

# Banking & Financial Services

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# Establishing Bank Holding Company Insolvency: Lessons Learned From The Bank Of New England Corporation Bankruptcy

By Ben S. Branch and James D. Higgason, Jr.

When a national bank is in financial distress government regulators<sup>1</sup> typically encourage or require the bank's holding company to act as a source of strength by making loans, equity infusions, and/or other asset transfers to the troubled institution.<sup>2</sup> If such measures heal the ailing bank, it is good for the banking system and the holding company's creditors and shareholders also likely will benefit, at least in the long term. If the bank nevertheless fails despite the holding company's transfers, the bank's assets are placed in a receivership administered by the Federal Deposit Insurance Corporation (FDIC) and the transfers end up enriching the FDIC at the expense of the holding company and its creditors.

The latter scenario unfolded in connection with the failure of the Bank of New England Corporation (BNEC), a Boston-based bank holding company, and the seizure of its subsidiary banks (the "BNEC Banks").<sup>3</sup> In 1989 bank regulators discovered fundamental asset quality and control problems at BNEC's largest bank, Bank of New England, N.A. (BNENA), that were so severe that it soon became apparent that its prospects for survival were bleak. Despite BNENA's terminal condition, the regulators nevertheless encouraged BNEC to downstream cash and merge non-bank subsidiaries into BNENA. As a result, when BNENA failed and its assets were placed in FDIC receivership, property that would have been available for BNEC's creditors but for the downstreaming went into the coffers of the FDIC.

The BNEC Chapter 7 bankruptcy trustee (the "Trustee") brought both "actual intent" and "constructive intent" fraudulent transfer claims against the FDIC and

against the banks to whom the FDIC subsequently transferred the property in question (the "FDIC Litigation"). The actual intent claim sought to avoid the transfers pursuant to Bankruptcy Code Section 548(a)(1)(A) on the grounds that they were made with "actual intent to hinder, delay, or defraud" BNEC's creditors. The constructive intent claim, based on Section 548(a)(1)(B), sought the return of such assets on the basis that BNEC was insolvent at the time the transfers were made and that BNEC did not receive reasonably equivalent value in exchange for the transfers.<sup>4</sup>

The Trustee's insolvency model was a cornerstone of his success on the actual and constructive intent fraudulent transfer claims.<sup>5</sup> Such models will be particularly important in the current environment<sup>6</sup> to trustees or debtors-in-possession of failed bank holding companies who have cause to pursue similar fraudulent transfer claims.<sup>7</sup> This article discusses certain legal and factual concepts relevant to establishing insolvency and explains how the BNEC insolvency model was constructed.

## The Anatomy of a Bank Failure

The BNEC system followed a typical path to failure. During the mid-to-late 1980s BNEC grew exponentially, primarily through acquisitions and the dramatic and uncontrolled growth of the real estate loan portfolios of the BNEC Banks. Adequate controls were not put in place to monitor its changing risk profile, and when the real estate market in New England began to crumble, BNEC careened into a death spiral from which it never would recover.

The BNEC Banks' primary regulator, the Office of the Comptroller of the Currency (OCC), and the FDIC discovered BNENA's desperate financial condition during 1989 bank examinations. The regulators nonetheless encouraged BNEC to issue \$250 million in additional subordinated debt and downstream the proceeds to BNENA, which the Trustee alleged was

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not only insolvent, but doomed to fail and be placed in FDIC receivership. BNEC also was instructed to merge certain valuable non-bank assets, like, for example, its information services subsidiaries, into BNENA so they would be able to service the BNEC Banks directly in the event they were placed into FDIC receivership.<sup>8</sup>

In January 1991 the OCC declared BNENA insolvent and the FDIC became receiver of its assets, including the transferred BNEC property. Pursuant to the “Cross-Guarantee Provision” of the recently enacted Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), the FDIC immediately served Notices of Assessment on the other BNEC Banks (BNENA’s “Sister Banks”) for the amount of the loss the FDIC anticipated incurring in connection with the failure of BNENA. The Sister Banks were unable to pay the assessed amounts, so they were declared insolvent and placed in FDIC receivership as well. The following business day, with hundreds of millions of dollars in debt and most of its assets in the coffers of the FDIC, BNEC filed for bankruptcy protection.

