AMERICAN BANKRUPTCY INSTITUTE

Northeast Bankruptcy Conference & Consumer Forum

Business Track

Bank Failures

Patricia Antonelli
Demerle & Associates, P.C. | Boston

Hon. Janet E. Bostwick
U.S. Bankruptcy Court (D. Mass.) | Boston

Kirk B. Burkley
Bernstein-Burkley | Pittsburgh

Adam J. Ruttenberg
Beacon Law Group, LLC | Boston

CONCURRENT SESSION

2024

Bank Failures Program

PATRICIA ANTONELLI, ESQUIRE
ADAM RUTTENBERG, ESQUIRE
KIRK BURKLEY, ESQUIRE
U.S. BANKRUPTCY JUDGE JANET E. BOSTWICK

Notable Bank Failures

- The Bank of New England – local bank fails 1991
- Washington Mutual – largest failure 9/25/2008
- Silicon Valley Bank – failed 3/10/2023
- Signature Bank – failed 3/12/2023
- First Republic Bank, CA - failed 5/1/2023
- Republic First Bank d/b/a Republic Bank Philadelphia, PA failed 4/26/2024

SVB Financial Group and Silicon Valley Bank

- SVB Financial Group (SVBFG) – publicly traded holding company $211.8 billion
- Silicon Valley Bank (SVB) – California state chartered commercial bank and primary subsidiary of SVB Financial Group valued at $209.0 billion
- SVB served technology start-ups and entrepreneurs and technology, life sciences, healthcare, private equity and venture capital companies

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The Run on SVB – Spring 2023

- End of 2020, SVB took in significant deposits from emerging technology and life sciences sectors
- Increases in investments in those sectors and capital flowing in from the Paycheck Protection Program
- Some deposits invested in long-dated gov't facilities like US Treasuries and gov't issued mortgage-back securities

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Contributors to SVB's Downfall

- Governance failures at both SVBFG and SVB
- SVB's books and records owned by holding company
- Deposits were not diverse; concentrated in a small number of tech industries
- SVB's assets had tripled in value from 2019 to 2022, but supervision and risk management lagged.

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Workings of a Failure

- FDIC protects depositors in insured banking institutions (IDI's)
- FDIC Act has a resolution process for insured depository institutions (banks) which cannot be debtors in bankruptcy
- FDIC Act allows appointment of FDIC as receiver or conservator
- Differences in receivership v. conservatorship

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Workings of a Failure (cont'd)

- Conservatorship – FDIC operates failed bank to restore it to solvency and ultimately sell the bank
- Receivership – FDIC charged with winding down bank's affairs by liquidating assets and administering claims process
- Typically bank has no advance warning of seizure
- FDIC typically all valid insured claims against the failed bank

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How the FDIC Acted

- FDIC insures deposits up to $250,000
- To avoid spreading panic of bank failures, FDIC invoked "systematic risk exception" to guarantee deposits at SV Bank and Signature Bank
- SV Bank's failure happened within hours giving the FDIC no time to work with parent SVBFG to inject capital into SV Bank

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Depositors

- Insured deposits typically transferred to acquiring bank
  - Sometimes FDIC will pay insured deposit balance to depositors itself
  - FDIC is subrogated to rights of insured depositors. Largest creditor of failed bank
  - Deposit insurance has maximum amount. Amounts in excess are uninsured deposits
- Uninsured depositors are creditors of failed bank
  - Have claim and get receiver certificate
  - Sometimes FDIC gives early advance dividend (depositor priority)
- Many recent failures have no uninsured deposit claims
  - Acquiring bank may accept all deposits including uninsured
  - Secretary of Treasury may invoke "systemic risk exception" to pay uninsured deposits

