to TBW, hidden in fake AOTs and secret books), the evidence clearly establishes that the economic decline from 2007 to 2009 did not cause the losses claimed as damages by the FDIC-R.

48. It is undisputed that Colonial Bank continued to profit on its legitimate MWL customers during the period of the fraud. Mr. Malek analyzed the financial performance of the Mortgage Warehouse Lending Unit, a separate segment reported in the Bank's financial statements, after excluding the income and losses from the Colonial-TBW relationship. Tr. 3712:11-22 (Malek). Colonial's MWL business with legitimate customers was profitable every

year from 2004 up through the first quarter of 2009 (last available segment reporting data available). Tr. 3712:11-3717:7 (Malek). Thus, despite the financial crisis, Colonial made money on its legitimate MWL business because it managed any potential losses by "putting back" and curtailing aged loans and cutting off non-profitable customers. Tr. 3578:1-24 (Malek); Tr. 3712:11-3717:7 (Malek) (discussing the mortgage warehouse lending unit's business with its legitimate customers as reflected in Colonial's financial statements); A66 at 110; A69 at 142; A73 at 38. PwC's damages expert Kenneth Lehn provided the Court with no analysis of how Colonial's legitimate mortgage warehouse lending fared during the financial crisis. Tr. 3866:16-3867:9 (Lehn).

49. Mr. Malek's opinion that these were fraud losses is further supported by the disproportionate number of TBW's aged COLB loans compared to legitimate Colonial customers. For instance, at year-end 2007, 99.6% of all the aged COLB loans in the MWLD were TBW loans. P2946; W. Kelly Dep. at 35:4-17; 37:11-38:12 (F4365). Other COLB customers had hundreds of millions of dollars of COLB loans but only one other customer had *any* aged COLB loans as of December 31, 2007: four loans, totaling $503,523 of the total $166 million in aged COLB loans existing at that date. Tr. 3867:7-19 (Lehn); P2946. And, of course, TBW's actual "aged" loan total was far higher, but the true amount was concealed in fake AOT trades and not on the COLB aging report.[13] Tr. 3433:13-25 (Malek).

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[13] PwC argued that the fact that other MWLD customers also had some aged loans at certain points in time is evidence that Kissick made a legitimate business decision not to send back TBW's junk loans. Tr. 3988:7-12. This assertion does not withstand minimal scrutiny. Even when other MWLD customers did have aged loans, the amount of TBW's aged loans was orders of magnitude greater, even taking into account the fact that TBW was the MWLD's largest customer. *See* D17 (reflecting that the lender with the second most aged loans after TBW, Bayrock, had 3% of the amount of aged loans that TBW had); D315 (reflecting that the lender with the second most aged loans after TBW, Pinnacle, had 10% of the amount of aged loans that TBW had). Furthermore, none of the other MWLD customer relationships were fraudulent, so these small percentages reflected the entirety of the legitimate customers' aged loans. Plus, those customers' aging loans were required to be repurchased ultimately or moved to Warehouse where the Bank would take

50. Similarly, as of December 31, 2008, legitimate, non-TBW COLB customers had $600 million outstanding in COLB but less than $2 million aged over 90 days. D356 at 5. Warehouse loans show the same story. Only 2% of legitimate Warehouse loans were aged as of December 31, 2008. *Id*. at 8. These legitimate customers aged loans were not hidden in fake trades or tracked in a secret second set of books. They were on the aging report and they were managed through curtailment so that Colonial's legitimate MWL business stayed profitable through the recession.

51. In 2008, when Ms. Kissick was asked about the volume of TBW aged COLB loans that were visible on Colonial's books, she claimed that the loans were all "quality, 'A' paper loans, 700-plus FICO scores" that were performing but had not been sold because of a "documentation error." A185 at 129 of 175, PWC-CBG-TBW00039656-39752; W. Kelly Dep. at 55:12-57:4 (F4365). In truth, Ms. Kissick had misrepresented the borrowers' FICO scores as was clear from the document in PwC's workpapers, but PwC made no attempt to verify those assertions. Tr. 3754:11-3757:5 (Malek) (discussing A185 and how it was evident that the loans thereon were not 700-plus FICO score loans); W. Kelly Dep. at 86:4-86:20 (F4365) (indicating that Kissick had

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back its money through margin calls. *See* D168 (MWL procedures manual showing careful procedures to manage Colonial's risk, require repurchase of COLB loans and move loans to warehouse where they will be margined, i.e. Colonial takes back its money if the loan does not sell). That is precisely what happened with Bayrock's unsold loans (which PwC highlighted at the damages phase) according to PwC's own exhibit. *See* D163 at 1, ¶ 3 ("Bayrock's loans will be moved to the PSTP sublimit tomorrow . . . . That will take all loans on Bayrock that fell out of the CountryWide and Citi Mortgage trades OFF the bank's books and back onto Bayrock's."). That is why customers like Bayrock and Pinnacle did not have aged loans on COLB at the end of 2007 or 2008. *See* P2946; D356. In contrast, the TBW agings reflected in these reports are but the "tip of the iceberg" with respect to aged and otherwise impaired loans. Tr. 3433:15-25, 3644:7-24, 3755:3-16 (Malek). As part of the fraud, Kissick and Kelly hid the rest of TBW's aged and impaired loans in a secret second set of books; that is, they concealed the body of the iceberg and did not send the COLB loans back because they were captive to the fraud.

stated the loans on A185 were 700-plus FICO score loans but that PwC did nothing to verify that).[14]

52. Moreover, if Colonial had actually had *good* TBW loans with simple documentation errors, the fraudsters would have readily corrected those errors in an attempt to get more cash. Tr. 3564:11-17; 3754:18-3755:2 (Malek). Because these loans were truly impaired, they sat on Colonial's books until they were so aged that the fraudsters had to secretly hide them in AOT. Tr. 3558:2-5; 3448:16-3449:8; 3453:5-8 (Malek).

53. The Court finds the fact that the overwhelming amount of aged loans were TBW loans, plus evidence that Colonial remained profitable on its legitimate MWL transactions, is proof that the losses on the "blue" loans were fraud losses, not economic losses. TBW was the only customer with this systemic aging problem where loans did not sell and were not curtailed or "put back." The Court concludes that the TBW aged loans were a product of the fraud and not the housing crisis. As to its other customers, Colonial was clearly exercising its rights to protect itself from impaired collateral. This is demonstrated by the fact that Colonial's MWLD business with legitimate customers remained profitable for the entire damages period. Tr. 3716:23-3717:7 (Malek).[15]

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[14] In truth, around 50% of the loans had FICO scores below 700. A185 at 145-175; Tr. 3755:17-3757:5 (Malek).

[15] Professor Lehn criticized Mr. Malek for not isolating market factors, calling his decision not to reduce damages "astounding." Tr. 3785:7-9 (Lehn). However, it is Professor Lehn who did no analysis of the actual effect the market had on legitimate mortgage warehouse lending, claiming that it was not "relevant to his opinion." Tr. 3866:5-24 (Lehn). Professor Lehn contended that the performance of Colonial's legitimate mortgage warehouse lending business was "not probative" of the impact of the economy. Tr. 3867:22-24 (Lehn). To the contrary, it is the best evidence and it disproves PwC's unsupported assertion that Mr. Malek did not "disentangle" fraud losses from economic factors. The evidence shows that the *fraud*, not market conditions, caused Colonial's losses on these junk loans hidden in fraudulent AOT trades.

54. PwC's contention that Ms. Kissick made a legitimate business decision based on Colonial's interests to accept and keep $415 million of junk loans, Tr. 3782:21-3783:13 (Lehn), is not credible. Kissick, with Kelly's assistance, accepted huge volumes of impaired loans from TBW, refused to exercise Colonial's "put back" rights, hid the impaired loans in fraudulent, fake securities on AOT, and tracked these loans in a secret, offline database—all for the purpose of preventing discovery of the fraud. Tr. 3566:24-3567:3 (Malek); T. Kelly Dep. at 81:8-83:7 (F4364) (explaining that Colonial was the dumping ground for impaired loans from other lenders because Kissick and Kelly were compromised by their involvement in the fraud).

III. <u>The damages calculation</u>

55. Before addressing the amounts disputed by PwC, the Court will summarize the largely undisputed methodology and calculations of the FDIC-R's expert, Kenneth Malek.

56. Mr. Malek is an expert in both accounting and fraud. P3076. He is a CPA, certified in financial forensics, and a Fellow of the American College of Bankruptcy. Mr. Malek has extensive experience investigating large scale frauds involving complex transactions, including fraudulent lending in the banking and real estate industry. *See* Tr. 3419:8-3425:23 (Malek); P3076.

57. Mr. Malek and his team of 14 investigators spent thousands of hours of forensic work studying the TBW fraud and Colonial's losses stemming from the fraud. Mr. Malek's team included experts in the extraction and interpretation of electronic data from mortgage warehouse lending records. *See* Tr. 3426:16-3427:6 (Malek). They quantified for each day how much was stolen, which required analyzing hundreds of thousands of transactions. *See* Tr. 3425:24-3426:15 (Malek). Mr. Malek was consistently conservative in his calculations and included *only* the losses sustained on fake AOT trades and fraudulent loans listed on a secret offline database for AOT. Tr. 3519:19-3520:18; 3535:4-6; 3557:22-23; 3568:23-24 (Malek).

58. The Court finds Mr. Malek credible and his team's work persuasive. The fact that PwC accepted Mr. Malek's methodology, with two exceptions discussed below, and did not offer any alternative methodology or calculations of its own, further supports Mr. Malek's credibility.

59. The following demonstrative sets forth Mr. Malek's calculation of the FDIC-R's damages. The Court will discuss each element of the calculation set forth therein.

Damages Caused By PwC's Negligent 2003 Audit	
AOT Losses at Bank Close:	**$1.473 Billion**
Money Stolen Before 2003 Audit:	**($229 Million)**
Net "Income" After 2003 Audit:	**($365 Million)**
Allocable Recoveries:	**($254 Million)**
Damages:	**$625 Million**

002-051

A. Starting point for fraud losses on AOT—$1.473 billion

60. It is undisputed that Colonial suffered approximately $2.37 billion in losses as a result of the fraud. ECF 798 at 6 ("fraudsters had diverted over $2 billion dollars' worth of assets from Colonial"); *id.* at 11 ("fraud had grown to $2.3 billion dollars" by August 2009); Tr. 286:11-287:7 (O'Halloran); F4368 (Luria), 1136:20-1137:7; Tr. 3414:14-24 (Malek).

61. It its Liability Order, this Court held that that the FDIC-R cannot recover Shipped-Not-Paid losses from PwC reducing the FDIC-R's recoverable fraud losses by 40%. Therefore, Mr. Malek reduced the $2.37 billion in losses by $900 million in shipped-not-paid losses to reach

the starting point for his damages calculations: $1.473 billion of fake AOT.[16] Tr. 3414:25-3415:2 (Malek); F4354 (summary exhibit of net cash out on fake AOT trades as of Bank close). PwC does not dispute this number.

B. Reduction for money stolen before PwC's negligent 2003 audit—$229 million

62. Mr. Malek properly deducted the $229 million in fraud losses that Colonial incurred before February 25, 2004. As a result, the $1.473 billion in fraud losses was reduced to $1.244 billion—the amount stolen between February 25, 2004 and Colonial's closure in August 2009. Tr. 3464:10-20 (Malek); F4355 (precise listing of Plan B COLB loans as of February 25, 2004 from Bank's ProMerit system, including amounts stolen on each loan); F4356 (precise listing of junk loans as of February 25, 2004 from Bank's ProMerit system, including amounts stolen on each loan).