### **Insolvency and Reasonably Equivalent Value**

When a parent company makes a transfer to a solvent subsidiary there typically is a presumption of an exchange for reasonably equivalent value because the parent company’s investment in its subsidiary is increased by the amount transferred.<sup>9</sup> If, however, the subsidiary is insolvent, then there is no such presumption because there is no corresponding increase in equity; *i.e.*, the value of its investment in its subsidiary is “zero” both before and after the transfer.<sup>10</sup> In such circumstances, when a transfer to or for the benefit of an insolvent subsidiary has the net effect of diminishing the value of the parent company, it is deemed to be for less than reasonably equivalent value.<sup>11</sup>

The Trustee’s insolvency model was designed to address whether both the transferor (BNEC) and the transferees (BNENA and its Sister Banks) were insolvent, thus providing proof for both the insolvency and reasonably equivalent value elements of his constructive intent claim. Since insolvency and lack of reasonably equivalent value also are “badges” of fraud from which a conclusion of actual intent to hinder, delay, or defraud can be drawn, the model also supported his actual intent claim.<sup>12</sup>

### **The Insolvency Standard**

Bankruptcy Code Section 101(32) defines “insolvent” as a “financial condition such that the sum of such entity’s debt is greater than all of such entity’s property, at fair valuation. . . .” In virtually all instances “fair value” under the Bankruptcy Code is synonymous with fair market value.<sup>13</sup>

The insolvency valuation methodology required by the Bankruptcy Code often is referred to as a “balance sheet test” because the assets in question typically are identified on the debtor’s balance sheet. This does not mean, however, that the book value appearing on the balance sheet necessarily reflects an asset’s fair market value. Financial statements of going concerns prepared in accordance with Generally Accepted Accounting Principles do not record assets at fair market value.<sup>14</sup>

Instead of relying on book values, asset values are measured by the amount of cash that would be generated if sold into the market that existed at the time of the transfer. If a debtor is on its deathbed and near-term failure is highly likely, then a so-called “liquidation value” approach is used, whereby one determines the amount for which the assets would sell over a short period in a forced or distressed sale.<sup>15</sup> If failure was not imminent at the time of the transfer, a “going concern” valuation approach is required, and fair value is the price that would be obtained for the debtor’s assets if they were sold in a prudent manner within a reasonable period of time to pay the debtor’s debts.<sup>16</sup> A reasonable period of time for a “going concern” valuation is “an estimate of the time that a typical creditor would find optimal: not so short a period that the value of the goods is substantially impaired via a forced sale, but not so long a time that a typical creditor would receive less satisfaction of its claim, as a result of the time value of money and typical business needs, by waiting for the possibility of a higher price.”<sup>17</sup>

Courts have rejected “operational” valuation methodologies in which the focus is not on how much cash assets would generate if they were sold to pay creditors, but on their value to the debtor if they are held indefinitely. In a seminal decision rendered in the Trans World Airlines bankruptcy, the Delaware bankruptcy court criticized the argument that a going concern valuation does not require consideration of what the assets could

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produce to pay creditors, but a derivation of the “in place” value to the debtor assuming the debtor would continue as a going concern for an indeterminate time and with no time constraints to pay off its creditors.<sup>18</sup> The court said, “I find nothing . . . to support [the] position that in making a ‘fair valuation’ determination, the so called ‘going concern’ approach does not involve a consideration of realizing value from the assets which value (cash) can be paid to creditors within a reasonable time period. . . . [F]air market valuation entails a hypothetical sale, not a hypothetical company.”<sup>19</sup>

Depending on the circumstances, courts generally consider a variety of methodologies to determine fair market value, including, but not limited to, actual sale price, discounted cash flow, market multiples, comparable transactions, and market capitalization.<sup>20</sup> Whether a particular methodology or methodologies are appropriate in an individual case depends on whether they reasonably and reliably calculate the amount of cash that would be generated if the asset were sold within a reasonable period of time.<sup>21</sup>

In some instances an analysis of a hypothetical sale of a debtor as a whole, operating concern may generate a premium over and above the sum of the values of the entity’s constituent parts. Other times, there may be no buyers for the entire enterprise and the fair market value of its individual assets may be far less than their recorded book value.

### **The BNEC Model**

Although there was convincing evidence to the contrary, to be conservative the Trustee’s model presumed that at all relevant times BNEC and the BNEC Banks were not in immediate danger of failure and liquidation. This ruled out a “liquidation” valuation methodology based on what would be generated in a short-term, forced sale. Instead, a “going concern” approach was used to determine the fair market value of BNEC’s assets if converted to cash in a prudent manner over a 12 to 18 month period. The Trustee’s experts first considered whether BNEC was an entity for which a buyer in an arm’s-length transaction who had the opportunity to perform adequate due diligence would pay a premium over and above the value of the sum of its parts. They concluded that it was not, based on factors like, for example, BNEC’s inability to find a merger partner or sell itself for any price after concerted efforts to do

so and contemporaneous opinions by informed expert observers that BNEC was not salable as a whole and had a high likelihood of near-term failure.

After it was determined that BNEC could not be sold for a premium, a fair market value analysis was performed on the individual assets on BNEC’s balance sheet. BNEC’s assets included: cash, interest bearing deposits, investment securities, investments in and advances to bank subsidiaries, investments in and advances to non-bank subsidiaries, other assets, and intangible assets.