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Deposit Insurance

- Deposit insurance is up to $250,000 per depositor PER CATEGORY. Seven Categories
  - Single Account (one depositor)
  - Joint Accounts (two or more depositors)
  - IRA's and other Retirement Accounts (one depositor irrespective of number of beneficiaries)
  - Trust Accounts Revocable and Irrevocable (per beneficiary and per owner)
  - Corporation/Partnership/Unincorporated Association (per entity)
  - Employee Benefit Plan (per plan participant with non-contingent interest)
  - Government (per official custodian)
- IOLTA accounts
  - Irrevocable Trust Account category
  - $250,000 in coverage per beneficiary
  - Must show as trust in bank records
  - Bank records won't show beneficial interests
    - Can be proven from law firm records
    - Will take time – amounts over $250,000 unlikely treated as insured on Day One
- New Rule with Trusts – No more than $1,250,000 coverage per owner irrespective of beneficiaries
  - That will affect IOLTA accounts for large law firms

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Loans Made by Failed Bank

FDIC Wants to Collect -- FAST

- *D'Oench, Duhme & Co., Inc. v. FDIC*, 315 U.S. 447 (1942)
  - Secret Agreements Cannot Be Asserted Against FDIC
  - Secret if, even though in writing, not part of official bank records
- 12 U.S.C. 1823(e) – Agreement Diminish/Defeat FDIC Interest Invalid unless
  - In Writing
  - Executed by Bank
  - Part of what approved by board directors / loan committee as reflected in the minutes
  - Continuously official record of bank
- Fraud in Inducement – Agreement outside of records, so barred by 1823(e)
- Fraud in Fact (forged signature) – Not barred by 1823(e)
- Can be asserted by Bank acquiring loan

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Landcastle Acquisition Corp. v. Renasant Bank, 57 F.4th 1203 (11th Cir. 2023)

- Crescent Bank makes loan to Law Firm, an LLC. Secured by pledge of certificate of deposit
- Crescent Bank fails. Renasant Bank acquires loan from FDIC.
- Law firm defaults on loan. Renasant Bank liquidates CD
- Law firm sues Renasant Bank for CD proceeds. Says pledge invalid because no authority
  - Pledge signed by name partner of law firm, but partnership agreement allegedly requires more
- Holding -- doesn't matter if law firm right about partnership agreement.
- Lack of authority evidence barred by *D'oench* -- Not in records of the bank
- Apparently sufficient that bank where CD held honored pledge
- Dissent – this is crazy, lack of authority always voids pledge

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Claims by FDIC

Fraudulent Transfer

- 12 U.S.C. 1821(d)(17)
  - Transfer of any interest in property of institution-affiliated party or debtor of the institution
  - Made within 5 years of FDIC appointment
  - With actual intent to hinder, delay, or defraud the insured depository institution
  - Property (or its value) may be recovered from
    - Initial transferee unless takes for value and in good faith
    - Mediate or immediate transferee unless takes in good faith
  - FDIC has first entitlement to property over other creditors including bankruptcy trustee
  - 12 U.S.C. 1813(u)
    - Institution-Affiliated Party is director, officer, employee
    - Controlling stockholder or other shareholder who participates in the conduct of the affairs of an insured depository institution
    - independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in
      - Violation of law or regulation, breach of fiduciary duty, or any unsafe or unsound practice,
      - Which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution

Preference

- No preference recovery for FDIC

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Contracts with Failed Bank

- 12 U.S.C. 1821(e)
  - FDIC may disaffirm or repudiate any contract or lease
  - Must do so within "reasonable period" following appointment
  - Need only determine, in FDIC's discretion,
    - (1) that performance of contract or lease is burdensome, and
    - (2) that disaffirmance or repudiation will promote orderly administration of receivership
  - Doesn't have to be executory
  - Can repudiate a letter of credit
  - Upon repudiation, counterparty claim is only actual direct compensatory damages
  - No lost profits
    - Disaffirm branch lease – no future rent (that is lost profits)

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Claims Against the Failed Bank