C. Reduction for net "income" from TBW—$365 million

63. Because Colonial's relationship with TBW would have terminated if PwC had discovered the fraud in 2003, Mr. Malek further reduced Colonial's $1.244 billion in fraud losses by the amount of "income" Colonial received from TBW during the liability period (between February 25, 2004 and Colonial's closure in August 2009). Tr. 3418:7-19 (Malek); F4357.

64. First, Mr. Malek calculated all income received by Colonial from TBW from February 25, 2004 through Bank close. Tr. 3464:23-3465:16 (Malek). Using the actual invoices, Colonial's ProMerit and WinCMSS systems and other Bank data, Mr. Malek precisely calculated the amount actually received by Colonial in fee and interest payments from TBW as well as Lee

[16] The FDIC-R reserves its right to challenge the Court's ruling regarding the FDIC-R's Shipped-Not-Paid claim on appeal.

Farkas personally from February 25, 2004 through Bank close.[17] Tr. 3465:9-3466:19 (Malek); F4357.

65. Next, Mr. Malek deducted the costs Colonial incurred in funding its relationship with TBW. Mr. Malek calculated the Bank's costs of financing the TBW relationship using the Bank's actual average cost of funds reported in Call Reports made by Colonial to the Federal Financial Institutions Examination Council. Tr. 3467:15-3472:14 (Malek); P1037 (Bank Call Report from Q1 2004). The use of an average cost of funds, rather than cutting the highest cost funds first, was a conservative approach that resulted in a reduced damages figure. Tr. 3470:15-3471:10 (Malek).[18] Mr. Malek also properly reduced variable personnel costs in the MWLD because, had TBW no longer been a customer, the size and needs of the MWLD would have been substantially reduced. Mr. Malek also conservatively concluded that Colonial would not have replaced TBW with a legitimate customer. Tr. 3472:18-3473:3 (Malek). If Mr. Malek had assumed otherwise, damages would have been significantly higher. Tr. 3469:11-25 (Malek).

66. The Court finds, and PwC does not dispute, that, by reducing Colonial Bank's fraud losses by $365 million—to $879 million—Mr. Malek properly accounted for these fees, interest

[17] Mr. Malek accounted for pass-through income received by the Bank on account of participations of other lenders, which reduced the amount of money that Colonial actually received pursuant to the TBW relationship. Tr. 3467:19-3468:6 (Malek). PwC designated testimony by the TBW Plan Trustee, Neil Luria, that Colonial received $800 million in fees but did not use this testimony during their cross-examination of Mr. Malek. F4368 (Luria), 1233:14-20. Mr. Luria and Mr. Malek's calculations are entirely consistent. The reason for the difference is that Mr. Luria did not factor in that some of the money paid by TBW passed through Colonial to other lenders and his calculation was not limited to post-February 2004 income.

[18] Mr. Malek's use of an actual average cost of funds is a conservative methodology to calculate the cost of funds. Upon termination of the TBW relationship, Colonial Bank likely would have reduced its cost of funds by eliminating higher cost sources of the money used to finance the TBW lending relationship first, rather than undertaking an average across-the-board reduction. Mr. Malek, however, used a more conservative, average-cost-of-funds approach, resulting in a lower damages calculation. Tr. 3470:15-3471:16 (Malek).

payments, and other "income" from TBW. Tr. 3473:4-10 (Malek); Tr. 3793:16-3794:1 (Lehn); F4357.

67. The Court thus finds that the FDIC-R's damages, prior to the setoffs discussed below, are $879 million. Tr. 3473:4-10 (Malek).

D. Reduction for allocable recoveries received by the FDIC-R—$254 million

68. PwC bears the burden of proving that any recoveries the FDIC-R obtained from other sources are attributable to its losses in this case, thereby reducing the damages for which PwC is ultimately responsible. *See Har-Mar Collisions*, *Inc. v. Scottsdale Ins. Co.*, 212 So. 3d 892, 904 (Ala. 2016) (discussed *infra*). Nevertheless, Mr. Malek affirmatively and correctly calculated all applicable recoveries to reduce the amount of damages the FDIC-R may recover from PwC.[19]

69. The FDIC-R's principal source of recovery for losses caused by PwC's negligent 2003 audit was the TBW bankruptcy, where the FDIC-R was allowed both secured and unsecured claims. *See* B182 at 14-17 (describing the FDIC-R's secured claim); *id*. at 21 (describing the FDIC-R's unsecured claim).

70. The FDIC-R has also recovered funds from criminal restitution paid by Mr. Farkas, and Mr. Malek has properly applied an approximately $1 million setoff for those payments. *See* Tr. 3502:2-8 (Malek); D4013.

71. With one exception relating to the FDIC-R's alleged rights to certain REO assets, PwC does not dispute Mr. Malek's calculations regarding the recoveries the FDIC-R has obtained through the TBW bankruptcy or these other sources. Tr. 3502:13-18.[20]

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[19] If the FDIC-R were to prevail against PwC on its shipped-not-paid claims, a portion of its recovery from the TBW bankruptcy and recoveries from the Ocala bankruptcy would be applicable as a setoff to the shipped-not-paid damages. Because this Court has denied those claims, however, no additional setoff is warranted.

[20] PwC suggested that the FDIC-R could receive additional recoveries from the TBW Bankruptcy Estate for which PwC could be entitled to an additional setoff. Tr. 3698:10-3702-4. Clearly, the Court

72. As part of its settlement with TBW in the bankruptcy proceedings, the FDIC-R received a secured claim on the "AOT loans" (i.e., the loans hidden in the secret second of books, none of which were associated with a legitimate AOT trade), which resulted in a $191 million recovery ($188 million of which Mr. Malek appropriately applied to the FDIC-R's fraud loss claim). Tr. 3649:15-3650:20 (Malek). The FDIC-R also negotiated and obtained an unsecured claim in the TBW settlement, for which it has recovered $124 million ($65 million of which Mr. Malek correctly applied as a setoff here).

73. Thus, Mr. Malek allocated $253 million in recoveries from the TBW Bankruptcy Estate and $1 million in restitution payments as setoffs, reducing the amount of damages the FDIC-R seeks to recover from PwC. Tr. 3418:20-3419:1 (Malek). PwC does not challenge these amounts.

74. After reducing the FDIC-R's $879 million fraud loss claim by this $254 million in allocable setoffs, the damages the FDIC-R is seeking from PwC for its negligent 2003 audit of Colonial Bank are $625,309,085. Tr. 3419:2-7; 3509:3-5 (Malek).

75. By reducing the FDIC-R's fraud losses by pre-existing losses, net "income," and setoffs, Mr. Malek reduced the FDIC-R's damages by more than 50% of the $1.473 billion in fake AOT losses at Bank close.

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cannot account for any future, speculative recoveries. Moreover, the record indicates that any additional recoveries coming out of the bankruptcy are likely negligible. F4361 (affidavit of TBW Bankruptcy Trustee setting forth that the remaining collateral allocated to the AOT facility was less than $4 million); Tr. 3701:7-16 (Malek).

E. The REO proceeds

76. One of PwC's two challenges to Mr. Malek's damages calculation involves the FDIC-R's right to certain REO on the books at the time Colonial closed. Tr. 3389:8-3391:11. The Court finds the following facts with respect to the REO.

77. After Colonial Bank closed, there were disputes between the TBW Bankruptcy Trustee and the FDIC-R over entitlement to many assets, including but not limited to COLB loans, Overline REO, AOT loans, AOT REO, as well as numerous other accounts. B182 at 4.

78. As the mortgage servicer, TBW had control and possession of the AOT and Overline REO. *See* Debtor's Emergency Motion, ¶ 38, *In re: Taylor Bean & Whitaker Mortgage Corp.* (8/31/2009) (09-bk-07047, ECF 83) (indicating TBW's control and possession of REO assets); F4352, ¶ 8 (noting that "REO and other related assets . . . were serviced, maintained and controlled by" TBW).

79. The AOT and Overline REO were liquidated through a bulk sale approved by the TBW bankruptcy court on December 17, 2009, which resulted in approximately $78 million in proceeds. B182 at 5; D4001; Tr. 3918:14-3919:2 (Malek).

80. The $78 million proceeds from the bulk sale of the AOT and Overline REO became part of the TBW Bankruptcy Estate. Tr. 3919:15-16 (Malek).

81. Nine months after the bankruptcy court approved this bulk sale, the TBW Bankruptcy Trustee and the FDIC-R entered into a global settlement agreement dated August 11, 2010, whereby they resolved a number of disputes between them. B182 at 4-5; Tr. 3922:10-16 (Malek).

82. The settlement agreement resolved many disputed assets but did not identify the reasons why particular assets were assigned to the TBW Bankruptcy Estate or FDIC-R. *See* B182;

Tr. 3921:21-3922:3 (Malek). Nor did the settlement identify any *quid pro quos* or linkages between settlement terms. *Id*.

83. The settlement included numerous provisions: (1) the FDIC-R received a 99% interest in the COLB loans; (2) the FDIC-R received a first-priority secured interest to 99% of the proceeds of the AOT loans; (3) the FDIC-R disclaimed any right it may have had to the AOT and Overline REO; (4) TBW received ownership of certain unrelated "Selene" loans; (5) distributed certain of the Debtor's accounts at Colonial; (6) provided that the FDIC-R will release its hold on certain of TBW's funds at the Bank; (7) provided for certain further eventual turnovers by the FDIC-R; (8) granted the FDIC-R a contribution claim in the Debtor's estate; (9) set the procedure for determining the allowed amount of the FDIC-R's general unsecured claim; (10) provided that the FDIC-R make available to certain "Trade Creditors" a portion of its recovery on its unsecured claim; (11) provided for releases between the parties; (12) provided that TBW withdraw its claims in the Colonial Bank Receivership; (13) FDIC-R disclaimed an interest in certain unrelated loans; and (14) provided for the FDIC-R's support and vote in favor of a bankruptcy plan to be proposed by the Debtor. B182 at 5-6. The settlement also provided certain other benefits to the TBW Bankruptcy Estate, which are set forth in the document. *Id.* at 6.

84. Nothing in the settlement agreement, however, linked the FDIC-R's relinquishment of any potential right in the Overline or AOT REO to the FDIC-R securing an interest in the COLB loans or any other term of the settlement. Tr. 3921:21-3922:3 (Malek).

85. The FDIC recovered $191 million on its secured claim on the AOT, for which Mr. Malek correctly applied a $188 million setoff to the FDIC-R's damages claim to account for that recovery. *See* Tr. 3649:15-3650:20 (Malek). PwC does not challenge that setoff amount. Tr. 3502:9-18 (Malek).

86. The FDIC-R also received its pro rata share (approximately 38 percent) of the $78 million proceeds from the liquidated REO via its unsecured claim against the TBW Bankruptcy Estate. Tr. 3920:6-15 (Malek).

87. Mr. Malek properly accounted for the FDIC-R's portion of the $78 million REO proceeds, which it received through its unsecured claim in the TBW Bankruptcy Estate, in his damages computation. Tr. 3919:3-3920:16 (Malek).

88. Aside from this pro rata share via its unsecured claim—that Mr. Malek has already accounted for—the FDIC-R received none of the proceeds of the AOT and Overline REO sales. Tr. 3933:14-3934:8 (Malek). Accordingly, the FDIC-R's damages calculation already accounts for the recoveries it actually received through the TBW settlement.