### **Valuing BNEC’s Subsidiary Banks**

Approximately 90 percent of BNEC’s book value was contained in its investments in and advances to its subsidiary banks, so the lion’s share of the valuation work focused on the banks.<sup>22</sup> Each bank was evaluated independently. Numerous data points reflecting on market value were considered, including any offers (or lack thereof) to buy all or parts of the banks, contemporaneous reports on asset quality and value generated by OCC and FDIC examiners and analysts,<sup>23</sup> contemporaneous analyses performed by experts retained by BNEC and regulators, and numerous other factors, depending on the unique circumstances presented by each bank.

BNEC’s largest bank on a book value basis was BNENA. Extensive efforts had been made to sell BNENA during the relevant period. Potential buyers performed varying levels of due diligence, but for a variety of reasons relating to asset quality and control problems no offers were forthcoming for any price.<sup>24</sup> Furthermore, numerous knowledgeable observers determined at the time that BNENA’s loan portfolio was in catastrophic condition and that BNENA was insolvent and doomed to fail. Under these circumstances, assigning a premium value to BNENA was not appropriate, so BNENA’s assets were valued individually.

As with most banks, BNENA’s most valuable asset was its loan portfolio. Bank loan portfolios are monitored, reserved, and valued by using risk rating systems that categorize loans from the highest quality (secured by cash on deposit) to the lowest quality (write-off). While such a system can be an effective tool in assessing loan portfolio value, BNENA’s nine-point rating system was completely unreliable and substantially

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understated the risk in the loan portfolio. Furthermore, many of the loan files were missing the most basic information, including appraisals, loan officer updates, rent rolls, financial information on guarantors, *etc.*

Because the risk rating system and other value indicators were unhelpful or unreliable, a bottom-up approach had to be implemented. Pursuant to this approach 56 percent of the loan portfolio, including virtually all the troubled real estate loans and all commercial loans above a certain dollar amount, was reviewed. Using information that was available at the time (but which perhaps had been missing from the loan files), the loans were re-rated and re-reserved. Discounts were then applied to the re-rated portfolio to reflect collection costs, the cost of funds, and an expected return on investment to determine the fair value amount that a buyer would actually pay for the loan portfolio considering the market conditions that existed at the time. When BNENA's liabilities were subtracted from the fair value of BNENA's assets it was determined that BNENA was insolvent by in excess of \$1.5 billion.<sup>25</sup>

BNENA's smaller Sister Banks also were valued. It was determined that three of those banks, BNE-West, Old Colony, and Maine National Bank, had positive fair market values on a stand alone basis.

### **The Effect of the Cross-Guarantee Provision**

What is commonly referred to as the FIRREA "Cross-Guarantee Provision" states that any FDIC insured bank is liable to the FDIC for losses the FDIC reasonably anticipates incurring in connection with a default of a "commonly controlled insured depository institution" (*i.e.*, a sister bank owned by the same bank holding company).<sup>26</sup> This meant that in the event the FDIC reasonably anticipated a default by BNENA the FDIC could turn to BNENA's Sister Banks for payment of the amount of the anticipated loss.<sup>27</sup>

The Trustee's experts concluded that the FDIC's reasonably anticipated loss for BNENA during the relevant period was at least \$1.5 billion, the amount by which BNENA was insolvent. Applying just 20 percent of the cross-guarantee liability to BNENA's solvent Sister Banks wiped out all of their positive value, leaving BNEC's investments in its bank subsidiaries at \$0.<sup>28</sup>

### **BNEC's Non-Bank Assets**

After investments in bank subsidiaries, the largest category of BNEC assets on a book value basis was investments in and advances to non-bank subsidiaries. These companies were engaged in various lines of business, including data services, commercial finance, investment banking, investment management, and lease management services. A fair market valuation was performed for each entity using methodologies ranging from cash generated from actual sales, to discounted cash flow analyses, to an examination of comparable sales data. The fair market value of these assets was determined to be approximately \$310 million, well in excess of the \$138 million book value assigned to them. The combined value of BNEC's other non-bank assets, including cash, interest bearing deposits, investment securities, other assets, and intangible assets, was just less than \$100 million, bringing the total of BNEC non-bank assets to approximately \$409 million.