- Claim is asserted through FDIC claim process 12 USC 1821(d)
  - Must submit written claim – 90 days after notice published
  - Notice usually published very soon after bank failure
  - FDIC must allow/disallow within 180 days
    - If disallow, 60 days to sue for *de novo* review in federal court
  - FDIC only allow if "proved to the satisfaction of the receiver"
  - Damages must be "fixed and certain" on date FDIC appointed
    - Actual compensatory damages
    - No lost profits or pain and suffering or punitive damages
  - Cannot bypass and sue – defense of failure exhaust administrative remedies
- If claim allowed, claimant receives a receiver certificate.
  - Paid like a dividend on proof of claim
  - Deposits have priority and are paid first 12 USC 1821(d)(11) (enacted 1993).
    - Only thing ahead of deposits are administrative expenses of receiver
    - Biggest deposit claims are with FDIC as subrogee
  - Discretion also give priority to wages / benefits / claims last 30 days

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Automatic Stay

- 12 U.S.C. 1821(d)(12) "Suspension of Legal Actions"
  - FDIC "may" request a stay
    - Any "judicial action or proceeding" to which failed bank "is or becomes a party"
    - Stay is 90 days (45 days if FDIC is conservator not receiver)
  - Upon receipt of FDIC request, "the court shall grant such stay as to all parties"
  - Intended to allow claim determination in FDIC claim process
  - "Judicial action or proceeding" not defined in statute
    - Entire bankruptcy case or just adversary proceeding?

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Key Bankruptcy Code Provisions

- Banks are not eligible for bankruptcy protection; 11 U.S.C. § 109(b)(2)
  - Banks are ineligible for bankruptcy meaning that neither the bank nor the bank's creditors can place the bank in bankruptcy.
  - Bank holding companies, on the other hand, may file for bankruptcy, and many of the largest bankruptcies on record have been bank holding companies, *e.g.*, Washington Mutual, Inc.

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Key Bankruptcy Code Provisions (cont'd)

- Section 365(o): Deemed Assumption of Capital Commitments
  - "In a case under chapter 11 of this title, the trustee shall be deemed to have assumed (consistent with the debtor's other obligations under section 507), and shall immediately cure any deficit under, any **commitment** by the debtor to a Federal depository institutions regulatory agency (or predecessor to such agency) to maintain the capital of an insured depository institution, and any claim for a subsequent breach of the obligations thereunder shall be entitled to priority under section 507. This subsection shall not extend any **commitment** that would otherwise be terminated by any act of such an agency."
  - I.e., this section departs from the default rule that provides debtors the unilateral option to assume or reject contracts
  - Instead, the Code provides for automatic assumption, resulting in the requirement that the debtor company immediately cures any and all relevant obligations
  - The Code does not, however, define *commitment*
    - In re The Colonial BancGroup, 436 B.R. 713 (Bankr. M.D. Ala. 2010) (holding that bank holding company did not make a commitment to maintain the capital of its bank subsidiary).
    - In re AmFin Financial Corp., Case No. 10-CV-1298, 2011 U.S. Dist. LEXIS 60297 (N.D. OH., June 6, 2011) (holding that the FDIC failed to present sufficient evidence that either the regulator or the holding company understood or intended for the documents at issue to create a "commitment" by bank holding company to maintain the capital of its former bank subsidiary).
    - In re Imperial Credit Indus., Inc., 527 F.3d 959 (9th Cir. 2008) (finding a holding company's performance guaranty constituted a capital maintenance obligation under section 365(o)).
    - In re Overland Park Fin. Corp., 236 F.3d. 1246 (10th Cir. 2001) (finding holding company's stipulation in writing to regulator that it would maintain net worth of savings and loan subsidiary constituted a commitment for purposes of section 365(o)).

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Key Bankruptcy Code Provisions (cont'd)

- Section 507(a)(9): FDIC Priority Claims
  - ". . . Ninth, allowed unsecured claims based upon any commitment by the debtor to a Federal depository institutions regulatory agency (or predecessor to such agency) to maintain the capital of an insured depository institution."
  - In addition to section 365(o), the FDIC and other regulatory agencies may seek priority status for any unsecured claims
  - This provides the FDIC and similar agencies an extra layer of protection even if a case is converted
  - Priority claims must be paid in full before other general unsecured claims

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Tax Refund Allocation Issues Relating to Bank Holding Company