CONCLUSIONS OF LAW

IV. PwC's negligence proximately caused the FDIC-R's fraud losses, as calculated by Mr. Malek.

89. The causation standard applicable here has already been set out in this case:

> Under Alabama law, "[p]roximate cause is an act or omission that in a natural and continuous sequence, unbroken by any new independent causes, produces the injury and without which the injury would not have occurred." *Gooden*, 966 So. 2d at 239. A "natural and continuous sequence" means "unbroken by any new independent causes." Subsequent causes of injury, such as fraudulent or criminal acts of a third person, are not "new independent causes" that intervene or break the chain of causation, unless those subsequent causes are unforeseeable by the defendant. *Thetford v. City of Clanton*, 605 So. 2d 835, 840 (Ala. 1992). The notion of foreseeability is key to a proximate cause analysis. *Gen. Motors Corp. v. Edwards*, 482 So. 2d 1176, 1194 (Ala.1985). There can be no liability where "the resulting injury could not have been reasonably anticipated by the defendant. Foreseeability does not require that the particular consequence should have been anticipated, but rather that some general harm or consequence could have been anticipated." *Thetford*, 605 So. 2d at 840 (emphasis added).

ECF 73 at 4-5 (Watkins, J.).

90. Foreseeability is at the heart of the proximate cause analysis, but the *actual* harm need not be anticipated, rather the anticipation of some "general harm" is sufficient. *See id.*; *see also Alabama Power Co. v. Taylor*, 306 So. 2d 236, 249 (Ala. 1975) ("In Alabama, foreseeability is the cornerstone of proximate cause.").

91. The Court has already held that it was reasonably foreseeable that PwC's failure to uncover the fraud would allow the fraud to continue, resulting in damages to Colonial. *See* ECF 798 at 52. Audits are critical to companies because creditors, regulators, investors, and the company itself rely on them for material financial transactions. It also therefore should be foreseeable to an independent public auditor like PwC doing an audit of a public company under the Sarbanes-Oxley Act that its negligence in failing to discover a material fraud could result in substantial losses.

92. Indeed, this Court has held that this type of loss was not only foreseeable, but that PwC *actually* foresaw it—recognizing that losses in the MWLD on account of mortgage originator (TBW) fraud was one of Colonial's greatest risks. ECF 798 at 33; *see also* A83 at 2.

93. Thus, the FDIC-R has carried its burden to show that the foreseeable, "natural and continuous" result of PwC's negligence was the continuation of the fraud, with the fraud causing significant losses to Colonial Bank—the "fraud losses."[21]

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[21]The cases PwC cites in support of its argument that some of the FDIC-R's claimed damages were not foreseeable may easily be distinguished from the case at hand. *See, e.g.*, *United Food & Commercial Workers Unions, Emps. Health & Welfare Fund v. Philip Morris, Inc.*, 223 F.3d 1271, 1273 (11th Cir. 2000) (holding in lawsuit against tobacco product manufacturers that costs allegedly incurred by employee health and welfare benefit plan due to tobacco-related illnesses were too remote under doctrine of proximate cause); *Hammonds v. United States*, 418 F. App'x 853, 857-58 (11th Cir. 2011) (holding in lawsuit brought by veteran against the United States under Federal Tort Claims Act that damages for inflammation of inner layer of heart, known as infective endocarditis, was not a foreseeable result of a dental procedure performed at the Veterans Administration Medical Center because the veteran had no history of heart trouble and showed no signs of risk of any other type of infection); *Maxwell v. KPMG, LLP*, No. 03-CV-3524, 2007 WL 2091184, at *3 (N.D. Ill. July 19, 2007), *aff'd*, 520 F.3d 713 (7th Cir. 2008) (Trustee of a newly merged technology consulting company claimed that if KPMG had conducted a proper audit then the company would have avoided insolvency because the merger would not have occurred and the pre-merger company

94. PwC does not dispute that the FDIC-R's "fraud losses" are the appropriate measure of damages, subject to setoffs for recoveries the FDIC-R has already received on its fraud losses from other sources.

95. The Court is now charged with determining what damages flowed from PwC's negligence. The FDIC-R is entitled to recover all damages that "flow directly and naturally from the breach and are not speculative." *Ramsey v. Avco Fin. Servs*., 646 So. 2d 142, 143-44 (Ala. Civ. App. 1994) (citing C. Gamble, Alabama Law of Damages, § 1-2 (2d ed. 1988)); *see also Seaboard Air Line Ry. Co. v. Latham*, 127 So. 679, 681 (Ala. Ct. App. 1930) ("[I]n tort all damages foreseeable as a result of the negligent act and connected therewith as an unbroken sequence are recoverable.").

96. Specifically relevant here, in a professional negligence case, "[t]he standard measure of damages . . . is the loss which resulted from the negligence." *Ramsey*, 646 So. 2d at 143-44 (citing C. Gamble, Alabama Law of Damages, § 36-43 (2d ed. 1988)).[22]

97. Accordingly, the FDIC-R is entitled to recover all losses which resulted from PwC's negligence.[23]

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would have survived the technology crash.). Each of these cases presents a causation theory that is much more attenuated and remote than the FDIC-R's here.

[22] PwC made some references to the lost profits causation standard at trial. Tr. 3515:24-3518:9 (Malek). Mr. Malek testified at trial that the FDIC-R's damages would be $364 million higher if it included lost profits that Colonial would have earned by replacing TBW with a legitimate customer. Tr. 3717:25-3718:25 (Malek). The FDIC-R has taken a conservative approach, however, and chosen not to pursue lost profits, which are more speculative than the direct fraud losses it seeks. The causation standard for a lost profits analysis is therefore irrelevant.

[23] PwC makes much of the fact that Mr. Malek speaks of the "but for world" in his analysis. Tr. 3515:18-23, 3973:25-3974:3. Despite the fact that Mr. Malek speaks of the world "but for" PwC's negligence, there is no question that the FDIC-R is not seeking true "but for" damages. The damages that the FDIC-R seeks are reasonably and appropriately limited to true fraud losses proximately caused by PwC's negligence. If the FDIC-R were seeking true "but for" damages, it would be asking for *all* losses stemming from *all* transactions between TBW and Colonial after February 2004. Instead, the FDIC-R has

98. If PwC had properly performed its professional responsibilities, the TBW fraud would have been uncovered during the 2003 audit, and Colonial Bank would have immediately ceased all business dealings with TBW. ECF 798 at 33; Tr. 2142:7-18 (Beville). AOT (where every fraudulent loan was ultimately hidden) never would have even existed. *See* F4315 (Malek Schedule 4.7 showing start of AOT as of April 28, 2004); Tr. 3758:16-23 (Malek) (proper 2003 audit prevents any junk loans being hidden in AOT).

99. Accordingly, the Court concludes that all fraud losses resulting from Colonial Bank's ongoing relationship with TBW—from February 25, 2004 to August 2009, when the fraud was finally discovered and Colonial Bank terminated its relationship with TBW—"flow directly and naturally from the breach and are not speculative." *Ramsey*, 646 So. 2d at 143-44.

100. Once more, the Court finds *Grant Thornton, LLP v. FDIC*, 535 F. Supp. 2d 676 (S.D. W.Va. 2007), *aff'd*, 435 F. App'x 188 (4th Cir. 2011), helpful.[24]

101. The *Grant Thornton* court, applying West Virginia law which is substantively similar to Alabama law, determined that because a proper audit would have resulted in the immediate closure of the bank, all of the bank's operating losses (from two days after the faulty audit was completed until the day the bank was closed by the OCC) were proximately caused by the accountants' failures. *Id.* at 711 ("Grant Thornton's negligence in failing to discover the fraud at Keystone allowed the fraud to continue, and the losses that the FDIC seeks to recover [the bank's

conservatively limited its requested damages to losses arising out of actual, *fraudulent* transactions with TBW.

[24] The Court also finds the *Grant Thornton* court's analysis of *Askanase v. Fatjo*, 130 F.3d 657 (5th Cir. 1997) applicable here. 535 F. Supp. 2d at 711-13. In this case, unlike in *Askanase*, there is no question that had PwC properly performed its audit, the relationship between TBW and Colonial Bank would have terminated immediately. *Id.* at 712. Moreover, PwC did not merely "furnish the condition" for Colonial Bank's harm, "[i]t affirmatively acted when it issued its audit report and that opinion effectively" allowed TBW to continue to steal from Colonial Bank. *Id.*

net operating losses from the time the fraud should have been discovered until it was discovered] are the foreseeable result of that ongoing fraudulent scheme.”).

102. The FDIC-R presents an even stronger case here. In *Grant Thornton*, the damages at issue were the ongoing operating expenses of the bank, which were incurred because the negligent audit allowed the bank to continue to operate. *Id.* at 712. Here, by contrast, the FDIC-R is not seeking its operating expenses, but only direct fraud losses from the TBW fraud, which PwC identified as a risk but negligently allowed to continue. Had PwC performed a proper audit during the 2003 audit period, Colonial Bank would have immediately terminated its relationship with TBW and none of these fraudulent transactions would have occurred after February 25, 2004.[25]

103. The court in *Grant Thornton* determined that “[t]he objective of awarding damages for negligent conduct is to put the plaintiff, insofar as possible, in the same position it would have been in if the tort had not been committed,” *id.* at 725, and awarded damages equal to the money lost during the bank’s prolonged operations. *Id.* at 729. Similarly, here the FDIC-R is entitled to recover all money lost on account of the fraud during the prolonged relationship between Colonial Bank and TBW after PwC’s negligent 2003 audit.

[25] In its opinion affirming the district court’s finding of proximate cause and award of damages in *Grant Thornton*, the Fourth Circuit found “it particularly significant in this case that Grant Thornton was hired to perform the audit, not in the ordinary course, but at the insistence of federal regulators who were closely watching Keystone. And Grant Thornton was well aware that factor was the reason behind its engagement.” 435 F. App’x at 195. The Court does not, however, read the Fourth Circuit’s opinion as requiring that specific type of knowledge. Indeed, the Fourth Circuit went on to favorably cite *Thabault v. Chait*, 541 F.3d 512 (3d Cir. 2008), in which the Third Circuit upheld a “jury verdict of almost $120 million as proximately caused by auditors’ negligent failure to discover insolvency of insurance company where the damages represented the net cost of continuing operations from the date of the audit to the date of liquidation, a period of more than nineteen months.” 435 F. App’x at 196. In *Thabault*, the auditor was neither hired at the insistence of a regulator nor aware of any potential problems at the insurance company. *See* 541 F.2d at 516. In fact, similar to this case, the various regulators in *Thabault* also failed to detect the problems with the insurance company. *Id.* at 523. Moreover, as noted, the damages the FDIC-R seeks here are *directly* tied to the TBW fraud that PwC allowed to continue.

104. The damages the FDIC-R seeks are "all natural and foreseeable losses" as a result of Colonial Bank's continued relationship with TBW that "would not have occurred but for [the auditor's] negligence and [] were a foreseeable result of [the auditor's] negligence." *Grant Thornton*, 435 F. App'x at 195-96.