### **BNEC Was Insolvent and Did Not Receive Reasonably Equivalent Value in Exchange for Its Transfers to BNENA**

BNEC had debt, consisting of commercial paper, other short-term borrowings, notes and debentures, and other liabilities, totaling approximately \$837 million. Because the fair value of its assets was approximately \$409 million, the Trustee's model showed that BNEC was insolvent by approximately \$428 million. In addition, because the model demonstrated that BNENA was deeply insolvent, it provided strong evidence BNEC did not receive reasonably equivalent value in exchange for its transfers to BNENA and its Sister Banks.<sup>29</sup>

### **Campbell Soup and Market Capitalization Analysis**

In *VFB LLC v. Campbell Soup Co.*, the Third Circuit held that it was not clearly erroneous for the trial court to rely primarily on a market capitalization data to determine whether reasonably equivalent value was exchanged in connection with a leveraged spinoff transaction.<sup>30</sup> Although some have claimed that *Campbell Soup* indicates that the Third Circuit has abandoned a flexible, fact and circumstance valuation approach in favor of a rigid market capitalization methodology, that argument has been specifically rejected by the Delaware district court.<sup>31</sup>

While a detailed discussion of *Campbell Soup* is beyond the scope of this article, it bears noting that

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market capitalization data would not have been a reliable indicator of the market value of the assets of BNEC or BNENA for at least two reasons. First, the public market in which BNEC's securities traded during the relevant period did not have access to complete or reliable information. For example, testimony from BNEC's underwriter and its Chief Financial Officer revealed that they (and the public) were unaware of material control deficiencies that understated the risk inherent in the loan portfolios of BNENA and the other BNEC Banks and the amount that was necessary to adequately reserve for losses in those portfolios. The Trustee's experts, on the other hand, had access to extensive amounts of internal BNEC and BNENA documents, materials generated by BNENA's bank regulators, and other reliable non-public information that supported the conclusion that BNEC and the BNEC Banks were deeply insolvent.

Second, the market capitalization value of BNEC's publicly traded stock was dramatically different from contemporaneous market valuation assessments performed by unbiased experts based on information that was vastly superior to what was available to the public market. These potential purchasers, bank regulators, and other experts reached conclusions regarding the value of BNEC and BNENA that were starkly inconsistent with a market capitalization valuation.

Although there may be instances in which a market capitalization valuation may provide a useful data point for a insolvency analysis of a bank holding company and its subsidiary bank(s), it likely is not be the best indicator of the fair market value of their assets. The public market does not have access to material information like, for example, bank regulators' assessments of financial condition and viability, materials relating to efforts to sell the holding company or its subsidiaries, valuation and solvency analyses performed by regulators and/or their outside experts, and loan files and other information that may be essential to valuing loan portfolios. This type of non-public information is in most instances going to be a far superior indicator of value than the public share price, which is calculated without the benefit of such data.

## Conclusion

When a bank becomes troubled, the interests of the bank's regulators and those of the bank's holding

company and its creditors, which typically are for the most part aligned, can dramatically diverge. Regulators, concerned about protecting the FDIC bank insurance fund and the stability of the banking system, often require bank holding companies to act as a source of strength and downstream funds and other property to their distressed banks. If a troubled bank fails and is placed into FDIC receivership after receiving holding company assets, such transfers end up benefitting the FDIC at the expense of the holding company's creditors. In the BNEC bankruptcy, the Trustee sued the FDIC and subsequent transferees to avoid fraudulent transfers to BNEC subsidiary banks that were seized by the FDIC. The Trustee's insolvency model supported both "actual" and "constructive" fraudulent intent claims and was a fundamental driver of the Trustee's \$140 million recovery from the FDIC.

Major factual and legal considerations and components of the BNEC insolvency analysis were:

- To pass *Daubert* muster an insolvency model must contain a reliable estimate of the amount of cash that would be generated if the debtor's assets were converted to cash over a reasonable period of time to pay creditors.
- There is no one-size-fits-all valuation methodology that is applicable to all insolvency analyses. What is appropriate depends on the nature of the asset, the market conditions that existed during the relevant period, and any other circumstances that may be relevant to calculating the amount of cash that would be generated in a hypothetical sale.
- Despite concerted efforts to sell BNEC and BNENA, no offers were made for the entities as whole, operating businesses. The lack of offers not only showed that a premium over and above the value of their individual assets was not justified, it provided direct evidence of the insolvency of BNEC and BNENA.
- The value of BNEC's non-bank assets was small in relation to the book value of its investments in its banks and in proportion to BNEC's outstanding debt. This meant that if the BNEC Banks were insolvent or their fair value was substantially less than their book value, then BNEC was insolvent.
- FIRREA's Cross-Guarantee Provision provides that if a bank is placed in FDIC receivership, the FDIC can turn to the failed bank's sister bank(s) for

payment in full of the amount the FDIC expects to incur in connection with the failure.

- Because BNENA was so deeply insolvent, the contingent liabilities that arose as a result of the Cross-Guarantee Provision rendered all of BNENA's smaller Sister Banks insolvent and, in turn, made the value of BNEC's investment in its subsidiary banks "zero."
- The insolvency of the BNEC Banks was strong evidence that transfers to those banks were for less than reasonably equivalent value.
- The conclusions that BNEC was insolvent and received less than reasonably equivalent value in exchange for the transfers in question supported both the Trustee's actual and constructive intent fraudulent transfer claims.