- Large financial institution failures resulting in significant losses gives rise to large tax refunds
- Unsurprisingly, these large losses lead to disputes between the FDIC, acting as the receiver, and the bank holding company *entitled* to the refund
- Rodriguez v. Fed. Dep. Ins. Corp., 140 S. Ct. 713 (2019) (held that the federal common law doctrine enunciated in In re Bod Richards Chrysler-Plymouth Corp., 473 F.2d 262 (9th Cir. 1973) was inapplicable to issues on property ownership, such as the tax refunds, which should be decided by applicable state law))

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Timeline of the End

- 3/10/2023 Cal bank regulator closes SV Bank and appoints FDIC as receiver; deposits were transferred on closing to Deposit Insurance National Bank of Santa Clara
- 3/13/2023 Silicon Valley Bridge Bank receives all deposits from DINBSC giving depositors access to insured funds and certificates for uninsured deposits
- 3/13 to 3/16/2023 SVBFG has access Bridge Bank deposits transfers $150 million to SVBFG
- 3/17/2023 wire transfers denied
- 3/17/2023 SVFG filed Chapter 11 bankruptcy

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SVB and SVFG Today

- Ongoing legal battle between SVBFG and the FDIC in USDC, SDNY
- At issue is announcement FDIC made on SVB's collapse that "all depositors of the institution will be made whole" even if uninsured
- Almost $2 billion in claims from creditors of SVB's parent SVBFG

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Current Deposit Issue re: SVB

- FDIC fully backstopped all deposits at SVB, above and beyond the $250,000 cap
- FDIC's seizure of deposits severed SVB's access to its own cash held
- FDIC has formally rejected and denied attempts by SVB to recover

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By the Numbers

- SVB's collapse, and the subsequent acquisitions by other banks, resulted in the twenty-five (25) largest banks gaining approximately $120,000,000,000 in deposits
- Meanwhile, small/regional lenders lost approximately $10,000,000,000
- Since 2000—small lenders represent thirty-eight percent (38%) of all outstanding loans
  - This represents a faster growth rate than many large Wall Street banks
- Sixty-seven percent (67%) of all commercial real estate loans outstanding have been extended by small/regional banks
  - This represents a significant portion of such banks' income generation
- $1,500,000,000,000 commercial real estate loans will close by or before the end of 2025

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Faculty

Patricia Antonelli is an attorney at Demerle & Associates, P.C. in Boston. She advises banks, credit unions, financial institutions and trade creditors in insolvency matters, including foreclosures, bankruptcies, state court receiverships and collection matters in Rhode Island and Massachusetts. She also advises clients on banking, mortgage banking and consumer finance regulatory compliance matters. Admitted to practice in Rhode Island and Massachusetts, Ms. Antonelli is a member of ABI, the Boston Bar Association's Bankruptcy Law Section and the International Women's Insolvency & Restructuring Confederation. She is certified by the Rhode Island Supreme Court as a Receiver/Trustee for Superior Court receiverships. Ms. Antonelli was selected as a *Super Lawyer* from 2009-24, and she was nominated for a Professional Excellence in Law award by *RI Monthly* for 2023. She is a member of the Planning Board for the City of Newport, R.I., and the Newport Preservation Society, and she is a member of Newport Lodge #104 of the Benevolent and Protective Order of the Elks. While at law school in Boston, Ms. Antonelli was accepted into the U.S. Department of Justice Honors Program, and she interned at the Office of the U.S. Trustee in Boston, which was the beginning of her career in insolvency and bankruptcy law. She graduated from Boston College in 1986 and received her J.D. from Suffolk University Law School in 1989.