105. This determination is consistent with other courts considering similar fact patterns. *See, e.g.*, *Thabault v. Chait*, 541 F.3d 512, 520 (3d Cir. 2008) (awarding nearly $120 million when auditor failed to detect financial failings and allowed insurer to continue to write policies, holding that "these losses, which arose from the continued writing of insurance policies, had an impact on Ambassador's solvency and increased Ambassador's liabilities. This increase in Ambassador's liabilities was caused by PwC's negligence and thus was properly considered as damages proximately caused by PwC's negligence"); *Comeau v. Rupp*, 810 F. Supp. 1172, 1176-79 (D. Kan. 1992) (accepting the FDIC's theory of causation that, by failing to conduct a proper audit so as to warn the board of probable losses on loans already in existence, the accountant allowed a dangerous condition to continue and that the continuation of the dangerous condition led to the purchase of additional loans which would not have been purchased but for the accountant's failure to alert the board of the unsoundness of the continued lending relationship; and that proximate cause existed because the accountant's omissions might reasonably have been expected to lead the board to believe that the loans did not pose a significant risk, such that "the nature of the omission (failure to disclose the deleterious effect of prior risky loans) bears a sufficient causal relationship to the ultimate injury (losses from similar risky loans purchased from the same source as the previous loans)"); *Bd. of Tr. of Cmty. Coll. Dist. No. 508, Cty. of Cook v. Coopers & Lybrand, L.L.P.*, 803 N.E.2d 460, 472 (Ill. 2003) (upholding jury verdict that because the auditor failed to detect the treasurer's violation of investment policies, the plaintiff could not take steps to correct

those violations, resulting in losses on those investments—the "Board could have ended those investment practices and the later investments that ultimately resulted in the claimed losses would not have occurred"); *see also World Radio Labs. v. Coopers & Lybrand*, 557 N.W.2d 1, 12 (Neb. 1996); *Stroud v. Arthur Andersen & Co*., 37 P.3d 783, 792 (Okla. 2001) (client "made several business decisions to its detriment in reliance on the flawed financial statements of its worth"); *Salisbury v. Arthur Andersen & Co*., 956 S.W.2d 601, 602-03 (Tex. Ct. App. 1997) (auditor failed to find and advise client of inventory overstatement, causing company's demise because management made business decisions in reliance on financial statements).

106. In *Thabault*, the court noted that "the negligent audit proximately caused an increase in liabilities through the writing of more insurance policies . . . [and] had an immediate negative consequence . . . . In other words, the damages here are losses incurred on insurance policies that would not have been written but for [the auditor's] negligence." 541 F.3d at 521.

107. Similarly, the money Colonial Bank lost on account of its continued dealings with TBW would not have been lost had PwC not been negligent. Had PwC properly performed its audit, Colonial Bank would have terminated its relationship with TBW by February 2004, either by its own volition or by regulatory mandate, and stopped advancing money for fake and/or impaired loans. *See* Section I, *supra*. Accordingly, the FDIC-R has met its burden to demonstrate that PwC's negligent audit caused the losses sustained on account of continued stealing by TBW between February 25, 2004, and the closing of Colonial Bank in August 2009.

108. As noted above, PwC does not dispute that the FDIC-R's fraud losses are the appropriate measure of damages.

109. Instead, it asserts that one category of loans—those originating outside AOT and subsequently hidden in AOT trades (the so-called "blue" loans)—are not "fraud losses" and, therefore, should not be included in the FDIC-R's damages.

110. In support of this argument, PwC posited at trial that the FDIC-R improperly pursued one strategy during the liability phase and a different strategy during the damages phase. Tr. 3405:12-15.

111. Specifically, PwC claimed that the FDIC-R failed to assert—and therefore the Court failed to find—that impaired loans originating outside of AOT and subsequently transferred into AOT, i.e., the "blue" loans, were part of the fraud. Tr. 3400:20-3403:4; Tr. 3978:25-3979:3 ("It was during the damages trial for the first time that somebody from the FDIC tried to redefine the fraud to include blue mortgages that were impaired and transferred into AOT.").

112. PwC is wrong. In its Liability Order, the Court, in describing the AOT fraud, cited evidence *from the liability phase record* and expressly referred to the fact that junk or impaired loans were included in the pools of loans underlying the fake AOT transactions. ECF 798 at 19.

113. The AOT fraud had multiple components, including both fake trades and impaired loans subsequently hidden in fake trades. TBW transmitted data on fictitious AOT trades, which were used to hide impaired loans, and *none* of the loans listed in the secret second set of books had the necessary takeout investor commitment. *Id.*; *see also* Tr. 3437:1; 3450:3-14; 3575:1-3 (Malek).

114. Both Mr. Malek and Professor Lehn were aware that the so-called "blue" loans were at issue in this case well before the liability trial, as they both addressed those loans in their respective expert reports. Tr. 3441:6-3442:1 (Malek); 3773:14-3774:16 (Lehn). Specifically, Mr. Malek precisely identified each loan ultimately hidden in fake AOTs that caused fraud losses, and

he specified whether they were originally funded on the Warehouse, Overline, COLB, or AOT lines.[26]

115. During the liability phase of trial, the question before the Court was *liability*—whether PwC negligently performed its audits. Accordingly, the liability phase necessarily focused on *PwC* and its audit failures, not *TBW* and the scope or specific mechanics of the fraud (although there was certainly overlap between the two). One of PwC's central audit failures was failing to test AOT, the very place these fraudulent junk loans were concealed. PwC's audit failure is directly tied to these junk loans hidden in fake AOT trades.

116. The full scope of the TBW fraud was not on trial in the liability phase (and the FDIC-R was not tasked with proving it); the issue was PwC's negligence. The Court certainly had to understand certain aspects of the fraud to evaluate PwC's audit, but that necessary context in no way limits what damages the FDIC-R may seek.

117. There is no incongruity between the FDIC-R's presentation in the liability phase of this trial and the damages it now seeks. The first phase of the trial established that PwC was negligent, and, had PwC not conducted a negligent audit, the fraud would have been detected. It was therefore appropriate for Mr. Malek—who was tasked with unravelling the fraud to determine the FDIC-R's resulting losses—to describe the fraud and the losses resulting from it.[27]

[26] PwC's counsel objected at trial that Mr. Malek's description of where the junk loans were dumped was "all brand new." Tr. 3441:6-3442:6. The Court overruled that objection because Mr. Malek's schedules accompanying his original report, dated July 20, 2016, detailed whether these junk loans were dumped on COLB, Warehouse or Overline. *Id.*; *see also* F4134, F4139, F4141, F4142, F4143, F4144 (Schedules to Malek's expert reports listing "Junk Loans Transferred to AOT by Bank Close" as of various damages dates and indicating on which line each loan was initially advanced). Mr. Malek has always identified these loans as fraud losses.

[27] PwC also argued in closing that Mr. Malek had somehow offered undisclosed causation testimony, but there is no basis for that assertion. Tr. 3975:12-17. Mr. Malek's reports made clear he would not address whether PwC's audits were negligent or if the fraud would have been discovered by a non-negligent audit and he did not do so. Tr. 3513:2-7 (Malek). But his detailed reports, including particularly his rebuttal report, always addressed foreseeability and why the FDIC-R's claimed losses were "fraud

V. <u>The FDIC-R has proven its damages with reasonable certainty.</u>

118. Damages can only be awarded where they are reasonably certain and not based upon speculation. This does not mean, however, that the FDIC-R must prove the amount of its damages to a mathematical certainty. Rather, it need only produce evidence tending to show the extent of damages as a matter of just and reasonable inference. *Jamison, Money, Farmer & Co., P.C. v. Standeffer*, 678 So. 2d 1061, 1067 (Ala. 1996); *Indus. Chem. & Fiberglass Corp. v. Chandler*, 547 So. 2d 812, 820 (Ala. 1988); Alabama Law of Damages §§ 1:5, 7:1 (6th ed. 2017).

119. Under this standard, absolute certainty is not required because "the risk of uncertainty must fall on the defendant whose wrongful conduct caused the damages." *Super Valu Stores, Inc. v. Peterson*, 506 So. 2d 317, 330 (Ala. 1987); *see also, e.g.*, *In re Neurontin Mktg. & Sales Practices Litig.*, 712 F.3d 21, 49-50 (1st Cir. 2013) ("The damages inquiry does not allow a defendant to benefit from the scope of its wrongdoing; this is why '[e]ven "speculation has its place in estimating damages, and doubts should be resolved against the wrongdoer."' *BCS Servs.,* 637 F.3d at 759 (quoting *Mid–Am. Tablewares, Inc. v. Mogi Trading Co.,* 100 F.3d 1353, 1365 (7th Cir. 1996))."); Restatement (Second) of Torts § 912 cmt. a (1979) ("It is desirable . . . that there be definiteness of proof of the amount of damage as far as is reasonably possible. It is even more desirable, however, that an injured person not be deprived of substantial

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losses," and not economic losses. ECF 529, Ex. 2, Expert Damages Rebuttal Report of Kenneth J. Malek, dated September 12, 2016. For example, Mr. Malek's rebuttal report included sections such as "The Full Damages on Junk Loans that I Have Computed Were Foreseeable." *Id.* at 28. Also, Section IV of his rebuttal report detailed deposition testimony showing how junk loans being dumped outside of AOT was part of the fraud. Furthermore, Mr. Malek always identified the $1.4 billion in fake AOT, including junk loans initially advanced outside of AOT, as part of the fraud losses. *See* Tr. 3441:25-3442:1; Tr. 3428:19-3429:11 (Malek); *see also* F4134, F4139, F4141, F4142, F4143, F4144 (Schedules to Mr. Malek's expert reports listing "Junk Loans Transferred to AOT by Bank Close" as of various damages dates and indicating on which line each loan was initially advanced).

compensation merely because he cannot prove with complete certainty the extent of harm he has suffered.”).

120. Although a court will not permit a plaintiff to recover damages based on “mere speculation or guess,” *Samaritan Inns, Inc. v. District of Columbia*, 114 F.3d 1227, 1235 (D.C. Cir. 1997) (quotation omitted), the plaintiff need only provide some reasonable basis upon which to estimate damages. *See Hill v. Republic of Iraq*, 328 F.3d 680, 684 (D.D.C. 2003); *see also Palmer v. Conn. Ry. & Lighting Co*., 311 U.S. 544, 561 (1941) (“Certainty as to the amount [of damages] goes no further than to require a basis for a reasoned conclusion.”); *In re Neurontin Mktg. & Sales Practices Litig.*, 712 F.3d 21, 50 (1st Cir. 2013) (“The burden of proof as to damages is lower than that for causation, and the factfinder is afforded a greater deal of freedom to estimate damages where the defendant, as here, has created the risk of uncertainty. *See Ocean Spray Cranberries, Inc. v. PepsiCo, Inc.,* 160 F.3d 58, 63 (1st Cir. 1998).”); *Nicolet Instrument Corp. v. Lindquist & Vennum*, 34 F.3d 453, 455 (7th Cir. 1994) (explaining that plaintiff merely had to “quantify [its] harm to a reasonable, which is not to say a high, degree of precision,” a “not very demanding standard” (citing Restatement (Second) of Torts § 912)).

121. Indeed “[a] defendant should not be permitted to profit on the basis that calculating damages may be theoretically challenging.” *In re MyFord Touch Consumer Litig.*, No. 13-CV-03072-EMC, 2018 WL 887534, at *27 (N.D. Cal. Feb. 14, 2018); *see Comcast Corp. v. Behrend*, 569 U.S. 27, 35 (2013) (noting that damages “[c]alculations need not be exact” so long as they “attempt” to “measure only those damages attributable to [plaintiffs’] theory”); *cf. Living Designs, Inc. v. E.I. Dupont de Nemours and Co*., 431 F.3d 353, 367 (9th Cir. 2005) (explaining that “[w]here the fact of damage is established,” the court will “not insist upon a higher degree of certainty as to the amount of damages than the nature of the case admits, particularly where the

uncertainty was caused by the defendant's own wrongful acts"); *Hunt Foods, Inc. v. Phillips*, 248 F.2d 23, 33 (9th Cir. 1957) ("[W]here it clearly appears that a party has suffered damage, a liberal rule should be applied in allowing a court or jury to determine the amount; and that, given proof of damage, uncertainty as to the exact amount is no reason for denying all recovery. The fact that the amount of damage may not be susceptible of exact proof or may be uncertain, contingent or difficult of ascertainment does not bar recovery.").