Banks and bank holding companies typically follow similar paths through decline and failure. The same palliative efforts, including the transfer of holding company property to banks doomed to FDIC receivership, have been employed time and time again. The issues discussed above, therefore, likely will be relevant in connection with the current cycle of bank failures.

## Notes

1. The regulators primarily involved when national banks become deeply troubled are the Office of the Comptroller of Currency (OCC), which regulates national banks, the Federal Reserve, which regulates bank holding companies, and the Federal Deposit Insurance Corporation (FDIC), which oversees the Bank Insurance Fund (BIF) that insures deposits. Because BIF funds are at risk, the FDIC is consulted early and often by the Federal Reserve and the OCC when a bank becomes troubled, and great deference is often given to the FDIC's wishes with respect to the treatment of such banks and their holding companies.
2. A 1987 Federal Reserve policy statement on the so-called "Source of Strength Doctrine" provides that a bank holding company has an obligation to "use available resources to provide adequate capital funds to its subsidiary during periods of financial stress or adversity..." 52 Fed. Reg. 15,707 (1987). See Christine Bradley & Kenneth Jones, *Loss Sharing Rules for Bank Holding Companies: An Assessment of the Federal Reserve's Source-of-Strength Policy and the FDIC's Cross-Guarantee Authority*, Munich Personal RePEc Archive (March 16, 2009) (discussion by FDIC staff members of history and application of Source of Strength Doctrine). Not all banks have holding companies. The Source of Strength Doctrine applies only to those that do.
3. The failure of the BNEC system was one of the largest in history and was the largest since the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") until the failure of IndyMac Bank, F.S.B. in July 2008.

4. In addition to fraudulent transfer claims brought pursuant to §548(a)(1)(A) and (B), the Trustee's Complaint included claims for avoidance of fraudulent conveyances pursuant to Bankruptcy Code § 544(b) and the Massachusetts fraudulent conveyance laws (109 Mass. Gen. Laws Ann. §§4-7), avoidance of preferential payments pursuant to Bankruptcy Code §§ 542 and 543, restitution of estate property in certain accounts and Rabbi Trusts, violation of § 91 of the National Bank Act, and constructive trust and equitable lien.
5. The Trustee recovered \$140 million from the FDIC. The Trustee also used his insolvency model to support fraudulent transfer and "deepening insolvency" claims he brought in an action against BNEC's former auditors, for which he recovered \$84 million.
6. After several years with no significant bank failures, the failure rate increased dramatically in 2008, when 25 banks with \$371.9 billion in assets failed. See 2009 FDIC Annual Report. In 2009, 140 banks failed. See [www.fdic.gov/bank/individual/banklist.html](http://www.fdic.gov/bank/individual/banklist.html). There were 552 banks on the FDIC's troubled bank list at the end of the third quarter of 2009, up from 416 the previous, and scores of additional banks are predicted to fail. Matthew Jaffe, *FDIC Bank Insurance Fund Plunges Into Red*, [abc.go.com/business](http://abc.go.com/business) (Nov. 24, 2009); Ari Levy, *Toxic Loans Topping 5% May Push 150 Banks Past Point of No Return*, [Bloomberg.com](http://Bloomberg.com), Aug. 14, 2009.
7. After the FDIC Litigation concluded, Congress passed the Gramm-Leach-Bliley Act. Section 730 of the Act prohibits any person from bringing preference or constructive intent fraudulent transfer claims against the FDIC to avoid transfers to subsidiary banks that occur after a bank receives a written direction from a bank regulator to raise capital. 12 U.S.C. § 1828(u)(1). There is, however, no restriction on bringing actual intent claims against the FDIC. *Id.* § 1828(u)(2)(B). In addition, Section 730 only limits claims against the FDIC and other bank regulators, and makes no reference to suits pursuant to Bankruptcy Code Section 550 to recover avoidable transfers from banks or other subsequent transferees that obtain them from an FDIC receivership. See *In re Int'l Admin. Servs., Inc.*, 408 F.3d 689, 704-08 (11th Cir. 2005) (trustee may sue subsequent transferee under Bankruptcy Code § 550 without first suing initial and intermediate transferees); *Woods & Erickson v. Leonard*, 389 B.R. 721, 734-35 (9th Cir. 2008) (same); *In re Richmond Produce*, 195 B.R.455, 463 (Bankr. N.D. Cal. 1996) (same).