Hon. Janet E. Bostwick is a U.S. Bankruptcy Judge for the District of Massachusetts in Boston, appointed on Sept. 27, 2019. Prior to her appointment, she practiced as a bankruptcy attorney with more than 30 years of experience with financially troubled companies, dealing with chapter 11 business reorganizations, liquidations and wind-downs, loan workouts and creditor negotiations. From 2001-19, Judge Bostwick practiced at her own firm, Janet E. Bostwick, PC, which focused on business bankruptcy and restructuring. Before launching her firm, she practiced at the Boston firms of Goldstein & Manello, PC and Sherin and Lodgen, LLP. Judge Bostwick is a member of the American College of Bankruptcy and serves on the *Pro Bono* Committee of the American College of Bankruptcy Foundation, which is the largest funder of bankruptcy *pro bono* projects and grants. Judge Bostwick frequently lectures on bankruptcy topics for professional organizations and bar organizations. She is a member of the American Bar Association and co-chairs the Administration and Courts Subcommittee of its Business Bankruptcy Law Committee. She also is a member of the National Conference of Bankruptcy Judges, for which she serves on the Membership and Next Generation Committees. Judge Bostwick is a member of the International Women's Insolvency & Restructuring Confederation and the Boston and Massachusetts Bar Associations. She also is the founding chair of the IWIRC's New England Network. In 2005, IWIRC recognized her contributions to the organization by awarding her the Melnik Award for Exceptional IWIRC Member. From 2005-16, Judge Bostwick was co-chair of the M. Ellen Carpenter Financial Literacy Program, a joint program of the U.S. Bankruptcy Court for the District of Massachusetts and the Boston Bar Association. In 2016, the U.S. Bankruptcy Court for the District of Massachusetts awarded her the District of Massachusetts *Pro Bono* Award for her work with the program as well as her other *pro bono* activities over the years. Judge Bostwick received her B.A. in economics and mathematics from the State University of New York at Albany and her J.D. from Cornell Law School.

Kirk B. Burkley is the managing partner of Bernstein-Burkley, P.C. in Pittsburgh, where his practice emphasizes all aspects of bankruptcy and restructuring, creditors' rights, business and corporate

transactions, litigation, real estate and oil and gas. He conducts seminars, live webinars and workshops on bankruptcy, creditors' rights and oil and gas, and has lectured for the National Association of Credit Management (NACM), ABI and the Pennsylvania Bar Institute. He also is a regular panelist for NBI and Lorman Educational Services on various legal topics. Mr. Burkley has written several publications related to the bankruptcy field, with work appearing in the *ABI Journal*, *Equipment Leasing Newsletter*, the Pennsylvania Association of Credit Managers newsletter, the *Creditor*, and more. He is an emeritus board member of the American Board of Certification, as well as a past president of the Turnaround Management Association. Mr. Burkley is a member of Allegheny County Bar Association, ABI and the Western District of Pennsylvania Local Rules Committee. Mr. Burkley received his B.S. in 1999 from Ohio University and his J.D. in 2002 from the University of Pittsburgh School of Law, where he was a recipient of the Center for Forensic Economic Studies Award for Excellence in Litigation.

Adam J. Ruttenberg is a partner at Beacon Law Group, LLC in Boston, where his principal areas of practice are bankruptcy litigation and business reorganization, representing debtors, creditors and bankruptcy trustees. His bankruptcy practice includes his representation of a chapter 7 trustee of an individual with multiple partial interests in real estate wherein he had arranged for all interests to be sold in multiple transactions, resulting in unsecured creditors receiving a significant dividend; his representation of creditor defendants in preference actions by a trustee that resulted in the negotiation of very favorable settlements; his representation of a chain of retail clothing stores in a successful chapter 11 reorganization; his successful representation of a creditor in challenging the chapter 7 bankruptcy discharges of two individuals, including an affirmance on appeal; and his representation of a failing hospital in shutting down and negotiating with its bank lender to successfully avoid bankruptcy. Mr. Ruttenberg learned bankruptcy during almost five years at the Federal Deposit Insurance Corp. in an office responsible for the defaulted loans of approximately 40 failed banks. He also previously was an attorney at Looney & Grossman LLP, Posternak Blankstein & Lund LLP and ArentFox Schiff LLP. Prior to attending law school, Mr. Ruttenberg worked in an actuarial program at John Hancock Mutual Life Insurance Company. He received his B.A. *summa cum laude* in mathematics from Yale University and his J.D. *magna cum laude* from Harvard Law School.