122. Moreover, "[t]he rule that one cannot recover uncertain damages relates to the nature of the damages, and not to their extent. If the damage or loss or harm suffered is certain, the fact that the extent is uncertain does not prevent a recovery." *Jamison, Money, Farmer & Co., P.C. v. Standeffer,* 678 So. 2d 1061, 1067 (Ala. 1996).

123. The Court finds the damages computations presented by the FDIC-R through its expert, Mr. Malek, to be logical, well-supported, and well-reasoned. Mr. Malek meticulously reconstructed TBW's relationship with Colonial Bank, accounted for the costs and income associated with that relationship, and deducted any other recoveries attributable to these same damages.

124. In fact, Mr. Malek's precise calculations far exceed those required to establish damages with reasonable certainty in the context of a failed bank. *See, e.g.*, *FDIC v. First Am. Title Ins. Co.*, 611 F. App'x 522, 533 (11th Cir. 2015) (noting that given "the circumstances of a failing bank" "'reasonable certainty' does not require a calculation of the book value of each loan"; damages are properly calculated by comparing the cash out on a loan with the amount recovered).

125. Accordingly, the Court finds that Mr. Malek's calculation of damages in the amount of $625 million is reasonably certain and amply supported by reliable evidence.

VI. The conduct and knowledge of Colonial Bank employees is irrelevant to the Court's damages calculations here.

126. During the damages trial, PwC intimated that it may attempt to lay blame for these losses on certain Colonial Bank employees, e.g., Kamal Hosein, presumably under either a failure to mitigate or an intervening cause type argument. Tr. 3399:8-3400:2. Regardless of how the argument is couched, however, this Court has already held that the misdeeds of Colonial Bank's employees will not be imputed to the FDIC-R as the innocent receiver. The Court must reject any argument that attempts to reduce damages based on the conduct of Colonial employees—whether fraudulent or negligent—because it would circumvent this ruling.

127. Indeed, this Court has already expressly ruled that a failure to mitigate defense based on the conduct of Colonial Bank employees does not lie against the FDIC-R. *See* ECF 720 at 5 (listing various defenses, including the failure to mitigate damages, and concluding that "[t]he gravamen of all these defenses is the same—they are based on the fraudulent conduct of Colonial employees who conspired with TBW and/or on the fact that CBG and Colonial employees failed to detect the fraud, and that this conduct should be imputed to the FDIC to prevent its recovery"); *id.* at 11 ("Colonial's employees' misconduct and/or alleged negligence that occurred pre-receivership is not attributable to the FDIC.").

128. Similarly, the actions or inactions of Colonial employees cannot serve as an intervening cause blocking the FDIC-R's ability to recover.[28]

129. This Court has already considered what constitutes an intervening cause under Alabama law, finding that "a person, who by some act or omission sets in motion a series of events,

[28] *See* Docket Minute Entry for Pretrial Conference held on 9/13/2017 ("Evidence regarding all alleged intervening causes except market conditions will be presented during the liability phase of the trial").

is not responsible for consequences of intervention of another agency, unless at the time of his original act or omission, the act of the intervening agency could be reasonably foreseen." *See* ECF 798 at 46-53.[29]

130. As noted, the Court went on to hold that "[i]t is foreseeable that an auditor's negligence in failing to discover fraud will allow that fraud to continue." *Id.* at 52. Accordingly, the Court has already held that it was reasonably foreseeable that the fraud would continue (i.e., TBW would continue to hide junk loans on Colonial's books) if PwC failed to properly perform its audit, and PwC cannot argue that the continued use of AOT as a dumping ground for these impaired mortgages somehow was an intervening cause.

131. Once more, the case of *Grant Thornton, LLP v. FDIC*, 435 F. App'x 188 (4th Cir. 2011), is directly on point.

132. In that case, the defendant claimed that the actions of the bank's management after the failed audit—separate and apart from any kind of imputation question—constituted an intervening cause extinguishing liability. *Id.* at 196-97. The defendants argued that, post-audit,

[29] Specifically, however, the Court determined the standard for a *third party's* conduct to constitute an intervening cause. ECF 798 at 48. The Court has already held, however, that the Colonial Bank employees were acting in Colonial Bank's best interest such that their conduct is imputed to the Bank. Accordingly, the Court must apply Alabama law regarding whether a *party's* own conduct can constitute an intervening cause. Under Alabama law, a party's pure negligence can never constitute an intervening cause, something more is required. *Gilmore v. Shell Oil Co.*, 613 So. 2d 1272, 1275 (Ala. 1993) (holding that, as a general rule, "plaintiff's own *negligence* cannot be an intervening efficient cause"). For a party's conduct to qualify as an intervening cause it must be "so highly extraordinary or unexpected that it can be said to fall without the realm of reasonable foreseeability as a *matter of law*"; it must be "more than mere contributory negligence and is of a higher culpability level than the defendant's negligence." *Id.* at 1275 (citing *Gen. Motors Corp. v. Edwards*, 482 So. 2d 1176, 1194-95 (Ala. 1985), and 57A Am. Jur. 2d Negligence §§ 650, 652 (1989)); *Rondini v. Bunn*, No. 7:17-CV-01114-RDP, 2018 WL 317713, at *11 (N.D. Ala. Jan. 8, 2018). Here, however, where PwC cannot establish the basic requirement that the act was unforeseeable, the Court need not even consider the heightened standard.

management was aware of the bank's insolvency but, nevertheless, continued to recklessly operate the bank. *Id.*

133. Applying West Virginia law on intervening cause, which tracks Alabama law, the Fourth Circuit affirmed the district court's holding "that the continued effort of the Bank's management post audit to conceal Keystone's insolvency was not an intervening and superseding cause." *Id.* at 197. An intervening cause only lies where "the two acts of negligence are unconnected and unrelated [and] the one could not be reasonably foreseen to be the result of the other." *Id*. at 198. In other words, "a superseding or intervening cause [exists when] the event in question was significantly independent from the initial negligence such that the separate acts of negligence had only a tangential relation to each other." *Id.*

134. Under the facts of that case, the court determined that "the continued fraudulent conduct by the Bank's management was not unforeseeable nor did it 'operate independently' of the established fact of Grant Thornton's negligent audit." *Id*. Indeed, the court held that "but for the negligent audit report, the management conduct posited by Grant Thornton could not have happened. In this sense, the post-audit actions by Bank's management are not a 'new effective cause' and did not 'operate[ ] independently' of Grant Thornton's negligence and thus do not constitute a superseding cause of the Bank's damages." *Id.* at 197 (citations omitted).

135. Just as the alleged "intervening cause" would not have occurred "but for" the negligent audit in *Grant Thornton*, "but for" PwC's failure to uncover the TBW fraud in 2003, the junk loans at issue would never have been on Colonial Bank's books, regardless of what Colonial Bank employees did or did not do, or what they knew or did not know.[30]

[30] There is no evidence in the record that Hosein, or anyone at Colonial Bank other than Kissick and Kelly, actually knew that the AOT trades were fake. The knowledge of any Colonial Bank employee is also irrelevant to the damages here.

136. PwC cannot establish that the Bank's conduct in continuing to conceal these impaired loans constituted an intervening cause.

VII. **The Court is unpersuaded by PwC's damages expert.**

137. Having found that the FDIC-R has established its damages with reasonable certainty, the burden shifts to PwC to prove why a reduction is warranted. *Intergraph Corp. v. Bentley Sys. Inc.*, 58 So. 3d 63, 77 (Ala. 2010) (explaining that once the plaintiff proved its damages with reasonable certainty, the defendant "then had the burden of introducing, or going forward with, evidence indicating that 'other causes' accounted for" plaintiff's losses) (citing *Corson v. Universal Door Sys., Inc.*, 596 So. 2d 565 (Ala. 1991)); *see also Team Sys. Int'l LLC v. Aquate Corp.*, 682 F. App'x 820, 826 (11th Cir. 2017) (under Alabama law, once "Plaintiff produced sufficient evidence to meet its burden of proving" its losses, "Defendant bore the burden of supporting its contrary view . . . with enough evidence to enable the court to quantify them") (citing *Intergraph*, 58 So. 3d at 78); *Burlington N. & Santa Fe Ry. Co. v. Grant*, 505 F.3d 1013, 1028 (10th Cir. 2007) (noting that "the burden of proving that damages should have been reduced or minimized is on the defendant."); *Gustafson v. Am. Family Mut. Ins. Co.*, No. 11-CV-01303-PAB-MEH, 2012 WL 5904301, at *4 (D. Colo. Nov. 26, 2012) ("[O]nce a plaintiff establishes damages, it is usually the defendant's burden to produce evidence on which any reduction of damages is to be predicated."); *Dahl v. Bartling*, No. S-721, 1986 WL 1165306, at *1 (Alaska Jan. 15, 1986) (defendant has the burden of establishing "reduction of damages"); *Gen. Ins. Co. of Am. v. City of Colo. Springs*, 638 P.2d 752, 759 (Colo. 1981) ("If damages are established, then it is a defendant's burden to produce evidence on which any reduction of damages is to be predicated.").

138. The only evidence PwC offers is the testimony of its expert, Professor Lehn.

139. The Court, however, finds Professor Lehn's testimony to be unsupported by the evidence and not persuasive.

140. In his expert report, Professor Lehn offered six criticisms of Mr. Malek's report, claiming that because of these flaws, "Mr. Malek has not estimated purported damage to a reasonable degree of certainty." ECF 521 at Ex. 1, Expert Report of Kenneth M. Lehn, dated August 29, 2016 ("Lehn Report") at 9-10.

141. At trial, however, PwC pursued only one of those criticisms: "Mr. Malek's calculations of Junk AOT losses fail to exclude losses resulting from nonfraud factors, such as declines in the value of Junk AOT resulting from the housing and mortgage crisis." *Id.* at 9.

142. In further support of that opinion prior to trial, Professor Lehn offered three paragraphs in his report. *Id.* at 13-14. He stated that Mr. Malek's estimated damages do not account for "losses associated with impaired mortgages that Colonial Bank may have incurred anyway if PwC had uncovered the fraud earlier." *Id.* at 13. He based this opinion on the assertion that "if the fraud had been uncovered earlier, Colonial Bank could have continued to acquire new mortgage loans, some fraction of which would likely have been impaired for nonfraud reasons." *Id.* at 14.

143. Professor Lehn then goes on to "recalculate" the FDIC-R's losses by removing all loans originally acquired outside of AOT, arguing that this somehow excludes "nonfraud losses" and reduces the FDIC-R's damage by approximately $400 million (net $300 million after backing out recoveries). *Id.*

144. However, the theory that Colonial Bank would have continued to acquire new mortgage loans that would have experienced market-based, non-fraud losses was *not* the theory that Professor Lehn presented at trial to support this same damages reduction.

145. Instead, Professor Lehn offered an entirely new opinion, claiming that Mr. Malek should have accounted for the market impact on the *impaired AOT loans* prior to Bank closure—rather than some other, hypothetical non-fraud loans Colonial would make to other customers had the fraud been discovered. Tr. 3785:7-9 (Lehn).