While only time will tell the extent to which GLBA Section 730 will effect constructive intent fraudulent transfer and preference claims against the FDIC, in at least one instance it has not acted as a barrier. For example, it does not appear that Section 730 was triggered before the failure of Washington Mutual Bank (WMB), a federal savings bank placed in FDIC receivership on September 25, 2008, because it does not appear that a bank regulator ever issued a written direction to WMB to raise capital. As a result, Washington Mutual, Inc. and WMI Investment Corp., holding companies of WMB, have brought preference and fraudulent transfer claims against the FDIC to recover certain amounts transferred to WMB before its failure. See Complaint, ¶¶25-44, *Washington Mutual, Inc. v. FDIC*, Case No. 1:09-cv-00533 (RMC)(March 20,2009)(preference and constructive intent fraudulent transfer claims); Memorandum of Law in Support

- of Motion to Dismiss of Defendant FDIC, as Receiver for Washington Mutual Bank, pp. 23-37 (moving to dismiss fraudulent transfer claims on grounds other than GLBA § 730).
8. After the FDIC seized banks in the First Republic Bank Corporation system in 1988, the FDIC discovered that the information services for the banks were provided by non-bank subsidiaries owned by the holding company. The FDIC had to pay what it viewed as “hostage money” for the systems needed to run the banks. Having learned its lesson with the First Republic resolution, one of the first things it did after assessing BNECA’s dire situation was to compel the merger of the BNEC information services subsidiaries into BNECA.
  9. See, e.g., *Branch v. FDIC*, 825 F. Supp. 384, 399-400 (D. Mass. 1993) (“Transfers to a solvent subsidiary are considered to be for reasonably equivalent value because, since the parent is the sole stockholder of the subsidiary corporation, any benefit received by the subsidiary is also a benefit to the parent.”); *In re Metro Communications, Inc.*, 95 B.R. 921, 933 (Bankr. W.D. Pa. 1989), *rev’d on other grounds*, 945 F.2d 635 (3rd Cir. 1991); *In re W.T. Grant Co.*, 699 F.2d 599, 608-09 (2d Cir. 1983); *In re First City Bancorporation of Tex., Inc.*, 1995 Bank. Lexis 1683, at \*34 n.9 (Bankr. N.D. Tex. May 15, 1995).
  10. *In re First City*, 1995 Lexis 1683 at n.9; *Branch*, 825 F. Supp. at 399-400.
  11. See, e.g., *In re First City*, 1995 Lexis 1683 at n.9; *Branch*, 825 F. Supp. at 399-400; *In re Duque Rodriguez*, 77 B.R. 937, 939 (Bankr. S.D. Fla. 1987) (finding no reasonably equivalent value because net worth of debtor diminished and its creditors harmed by payment made on behalf of insolvent subsidiary), *aff’d*; 895 F.2d 725 (11th Cir. 1990); *Commerce Bank of Kansas City v. Achtenberg*, 1993 WL 476510, at \*2-4 (W.D. Mo. 1993) (debtor did not receive reasonably equivalent value in exchange for guarantee of wholly-owned insolvent subsidiary’s debt because debtor’s net worth was diminished by the obligation).
  12. See, e.g., *Land O’Lakes, Inc. v. Schaeffer*, No. 99-7147, Slip Op. at 5 (10th Cir. Jan. 19, 2001); *United States v. Fernon*, 640 F.2d 609, 613 (5th Cir. 1981); *Asareo LLC v. Am. Mining Corp.*, 396 B.R. 278, 370-74 (S.D. Tex. 2008).
  13. See, e.g., *In re Trans World Airlines, Inc.*, 134 F.3d 188, 194 (3d Cir. 1998) (“Overwhelming body of authority” provides that appropriate methodology is a market valuation); *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 548-49 (1994) (“Fair market value” is “normal tool for determining what property is worth” under the Bankruptcy Code).