146. Professor Lehn's decision to present an entirely different theory to support the *same* reduction in damages undermines his credibility. Indeed, his entire reduction is premised on Mr. Malek's alleged failure to consider market factors, when Professor Lehn himself did no analysis of market factors, cited no economic data and failed to analyze the effect of the market on Colonial's legitimate mortgage warehouse lending relationships. Tr. 3866:25-3867:7 (Lehn).

147. Professor Lehn's failure to actually assess the potential impact of market fluctuations is fatal to PwC's argument. PwC had to do more than just posit that some of the FDIC-R's claimed damages *could* be attributable to market fluctuations. It had to actually prove that some of the damages *were* attributable to such fluctuations. In *Intergraph*, the Alabama Supreme Court concluded that once the plaintiff "presented reliable proof" of its damages, the defendant "then had the burden of introducing, or going forward with, evidence indicating that 'other causes' accounted for" plaintiff's losses. 58 So. 3d at 77 (applying model of burden shifting discussed in *Corson v. Universal Door Systems, Inc.*, 596 So. 2d 565 (Ala. 1991)). In *Intergraph*, the Court found that the defendant had not introduced sufficient evidence that the plaintiff's losses were attributable to other causes because the defendant's expert "repeatedly stated that she did not analyze the possible effects of [defendant]'s suggested 'other causes.'" *Id.*; *see also Aquate*, 682 F. App'x at 826 (affirming district court's refusal to apply defendant's proposed reduction in damages because defendant "failed to introduce any evidence" from which the district court could calculate the reduction and finding that defendant's argument that the district court "improperly

shifted the burden of proving Plaintiff's" losses to the defendant was "misguided"); *Cashman Equip. Corp. v. U.S. Fire Ins. Co.,* No. 06-3259, 2008 WL 4287631, at *26 n.15 (E.D. Pa. Sept. 17, 2008), *aff'd in part, rev'd in part*, 368 F. App'x 288 (3d Cir. 2010) ("[C]ourts in several other jurisdictions have put the burden of establishing evidence of diminution of market value more squarely upon the defendant as the breaching party.") (citing cases); *S. Cal. Fed. Sav. & Loan Ass'n v. United States*, 422 F.3d 1319, 1337-38 (Fed. Cir. 2005) (explaining that the government's failure to present an alternative damage theory "undermined its efforts to challenge the [damages] model presented by the" plaintiffs); *Siga Techs, Inc. v. PharmAthene, Inc.*, 132 A.3d 1108, 1126 (Del. 2015), *as corrected* (Dec. 28, 2015); *Agilent Techs., Inc. v. Kirkland*, No. CIV.A. 3512-VCS, 2010 WL 610725, at *29 (Del. Ch. Feb. 18, 2010) (awarding damages in the amount reasonably calculated by plaintiff's expert, where the defendant's expert "failed to present a compensatory damages calculation of his own" and did "little more than point out potential flaws in [plaintiff's expert's] analysis").

148. In contrast, Mr. Malek *did* consider market influences and correctly determined that it would be wrong to reduce the FDIC-R's damages based on market factors. Tr. 3578:8-25, 3716:16-3717:7 (Malek). This is true for several reasons. First, the purpose of the "put back" was to insulate Colonial Bank from these very market losses. If a loan was or became impaired, Colonial was supposed to put that loan back on TBW and recover the full amount of the advance. Tr. 3564:2-10; 3574:16-21 (Malek). The fraud that PwC failed to uncover deprived Colonial of this important right. Moreover, the fact that the vast majority of the impaired loans held by Colonial Bank were TBW loans, Tr. 3868:5-19 (Lehn, discussing P2946), indicates that these loans were aging because of fraud, not because of the market. None of Colonial Bank's legitimate mortgage warehouse originators had aging problems even approaching the magnitude of TBW's problems

and, when they did, Colonial worked out those loans or put them back for a refund so the business remained profitable. Tr. 3716:16-3717:7 (Malek). The fact that Colonial's non-TBW mortgage warehouse lending business remained profitable, even during the housing crisis, shows that these were fraud (not economic) losses.

149. All of these facts support Mr. Malek's decision not to reduce his damages calculation based on market factors.

150. Moreover, given Professor Lehn's limited review of the materials at issue in this case (particularly his failure to review any of the depositions or criminal trial testimony of the TBW fraudsters), Tr. 3829:10-23; 3831:6-15 (Lehn), the Court is unconvinced that he was sufficiently knowledgeable about the facts at issue to offer any opinions, much less the unsupported factual assertions about the fraud, the fraudsters, and what constituted fraud losses about which he testified at trial. Professor Lehn spent twenty-five to thirty hours reviewing Mr. Malek's report and underlying materials and preparing his opinions in this case in response to Mr. Malek, which included a number of issues completely unrelated to the junk loan fraud at issue in the damages trial. Tr. 3826:6-25 (Lehn). Given the magnitude of the data and testimony required to understand the fraud here, the Court finds Professor Lehn's limited investigation undermines the weight of any opinions he has offered.

151. Moreover, Professor Lehn did no real analysis and offered no real expertise on the issues he purported to opine on. Tr. 3866:16-24 (Lehn). He is not an expert in fraud or forensic accounting, Tr. 3838:1-19 (Lehn), and the Court gives little if any weight to his opinions. *See Advanced Telemedia, LLC v. Charter Commc'ns, Inc.*, No. 1:05-CV-2662-RLV, 2008 WL 6808442, at *1 (N.D. Ga. July 17, 2008) (excluding defendant's damages rebuttal expert testimony

as speculative and unreliable where he did not review underlying data or perform his alternative proposed methodology).

152. Professor Lehn merely offered argument, conjecture, and "possible" reductions to the FDIC-R's damages calculations without doing any analysis or investigation of his own.

VIII. The Court rejects PwC's first challenge to the FDIC-R's claimed damages: the "blue" loans.

A. All AOT losses, regardless of the origination of the loans, are fraud losses.

153. The central focus of the damages trial was whether Mr. Malek properly included the "blue" loans as part of Colonial Bank's fraud losses. Tr. 3527:9-14 (Malek). Even though each of these so-called "blue" loans was fraudulently hidden in fake AOT trades at Bank close, Professor Lehn criticized Malek for counting the "blue" loans, claiming that because Mr. Malek did not prove that Colonial Bank received a loan worth less than the amount advanced at the time of the advance, any later loss on that loan should be attributed to the market, not the fraud, and therefore, was not a fraud loss. Tr. 3774:10-16 (Lehn).

154. In other words, PwC seeks to limit the FDIC-R's damages to losses suffered at the moment the loan was funded. If Colonial Bank got collateral worth the full value of the advance at the time of the advance—according to PwC—there can be no subsequent fraud loss, even if the fraud prevented Colonial from recovering its money on those loans.

155. The Court rejects this artificial damages construct.

156. First, as the Court has already noted, had PwC properly performed its audit, Colonial Bank's relationship with TBW would have ended by February 25, 2004, and no TBW loans would have funded—inside or outside AOT, impaired or otherwise. *See* Section IV, *supra*. Thus, all of the losses on AOT loans, regardless of origination, "flow directly and naturally" from PwC's breach. *Ramsey*, 646 So. 2d at 143-44.

157. Second, PwC has no basis for its exceedingly limited articulation of "fraud losses." While Colonial certainly sustained losses when it advanced funds for fake or already impaired loans, that is not the *only* way fraud losses occurred here.

158. Even if one were to ignore the undisputed evidence that dumping junk loans on Colonial was a standard practice for the fraudsters, Colonial was damaged not only by the initial funding but also by the active concealment of that loan in AOT once it became impaired. Tr. 3710:11-18, 3712:6-9 (Malek). By hiding aged loans on AOT, the fraudsters deprived Colonial of exercising its "put back" and curtailment rights, which entitled it to recover the *full* amount initially advanced and would have protected Colonial from any loss. Tr. 3564:2-10; 3566:11-17 (Malek); *see also* Beahler Dep. at 45:15-18 (if there was any indication that a COLB loan was not going to be purchased by an end investor, TBW could be forced to pay that loan in full at any time) (D4017); Bowman Dep. 186:24-187:17 (F4362); W. Kelly Dep. at 83:9-22 (Colonial had the ability to push COLB loans back on the originator) (F4365).

159. Pursuant to the terms of the agreement between Colonial Bank and TBW, Colonial had the right to force TBW to buy back any impaired loan at any time, recovering the full amount of the advance. Tr. 3564:2-10; 3574:16-21 (Malek); *see also* A372 at 5-6, ¶ 4 (setting forth requirements for COLB loans including existence of commitment of an end investor), 6-8, ¶ 5 (setting forth documents TBW had to deliver including end investor commitment and note); 11, ¶ 10 (representations and warranties of TBW that loans comply with requirements for sale); 18-20, ¶ 17 (contract provision obligating TBW to buy back COLB loans from Colonial for **full repurchase price** when in violation of representations and warranties), Ex. C (Participated Mortgage Loan Requirements). Thus, as a matter of contract, TBW bore all the risk associated with any market fluctuations. *See Resolution Tr. Corp. v. Key Fin. Servs., Inc.*, 280 F.3d 12, 18

n.14 (1st Cir. 2002) (finding that repurchase provision was meant to shift the risk to the selling party, and that "it is irrelevant that the loans may have suffered a loss in value because of changing market conditions" because the contract "obligated [the seller] to repurchase these faulty mortgages upon demand, meaning that from the moment a proper repurchase demand was made, [the seller]—not [the lender]—should have borne the risk of any market fluctuations."); *see also MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC*, 58 N.Y.S.3d 874, at *21 n. 35 (N.Y. Sup. 2017) (finding that losses associated with the concealment of nonconforming loans were recoverable by virtue of a contractual put-back remedy, and that the harm suffered "was exposure to loans that, under the PSA, were not legally permitted to be included in the Transaction").

160. The record is clear that because of Kissick and Kelly's entanglement in the fraud, Colonial Bank had to keep all impaired TBW mortgages and could not exercise its "put back" rights with regard to TBW. Bowman Dep. at 184:16-185:8 (F4362); T. Kelly Dep. at 81:8-83:7 (Kelly conceding that being the dumping ground was not in Colonial's best interests and that she and Kissick were compromised by the fraud and could not refuse) (F4364); Tr. 3566:24-3567:3 (Malek). TBW used Colonial as a dumping ground for impaired mortgages. When or how a mortgage became impaired is irrelevant.[31]

161. By hiding these aging loans in the AOT, the fraudsters shifted the risk of loss to Colonial in clear violation of its "put back" rights in order to conceal their criminal acts as part of the fraud. Tr. 3564:2-10 (Malek).

[31] While there is some evidence that, on a token basis, Colonial would curtail some of the TBW Warehouse loans, the record evidence shows that TBW would just seek another advance on those same loans stealing the same funds back again. Tr. 3546:23-3547:10 (Malek). Regardless, limited curtailment on the Warehouse line has nothing to do with the fact that Kissick and Kelly clearly refused to exercise Colonial's "put back" rights on the COLB loans, choosing instead to hide them in AOT where their advanced age could go undetected. Tr. 3564:2-10 (Malek).

162. Had Colonial put back the nearly $16 million of junk loans sitting on Warehouse, COLB and Overline at the time of PwC's negligent 2003 audit, the "fraud would have been stopped in its tracks" because TBW could not have repaid the loan and the fraud would have been exposed. Tr. 3435:1-23; 3452:1-19 (Malek) (if Kissick had stopped accepting junk loans or required repurchase, it would have exposed the fraud).

163. Additionally, all of these loans—those originating inside or outside of AOT—were part of the fraud as they were (1) associated with fake AOT trades; (2) ineligible to be in an AOT trade as they had no takeout commitment; and (3) hidden on a secret, offline database. Accordingly, all of the losses sustained on account of these loans are "fraud" losses. Tr. 3437:1-22; 3450:3-14; 3519:19-3520:18; 3535:4-6; 3557:22-23; 3568:23-24; 3575:1-3 (Malek).

164. Thus, the Court draws no distinction between loans originating inside AOT and loans originating outside AOT for purposes of determining fraud losses. Both sets of loans violated the terms of the AOT and were hidden in AOT on a secret database to conceal TBW's massive volume of impaired loans and prevent Colonial from forcing TBW to repurchase them. The associated losses on both categories of loans are clearly fraud damages.

B. PwC's admission that hiding junk loans on the COLB was part of the Fraud provides an independent basis to reject its $300 million reduction to damages.

165. Moreover, PwC's current position—that loans originating outside of AOT were not part of the fraud—directly contradicts the position it took in the TBW case. In 2013, PwC was sued by the TBW Plan Trust in Florida for negligent misrepresentation. *Taylor, Bean & Whitaker Plan Trust v. PricewaterhouseCoopers LLP*, Case No. 13-33964 CA (Fla. Cir. Ct. for Miami-Dade County).

166. In its answer to the Third Amended Complaint in that case (after the fraudsters had been deposed), PwC set out a description of the "Collusive Fraud," devoting an entire section to

the "Falsifying the Value of Loans on the **COLB and AOT** Facilities" portion of the fraud. *See* P2879 at 20-23 (emphasis added).

167. Specifically, PwC stated that, as part of the overall Collusive Fraud, "TBW sold Colonial Bank interests in mortgage loans that were foreclosed, real estate owned, or otherwise impaired. The Colonial Bank and TBW employees involved in these transactions referred to these mortgage loans as 'crap' loans. Colonial Bank and TBW manufactured and falsified transaction details for 'crap' loan transactions, making them appear like legitimate transactions and moving them through Colonial Bank and to end investors as if they were legitimate transactions." *Id.* at 20. PwC went on to say that the TBW fraudsters and Kissick and Kelly "were aware of the 'crap' loans . . . on the COLB . . . " *Id.* Thus, PwC previously admitted that dumping impaired loans on the *COLB* was part of the fraud.

168. In the damages phase, PwC offered no evidence to contradict its previous claim that "crap" or junk loans on the COLB were part of the fraud. Therefore, the Court accepts as an evidentiary admission that junk loans on the COLB were part of the fraud. *See, e.g.*, *Williams v. Union Carbide Corp*., 790 F.2d 552, 555-56 (6th Cir. 1986) ("Pleadings in a prior case may be used as evidentiary admissions."), *cert. denied*, 479 U.S. 992 (1986); *Enquip, Inc. v. Smith-McDonald Corp*., 655 F.2d 115, 118 (7th Cir. 1981) ("It is well established in this circuit and elsewhere that [a pleading] from one proceeding is indeed admissible and cognizable as an admission in another."); *Ross v. Philip Morris & Co*., 328 F.2d 3, 15 (8th Cir. 1964) ("[A]n admission in a pleading in one action may be received in evidence against the pleader on the trial of another action to which he is a party . . . ."); 2 McCormick On Evid. § 257 (7th ed.) ("A party's pleading in one case may generally be used as an evidentiary admission in other litigation.").

169. The Court, therefore, finds that losses associated with the "blue" loans were part of the fraud and should not be deducted from Mr. Malek's calculations.

C. The FDIC-R has sufficiently shown that the "blue" loans were impaired for purposes of damages.

170. PwC argues that the FDIC-R bears the burden of proving that each one of the approximately 4,000 "blue" loans was impaired at the time of funding. Tr. 3998:4-8.

171. Given that the Court has rejected PwC's artificial damages construct, the FDIC-R has no such burden.

172. Nevertheless, even if the Court were to find that the FDIC-R must demonstrate impairment at the point of funding for all of the "blue" loans, the Court determines that the FDIC-R has done so with the requisite degree of reasonable certainty.

173. The Court finds Mr. Malek's badges of fraud compelling. All of the "blue" loans—found as part of fraudulent AOT trades at Bank closure—carry the first four of these badges: (1) they all ended up hidden on the secret, offline database; (2) none of them were "put-back" to TBW; (3) they were all clearly "dumped" on Colonial (TBW's "dumping ground" for all impaired loans); and (4) they all must have had major impairments, otherwise TBW would have quickly rectified any minor, ministerial issues so that it could sell the loans as quickly as possible to get any cash it could to meet its ever-increasing need to cover its losses. Tr. 3519:19-3520:18; 3535:4-6; 3557:22-23; 3558:2-5; 3568:23-24; 3564:2-10; 3564:13-17 (Malek); Bowman Dep. at 184:16-185:8, 186:24-187:24 (describing Colonial as the dumping ground for TBW's repurchased loans) (F4362); Brown Dep. at 266:19-267:3 (F4363), 298:18-25; 313:10-314:15 (TBW dumping on Colonial aged, REO and repurchased loans); T. Kelly Dep. at 81:8-83:7, 84:19-85:09 (Colonial was dumping ground for TBW's rejected loans) (F4364); P1907 (identifying Colonial as the dumping ground for loans rejected by other lenders); P2094 (same); P2100 (Farkas indicating that

Colonial is "full of total junk"); *see also* Tr. 3842:7-15 (D. Brown discussing P2100 and testifying that TBW dumped junked loans **on any of TBW's lines** with Colonial).

174. Given the presence of these four badges, coupled with the fact that Colonial carried a grossly disproportionate volume of TBW impaired loans (e.g., 99.6% of all impaired loans actually appearing on Colonial's COLB aging report at 2007 year-end were TBW loans), the Court finds that the FDIC-R has carried its burden in proving—with the reasonable certainty necessary for a damages analysis—that these loans were impaired at the time of funding.[32]

175. Additionally, approximately half of the "blue" loans carry the fifth badge of fraud—a serious issue with the mortgage was flagged in the electronic data. Tr. 3531:17-21; 3529:15-18 (Malek); F4100.[33] And of those, approximately half actually contained notations from TBW's data that said "DNS" or "do not sell." Tr. 3703:10-24 (Malek). The fact that half of the "blue" loans

[32] PwC's citation to *Corson v. Universal Door Systems, Inc.*, 596 So. 2d 565 (Ala. 1991) in closing offers no support for its position that the FDIC-R had to itemize the impairment at funding for all 4,225 so-called "blue" loans. Tr. 3995:24-3997:25. In *Corson*, the plaintiff proved that its former employee, who went to work for a competitor, had breached a non-solicitation covenant. The trial court awarded the plaintiff damages based on the "fair value" of the four jobs that Corson successfully solicited for his new employer. The Supreme Court of Alabama reversed the damages award because the plaintiff produced "no evidence that it would have received the revenue for the work done at Handy Dan, Delchamp's, or Sam's Wholesale Warehouse, but for Corson's breach of contract." 596 So. 2d at 571. By contrast, the FDIC has produced evidence that each of the 4,225 loans were hidden by the fraudsters in a second set of books on the offline database; that even though the loans were supposed to be sold within 30-45 days of origination, each of the 4,225 loans lacked an investor commitment and failed to sell during the often lengthy period (from 1-5 years) between origination and the closing of the Bank; that Kissick did not require TBW to repurchase any of the 4,225 loans, even though TBW was required to repurchase the 4,225 loans by contract or MWLD practice; that the Bank was a dumping ground for TBW's impaired loans rejected by other lenders; and that many of the 4,225 loans were noted in TBW's records as "do not sell" due to an array of credit issues including foreclosures, bankruptcies, and defaults. Tr. 3528:19-23 (Malek). Whereas in *Corson*, there was no evidence of any connection for the claimed damages, there is ample evidence here that these junk loans hidden in fake AOT trades were part of the fraud losses.

[33] Professor Lehn belatedly tried to analyze the TBW data showing "Do Not Sell" and other fundamental problems with the junk loans. However, in his deposition, he conceded that he lacked the expertise to interpret this data. Tr. 3850:10-3851:10; 3851:18-24 (Lehn). Even at trial, Professor Lehn conceded he was still trying to understand what the data meant. Tr. 3853:17-19 (Lehn). In contrast, Mr. Malek retained experts in analyzing mortgage warehouse data and analyzed the data in forming his opinions. Tr. 3427: 9-25; 3428:6-12 (Malek).

clearly had serious issues prior to being sold to Colonial, further supports the Court's conclusion that all of the so-called "blue" loans were impaired in some way prior to funding. *See* Tr. 3531:17-21 (Malek); F4100. Because TBW would have no reason to make "do not sell" notations in the RULES database after sale, even while servicing the loan, the Court finds PwC's argument that these notations could been made *after* the sale to Colonial implausible.

176. Given that the FDIC-R need only prove its damages to a reasonable certainty, the Court finds sufficient evidence to conclude, were it necessary to do so, that the "blue" loans were impaired prior to funding, such that Colonial sustained a loss the moment it advanced full price for a loan worth less than that amount.

IX. **The Court rejects PwC's second challenge to the FDIC-R's Claimed Damages: the REO.**

177. PwC's second dispute with the FDIC-R's damages calculation involves certain foreclosed AOT and Overline REO that were on Colonial Bank's books at the time it closed and eventually were sold by the TBW Trustee at a bulk-sale auction for approximately $78 million.

178. PwC asserts, without any factual support, that the FDIC-R had "valuable rights related" to the REO, which it supposedly traded to the TBW Bankruptcy Trustee in exchange for COLB loans. ECF 841 at 2. PwC does not contend that the FDIC-R failed to receive fair value in exchange for its alleged right to the REO. ECF 841 at 2-3 ("PwC is not . . . contending that the FDIC did not receive fair value in return."). Nevertheless, it claims that Mr. Malek should have included the value of the relinquished REO in computing the FDIC-R's damages, resulting in a reduction of approximately $30 million. Tr. 3935:22-25; ECF 841 at 3.[34]

[34] PwC initially asserted that it was entitled to a $45 million reduction for the REO. After the FDIC-R pointed out errors in its calculation, PwC conceded that its original figure was overstated by about $15 million. *See* Tr. 3927:9-3931:3.

179. The Court is not persuaded by PwC's argument with respect to the AOT and Overline REO.

180. PwC's argument is based on the settlement agreement between the FDIC-R and the TBW Bankruptcy Trustee, which resolved many disputes over TBW's assets, including, but by no means limited to, who was entitled to the $78 million proceeds from the sale of the AOT and Overline REO. *See* B182 at 5 (stating that the settlement agreement "resolves in favor of the Debtor *the issue of entitlement* to the AOT REO and the Overline REO (as a result of which, inter alia, the Debtor's estate will have available to it approximately $78 million in proceeds from AOT and Overline REO that has already been liquidated through the court-approved bulk sale as well as ordinary course sales)" (emphasis added)); *id.* at 19 ("On the Effective Date, in exchange for the treatment specified herein, the FDIC-R will disclaim its interest, *if any*" in the AOT and Overline REO) (emphasis added).

181. The FDIC-R did not have possession of the REO assets, which were held by TBW, or the $78 million in proceeds from the bulk sale, which went straight to the TBW Bankruptcy Estate. *See* Debtor's Emergency Motion at ¶ 38, *In re: Taylor Bean & Whitaker Mortgage Corp.* (8/31/2009) (09-bk-07047, ECF 83) (indicating TBW's control and possession of REO assets); F4352, ¶ 8 (noting that "REO and other related assets . . . were serviced, maintained and controlled by" TBW).