  14. See *In re Trans World Airlines, Inc.*, 180 B.R. 389, 405 n.22 (Bankr. D. Del. 1994), *aff’d in part, rev’d in part on other grounds*, 203 B.R. 890 (D. Del. 1996), *aff’d in part, rev’d in part on other grounds*, 134 F.3d 188 (3d Cir. 1998); *Briden v. Foley*, 776 F.2d 379, 382 (1st Cir. 1985); *Nickless v. Golub*, 152 B.R. 394, 403 (Bankr. D. Mass. 1993) (book value does not reflect “fair valuation” under the Bankruptcy Code.) Book value was specifically rejected as an appropriate measure of the fair value of the assets of a bank and bank holding company in *Corbin v. Franklin Nat’l Bank*, 2 B.R. 68, 7127 (E.D.N.Y. 1979), *aff’d*, 633 F.2d 203 (2d Cir. 1980) (“In this particular case it is fruitless to argue . . . that book value has any meaning.”)
  15. See, e.g., *Diamond v. Osborne*, 102 F. App’x 544, 548 (9th Cir. 2004); *In re Taxman Clothing Co.*, 905 F.2d 166, 170 (7th Cir. 1990); *Langham, Langston & Burnett v. Blanchard*, 246 F.2d 529, 532-33 (5th Cir. 1957); *In re DAK Indus., Inc.*, 195 B.R. 117, 125 (Bankr. D. Ca. 1996).
  16. See, e.g., *Lawson v. Ford Motor Co.*, 78 F.3d 30, 35 (2d Cir. 1996); *Constructora Maza, Inc. v. Banco de Ponce*, 616 F.2d 573, 577 (1st Cir. 1980); *In re Irridium*, 373 B.R. 283, 344 (Bankr. S.D.N.Y. 2007); *Sleepy Valley, Inc. v. Leisure Valley, Inc.*, 93 B.R. 925, 927 (Bankr. W.D. Tex. 1988).
  17. *In re Trans World Airlines*, 134 F.3d at 195. In the *TWA* case 12 to 18 months was deemed reasonable. *Id.*
  18. *In re Trans World Airlines*, 150 B.R. 389, 411 (Bankr. D. Del. 1994) *aff’d in part and rev’d in part on other grounds*, 203 B.R. 890, 893 (D. Del. 1996) *aff’d in part and rev’d in part*, 134 F.3d 188 (3d Cir. 1998).
  19. *Id.* at 410 (citations omitted). See also *Lawson*, 78 F.3d at 35 (“Fair value, in the context of a going concern, is determined by the fair market price of the debtor’s assets that could be obtainable in the market if sold in a prudent manner over a reasonable period of time”); *Briden v. Foley*, 776 F.2d 379, 382 (1st Cir. 1985); *Constructora Maza*, 616 F.2d at 577; *Sleepy Valley*, 93 B.R. at 927. In considering *Daubert* motions relating to expert testimony on asset valuation, the court held in the FDIC Litigation that the Trustee’s arguments regarding the necessity of a market-based valuation methodology were persuasive and prohibited the FDIC from proffering an inconsistent methodology at trial. See *Branch v. FDIC*, C.A. No. 91-10976 (RGS), slip op. at 1 (May 15, 1998).
  20. See, e.g., *In re Irridium*, 373 B.R. 283, 344 (Bankr. S.D.N.Y. 2007) (listing various methodologies); *VFB LLC v. Campbell Soup Co.*, 482 F.2d 624, 631 (3rd Cir. 2007) (market capitalization); *In re Coated Sales, Inc.*, 144 B.R. 663, 670 (Bankr. S.D.N.Y. 1992) (actual sale); *MFS/Sun Life Trust-High Yield Sec. v. Van Dusen Airport Servs. Co.*, 910 F. Supp. 913, 939-43 (S.D.N.Y. 1995) (asset purchase price, discounted cash flow and comparables); *In re Lids Corp.*, 281 B.R. 535, 541 (Bankr. D. Del. 2002) (market multiple and comparables); *In re Zenith Elec. Corp.*, 241 B.R. 92, 104 (Bankr. D. Del. 1999) (discounted cash flow).
  21. See, e.g., *In re TWA*, 134 F.3d at 194; *Lawson*, 78 F.3d at 35-36; *LaSalle Nat’l Bank Ass’n v. Paloian*, 406 B.R. 299, 350-52 (N.D. Ill. 2009).
  22. The value of BNEC’s non-bank assets was dwarfed by the amount of its public debt. As a result, without the substantial book value assigned to its investments in its subsidiary banks, BNEC was deeply and hopelessly insolvent.
  23. Bank regulators generate an extraordinary amount of non-public reports, analyses, and other material designed to quantify and predict risk and value in the institutions over which they have supervisory responsibility. See *An Examiners Guide to Problem Bank Identification, Rehabilitation, and Resolution*, pp. 18-26 (Describing systems and reports designed to monitor, document, and communicate risks and concerns in banks). The OCC, for example, has a “Canary” web-based early warning system that provides benchmarks, credit risk analysis, market barometers, and predictive models. See *id.* at 19. Some of its models include, for example, a Bank Performance Projection