182. On the contrary, the FDIC-R merely had a disputed claim to the REO proceeds. Ultimately, the FDIC-R gave up any rights it may have had to those proceeds through its settlement with the TBW Bankruptcy Trustee as part of an overall settlement.

183. Although PwC claims it is not asking for a "setoff" based on a settlement, this is plainly a setoff issue. At root, PwC is challenging the settlement made by the FDIC-R with the

TBW Bankruptcy Trustee. Specifically, PwC claims that the FDIC-R chose to relinquish a right that may have provided PwC with a damages credit (recovery on the AOT REO) in exchange for a right that did not provide PwC with a damages credit (recovery on the COLB loans).

184. PwC does not contend—nor is there any evidence—that the FDIC-R's settlement with the TBW Bankruptcy Trustee was unreasonable, made in bad faith, or anything other than a legitimate compromise of various disputed claims between the parties.[35]

185. Nevertheless, PwC argues that it should get credit for the REO proceeds, even though the FDIC-R never physically possessed the REO assets or the proceeds, gave up whatever disputed rights it had to those proceeds in settlement with the TBW Bankruptcy Trustee and did not receive that money. ECF 841 at 3.

186. PwC's argument runs afoul of this Court's prior ruling that PwC is not entitled to second guess the FDIC-R's settlement with another party and is limited to a credit as to common damages based on the actual terms of the settlement agreement—not what they could have been. ECF 673. The Court has previously rejected this exact same argument by PwC and does so again here.

187. PwC previously attempted to obtain a setoff from the FDIC-R's settlement with Bank of America greater than the settlement amount actually allocated to the claims at issue in this case. This Court rejected that effort, agreeing with the FDIC-R that, "because Alabama is a joint-

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[35] Unlike some states, Alabama's statute regarding *pro tanto* settlements does not impose a "reasonable" or "good faith" requirement. *Compare* Ala. Code § 12-21-109 (1975) *with* Wash. Rev. Code Ann. § 4.22.060(2) (West 1988) (expressly providing that a court must determine whether a partial settlement was reasonable); Haw. Rev. Stat. Ann. § 663-15.5 (West) (setting out a specific procedure for "a hearing on the issue of good faith of a settlement entered into by the plaintiff or other claimant and one or more alleged tortfeasors . . ."); Cal. Civ. Pro. Code § 877.6 (West) (providing a framework for determining whether a settlement in a multi-party litigation was made in good faith). In any event, PwC does not contend that the parties to this bankruptcy-court-approved settlement acted unreasonably or in anything other than good faith.

and-several liability state wherein joint tortfeasors are each liable for the total amount of any judgment . . . a non-settling defendant cannot challenge the amount of any settlement the plaintiff may reach with a co-defendant." ECF 673 at 3.

188. Here, PwC is responsible for the full measure of damages resulting from its negligence. While PwC may benefit, through a setoff, from any recovery the FDIC-R actually receives through settlement with another party, PwC is *not* entitled to second guess the terms of that settlement and claim it should have gotten more. Regardless of how the settlement agreement *could* have been drafted, PwC is entitled to a credit only for the *actual* settlement amount for common claims. *See Campbell v. Williams*, 638 So. 2d 804, 812 (Ala. 1994) ("The relief to which the joint [tortfeasor] is entitled is a set-off of the *amount* of the *pro tanto* settlement against the amount of the verdict.") (emphasis added); *Ex parte Barnett*, 978 So. 2d 729, 733 (Ala. 2007) ("Under Alabama law, among defendants jointly liable for the injury to the plaintiff, where one tortfeasor settles, we have allowed the nonsettling tortfeasor to have the jury award reduced by the *amount of any pro tanto settlement*.") (emphasis added; quotations omitted); *Anderson v. Kemp*, 184 So. 2d 832, 834 (Ala. 1966) ("Any *amount* received by a party as compensation for his injuries . . . should be applied as a *pro tanto* reduction upon damages recoverable from another joint tortfeasor.") (emphasis added).

189. Accordingly, it is irrelevant that the FDIC-R and the TBW Bankruptcy Trustee could have reached different terms. All that matters is the actual terms reached and what the FDIC-R actually received under those terms for claims for which PwC is liable.

190. Under the actual terms of the TBW bankruptcy settlement, PwC is entitled to a $188 million setoff—undisputedly already applied by Mr. Malek—for the FDIC-R's actual

recovery through its secured claim on the AOT loans. *See* Tr. 3649:15-3650:20; 3502:9-18 (Malek).

191. PwC is not, however, entitled to any further setoff based on the value of the FDIC-R's disputed pre-settlement right to the AOT REO. Whatever alleged right the FDIC-R may have had to more of the REO recovery was settled as part of a multi-factor settlement, and it would be unfair and improper to give PwC credit for the full value of that alleged right without also unwinding the other parts of the settlement, which this Court obviously cannot do.

192. Because PwC is seeking a setoff based on the FDIC-R's settlement with the TBW Trustee, it carries the burden of proof, and it has failed to carry that burden here. *Har-Mar Collisions*, *Inc.*, 212 So. 3d at 904 ("The applicability of a setoff arising from a settlement agreement is an affirmative defense. *Morris v. Laster*, 821 So. 2d 923, 930 (Ala. 2001). Therefore, the party offering the defense . . . carries the burden of proof. *Ex parte Rogers*, 68 So. 3d 773, 780 (Ala. 2010).").

193. PwC has failed to provide any evidence to support its basic hypothesis—that the FDIC-R gave up rights to the AOT and Overline REO in exchange for the COLB loans. *See* Tr. 3504:15-20 (Without any support, PwC's counsel asserted that "Colonial said, we'll give you, TBW, this right to the $78 million in exchange for us, Colonial, getting something else, some legitimate COLB loans."). There is no record evidence that the FDIC-R disclaimed its disputed right to the AOT and Overline REO in exchange for COLB loans. The settlement agreement does not include any such link, and Mr. Malek, the FDIC-R's damages expert, could not provide any testimony regarding the FDIC-R's settlement strategies or priorities or what the FDIC-R and TBW Trustee thought or intended with regard to the terms of the settlement. *See* Tr. 3933:7-13 (Malek).

194. In fact, it is equally possible that the FDIC-R gave up the AOT REO in order to obtain its secured claim as to the AOT loans, a right that has *already resulted* in a $188 million credit for PwC. Indeed, when the FDIC-R and the TBW Trustee set out the various aspects of the settlement for the bankruptcy court's review, they listed the FDIC-R's rights under the settlement in the *AOT loans* just before they listed TBW's rights to the AOT REO. *See* B182 at 5; *see also id.* at Ex. A at §§ 1.3 and 1.5.

195. Based on the record evidence, there is simply no way for the Court to know whether the FDIC-R traded off the value of the REO for something else. The lengthy negotiations between the FDIC-R and the TBW Trustee resulted in a single settlement, covering a wide variety of compromises, and there is no way to tell what rights were exchanged for what, if any such exchange occurred at all. The speculation and guessing that would be required under PwC's argument demonstrates perfectly why this Court will not second guess the FDIC-R's settlements but rather apply setoffs based on the FDIC-R's actual recoveries.

196. PwC's argument is further undermined by the fact that its own damages expert, Professor Lehn, did not think those proceeds should have been included in Mr. Malek's analysis. Professor Lehn referenced this very issue on which this new setoff argument is based in his report. *See* Lehn Report at 13, n.58 (acknowledging that "as part of this settlement agreement, the FDIC disclaimed its interest in and transferred ownership of certain Junk AOT loans in REO status to TBW."). Yet Lehn did not identify the value of the REO as something that Mr. Malek should have included to reduce his damages calculations. Lehn admitted in his deposition that he "reviewed the recoveries Mr. Malek calculated and [] didn't identify any additional recoveries that [he] thought [Malek] should have included." Tr. 3503:3-19.

197. PwC's argument is also undermined by the fact that PwC waited to raise this issue until its opening statement in the damages trial.

198. PwC raised other setoff issues earlier in the case, namely related to the FDIC-R's Bank of America settlement, which generated significant briefing between the parties involving expert witnesses, factual discovery, and several court orders. *See*, *e.g.*, ECF 324, 344, 367, 437, 441, 509, 671, 673.

199. By contrast, PwC's failure to raise this new REO setoff issue until the first day of trial unnecessarily imposed additional burdens on the parties, the FDIC-R's expert, and the Court in the heat of trial, when the issue could have been addressed with the benefit of greater time and thought had PwC timely raised it. PwC did not identify anything that prevented it from raising this setoff issue earlier. The FDIC-R was denied the ability to conduct fact discovery to disprove PwC's new argument at trial.

200. In fact, the FDIC-R specifically asked PwC for information about any setoff defenses in its interrogatories, and PwC mentioned nothing about this potential REO setoff in either of its September 2016 responses. Nor did PwC timely supplement or correct its interrogatory response once it "discovered" this alleged setoff issue, as required by Federal Rule of Civil Procedure 26(e). Fed. R. Civ. P. 26(e)(1) ("A party . . . who has responded to an interrogatory . . . must supplement or correct its . . . response (A) in a timely manner if the party learns that in some material respect the . . . response is incomplete or incorrect, and if the additional or corrective information has not otherwise been made known to the other parties during the discovery process or in writing . . . ."). PwC's counsel admitted that they "discovered" this alleged issue based on questions asked by the FDIC-R's counsel in Lehn's deposition—which was taken nearly 18 months before the damages trial, on **October 4, 2016**. Tr. at 3505:24-3506:4.

201. Given PwC's delay in raising this new setoff issue, the Court would be justified in refusing to consider it. *See* Fed. R. Civ. P. 37(c)(1) ("If a party fails to provide information or identify a witness as required by Rule 26(a) or (e), the party is not allowed to use that information or witness to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless."); *Mee Indus. v. Dow Chem. Co.*, 608 F.3d 1202, 1221-22 (11th Cir. 2010) (district court did not err in excluding previously undisclosed damages theory under Rule 37(c)(1)).

202. The Court of Claims, for example, has routinely held that the "any undue delay on the part of the government" in raising setoff defenses "will result in the denial of the right to raise setoff defenses" because "the defense must be raised at the earliest possible stage in the proceedings." *St. Louis-San Francisco Ry. v. United States*, 417 F.2d 1359, 1360 (Fed. Cl. 1969); *Abramson v. United States*, 42 Fed. Cl. 326, 331 (1998) (ruling that defendant's assertion of an additional offset during the briefing of summary judgment motions was untimely, "[a]s there was no prior indication that defendant would seek this additional offset"). In *Abramson*, the court specifically noted that it would not allow the additional setoff claimed by the government because "[t]he parties have had ample time over the past two years and during the prior two dispositive motions to consider their positions and put forth available arguments," and "the most recent Joint Status Report, which lists the remaining matters at issue, fails to make any mention of this potential offset." *Id.* at 331 n.7. *See also Buder v. United States*, 7 F.3d 1382, 1386-87 (8th Cir. 1993) (affirming the district court's decision to decline to hear government's setoff defense raised for the first time in its trial brief filed ten days before the scheduled trial date).

203. For all of these reasons, the Court concludes that PwC is not entitled to an additional setoff for the FDIC-R's purported claim to the proceeds from the sale of the AOT REO.

CONCLUSION

Having already found that PwC was liable for its negligence, for the foregoing reasons, the Court finds that PwC is liable to the FDIC-R in the amount of $625,309,085.

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Respectfully submitted,

/s/ Grace L. Kipp

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing document was electronically served on March 30, 2018, by transmission of Notices of Electronic Filing generated by CM/ECF to persons registered as of issuance of filing.

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