Model (predicts future performance when a bank's ultimate solvency is in question), a Risk Based Capital Model (provides a uniform and consistent estimate of risk-based capital ratios and enables evaluation of expected changes to capital, assets, and off-balance sheet items), and a Credit Assessment Tool (uses Call Report information to classify banks according to credit quality condition and potential to develop problems). *See id.* at 19–20. Other OCC and FDIC materials relate to virtually every aspect of the supervision of troubled banks. *See id.* at 18–26.

The Trustee was able to overcome the regulators' assertions of the deliberative process privilege and obtain unfettered access to their files relating to the supervision of the BNEC system. Although this was an arduous process involving motion practice in multiple courts, it provided a treasure trove of documents for the Trustee and his experts. These contemporaneous materials generated by experts with the best knowledge available regarding the condition of BNEC and the BNEC Banks were primary support for the Trustee's valuation model. They also provided strong evidence in support of the Trustee's actual intent claim Protective orders issued in connection with the production of the documents prevent the Trustee from disclosing their contents.

24. The fact that BNEC and BNENA were unable to find any buyers despite concerted efforts to do so is, in and of itself, strong evidence of insolvency. In *Corbin v. Franklin Nat'l Bank*, 2 B.R. 687 (E.D.N.Y. 1979), *aff'd*, 683 F.2d 203 (2d Cir. 1980), the court, considering the solvency of Franklin National Bank ("FNB") and its holding company, Franklin New York Corporation ("FNYC"), held:

The facts here are that FNYC tried to sell stock of FNB to Manufacturers Hanover Trust Company in early May, 1974 and were on May 11th that that bank was not interested because 'there was nothing left on Franklin's bottom line.' Thereafter the Secretary of the Treasury, the Federal Reserve Bank of New York, the Comptroller, the FDIC, FNYC and FNB all attempted during May and June 1974 to find a purchaser for FNB but were utterly unsuccessful. In this particular case it is fruitless to argue, as FDIC does, that book value has any meaning. If there were no purchasers or bidders for FNB in May and June 1974, its stock, realistically speaking, had no value and that meant that FNYC was insolvent . . . .

*Id.* at 711–12. *See also Briden*, 776 F.2d at 382 (requiring reductions for assets not readily susceptible to liquidation and payment of debts); *Constructora Maza*, 616 F.2d at 577 (same).

25. The credibility of this number was bolstered by similar conclusions reached in analyses performed by informed, expert observers at or around the time of the transfers.
26. 12 U.S.C. § 1815(e).
27. BNEC acknowledged the contingent liability the cross-guarantee provision imposed on its subsidiary banks in its 1989 Form 10-K, stating, "In the event that the FDIC experiences losses or reasonably anticipates losses in connection with the appointment

of a conservator or a receiver for a national bank subsidiary of [BNEC] or in connection with assistance provided by the FDIC in anticipation of a danger of default by a subsidiary bank, the FDIC may make an assessment against other [BNEC] subsidiary banks in the amount of the loss or reasonably anticipated loss, which assessment could result in those other subsidiary banks being declared in default and placed in receivership."

After BNENA was declared insolvent and placed in an FDIC receivership, the FDIC served Notices of Assessment on BNENA's Sister Banks for the full amount of the anticipated loss. The Sister Banks were unable to pay the demanded amounts, so they too were declared insolvent and placed in FDIC receiverships.

28. Numerous cases have held that contingent liabilities are to be considered when evaluating the insolvency of a company. *See, e.g., In re Trans World Airlines*, 134 F.3d at 197; *Mellon Bank, N.A. v. Official Comm. of Unsecured Creditors*, 92 F.3d 139, 156 (3d Cir. 1996); *In re Xonica Photochemical, Inc.*, 841 F.2d 198, 200 (7th Cir. 1988). In the FDIC Litigation, the FDIC moved to dismiss the Trustee's § 548(a)(1)(B) claims to avoid transfers to two of the Sister Banks on the grounds that those banks were solvent on a stand-alone basis at the time of the transfers and that BNEC thus received reasonably equivalent value in exchange for the transfers. *Branch*, 825 F. Supp. at 399–40. The court noted that while there is a presumption of reasonably equivalent value when a company transfers assets to a solvent subsidiary, the Trustee had alleged that BNENA was deeply insolvent at the time of the transfer and that a contingent liability that arose from a possible cross-guarantee assessment rendered the Sister Banks insolvent. *Id.* The FDIC's motion was denied on the basis that transfers to Sister Banks rendered insolvent by cross-guarantee liability may not have been for reasonably equivalent value. *Id.*
29. *See In re First City*, 1995 Lexis 1683 at n. 9; *Branch*, 825 F. Supp. at 399–400; *In re Commerce Bank*, 1993 WL 476510, at \*2–4; *In re Duque*, 77 B.R. at 939.
30. 482 F.3d 624, 627–34 (3d Cir. 2007). The trial court also relied on other contemporaneous indicators of value in addition to market capitalization, like valuations performed internally by the transferor and the transferee both before and after the spinoff. *Id.* at 629. The 3rd Circuit noted that the trial court's valuation was "largely immune from attack" and could not be overturned unless it was "completely devoid of credible evidentiary basis" or bore "no rational relationship to the supporting data." *Id.* at 683.
31. *In re American Classic Voyages Co.*, 384 B.R. 62, 65 (D. Del. 2008) (noting that *Campbell Soup* does not require a market capitalization approach in all instances). *See LaSalle Nat'l Bank Ass'n v. Paloian*, 406 B.R. 299, 351 (N.D. Ill. 2009) (discussing *Campbell Soup* and holding that even where contemporaneous market data is available a court may assign greater weight to expert testimony, particularly if the contemporaneous methodology was faulty or biased).